

PHILIPPINE LONG DISTANCE TELEPHONE CO
Form 20-F
June 27, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

REGISTRATION STATEMENT PURSUANT TO SECTION 12(B) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from _____ to _____

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 Date of event requiring this shell company report _____

Commission file number 1-03006

Philippine Long Distance Telephone Company

(Exact name of Registrant as specified in its charter)

Republic of the Philippines

(Jurisdiction of incorporation or organization)

Ramon Cojuangco Building

Makati Avenue

Makati City, Philippines

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

| <u>Title of each class</u> | <u>Name of each exchange on which registered</u> |
|--|--|
| Common Capital Stock, Par Value Five Philippine Pesos Per Share | New York Stock Exchange* |
| American Depositary Shares, evidenced by American Depositary Receipts, each representing one share of Common Capital Stock | New York Stock Exchange |

** Registered on the New York Stock Exchange not for trading but only in connection with the registration of American Depositary Shares pursuant to the requirements of such stock exchange.*

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

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10.500% Notes due 2009

11.375% Notes due 2012

8.350% Notes due 2017

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as at the close of the period covered by the annual report.

As at December 31, 2006:

188,434,695 shares of Common Capital Stock, Par Value Five Philippine Pesos Per Share

442,375,057 shares of Serial Preferred Stock, Par Value Ten Philippine Pesos Per Share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act: Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934: Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

-

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

-

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

-

Indicate by check mark which financial statement item the registrant has elected to follow: Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No

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CERTIFICATION

CERTAIN CONVENTIONS AND TERMS USED IN THIS REPORT

Unless the context indicates or otherwise requires, references to we, us, our or PLDT Group mean Philippine Long Distance Telephone Company and its consolidated subsidiaries, and references to PLDT mean Philippine Long Distance Telephone Company, not including its consolidated subsidiaries (see *Note 2 Basis of Consolidated Financial Statements Preparation* to the accompanying consolidated financial statements in Item 18 for a list of these subsidiaries, including a description of their respective principal business activities).

Any discrepancies in any table between totals and the sums of the amounts listed are due to rounding.

All references to the Philippines contained in this report mean the Republic of the Philippines and all references to the U.S. or the United States are to the United States of America.

In this report, unless otherwise specified or the context otherwise requires, all references to pesos, Philippine pesos or Php are to the lawful currency of the Philippines, all references to dollars, U.S. dollars or US\$ are to the lawful currency of the United States, all references to Japanese yen, JP¥ or ¥ are to the lawful currency of Japan, and all references to Euro or € are to the lawful currency of the European Union. Unless otherwise indicated, translations of peso amounts into U.S. dollars in this report were made based on the volume weighted average exchange rate quoted through the Philippine Dealing System, which was Php49.045 to US\$1.00 on December 31, 2006. On June 26, 2007, the volume weighted average exchange rate quoted was Php46.222 to US\$1.00.

In this report, each reference to:

- ACeS Philippines means ACeS Philippines Cellular Satellite Corporation, our wholly-owned subsidiary;
- AIL means ACeS International Limited, a 36.99%-owned associate of ACeS Philippines;
- Airborne Access means Airborne Access Corporation, a 51%-owned subsidiary of ePLDT;
- ARPU means average monthly revenue per user;

- BCC or Bonifacio Communications Corporation, our 75%-owned subsidiary;
- BSP means Bangko Sentral ng Pilipinas;
- ClarkTel means PLDT Clark Telecom, Inc., our wholly-owned subsidiary;
- CyMed means CyMed, Inc., a wholly-owned subsidiary of SPI;
- Digital Paradise means Digital Paradise, Inc., a 75%-owned subsidiary of ePLDT;
- DoCoMo means NTT DoCoMo, Inc.;
- DSL means digital subscriber line;
- ePLDT means ePLDT, Inc., our wholly-owned subsidiary;
- ePLDT Ventus means the umbrella brand name for ePLDT's call center business, including Ventus, Vocativ and Parlance;
- First Pacific means First Pacific Company Limited;
- First Pacific Group means First Pacific and its Philippine and other affiliates;
- GAAP means generally accepted accounting principles;
- GSM means global system for mobile communications;

- Infocom means Infocom Technologies, Inc., a 99.6%-owned subsidiary of ePLDT;
- Level Up! means Level Up!, Inc., a 60%-owned subsidiary of ePLDT;
- Mabuhay Satellite means Mabuhay Satellite Corporation, our 67%-owned subsidiary;
- Maratel means PLDT-Maratel, Inc., our 97.5%-owned subsidiary;
- netGames means netGames, Inc., an 80%-owned subsidiary of ePLDT;
- NTC means the National Telecommunications Commission of the Philippines;
- NTT means Nippon Telegraph and Telephone Corporation;
- NTT Communications means NTT Communications Corporation, a wholly-owned subsidiary of Nippon Telegraph and Telephone Corporation of Japan;
- NTTC-UK means NTT Communications Capital (UK) Ltd., a wholly-owned subsidiary of NTT Communications;
- PAPTELCO means Philippine Association of Private Telephone Companies, Inc.;
- Parlance means Parlance Systems, Inc., a wholly-owned subsidiary of ePLDT;
- PFRS means Philippine Financial Reporting Standards;

- Piltel means Pilipino Telephone Corporation, a 92.1%-owned subsidiary of Smart;
- PLDT Beneficial Trust Fund means the beneficial trust fund created by PLDT to pay the benefits under the PLDT Employees Benefit Plan;
- PLDT Global means PLDT Global Corporation, our wholly-owned subsidiary;
- SEC means the Securities and Exchange Commission;
- SIM means subscriber identification module;
- SMS means short messaging service;
- Smart means Smart Communications, Inc., our wholly-owned subsidiary;
- Smart Broadband means Smart Broadband, Inc. (formerly Meridian Telekoms, Inc.), our wireless broadband provider and a wholly-owned subsidiary of Smart;
- SPi means SPi Technologies, Inc., a wholly-owned subsidiary of ePLDT;
- SubicTel means Subic Telecommunications Company, Inc., our wholly-owned subsidiary;
- Telesat means Telesat, Inc., our 94.4%-owned subsidiary;
- VAS means value-added service;
- VAT means value-added tax;

- Ventus means ePLDT Ventus, Inc., a wholly-owned subsidiary of ePLDT;
- Vocativ means Vocativ Systems, Inc., a wholly-owned subsidiary of ePLDT;
- VSAT means very small aperture terminal;
- WAP means wireless application protocol;
- W-CDMA means wireless-code division multiple access; and
- Wolfpac means Wolfpac Mobile, Inc., our wireless content operator and a wholly-owned subsidiary of Smart.

FORWARD-LOOKING STATEMENTS

Some information in this report may contain forward-looking statements within the meaning of Section 27A of the U.S. Securities Act of 1933, as amended, and Section 21E of the U.S. Securities Exchange Act of 1934, as amended. We have based these forward-looking statements on our current beliefs, expectations and intentions as to facts, actions and events that will or may occur in the future. Such statements generally are identified by forward-looking words such as believe, plan, anticipate, continue, estimate, expect, may, will or other similar words.

A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. We have chosen these assumptions or bases in good faith. These forward-looking statements are subject to risks, uncertainties and assumptions, some of which are beyond our control. In addition, these forward-looking statements reflect our current views with respect to future events and are not a guarantee of future performance. Actual results may differ materially from information contained in the forward-looking statements as a result of a number of factors, including, without limitation, the risk factors set forth in Item 3. Key Information Risk Factors. When considering forward-looking statements, you should keep in mind the description of risks and other cautionary statements in this report.

You should also keep in mind that any forward-looking statement made by us in this report or elsewhere speaks only as at the date on which we made it. New risks and uncertainties come up from time to time, and it is impossible for us

to predict these events or how they may affect us. We have no duty to, and do not intend to, update or revise the statements in this report after the date hereof. In light of these risks and uncertainties, you should keep in mind that actual results may differ materially from any forward-looking statement made in this report or elsewhere.

PART I

Item 1. Identity of Directors, Senior Management and Advisors

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

Selected Financial Data

The selected consolidated financial information below should be read in conjunction with, and is qualified in its entirety by reference to, our consolidated financial statements, including the notes, included elsewhere in this report. The consolidated financial statements have been prepared and presented in conformity with U.S. GAAP.

Prior to the filing of our Annual Report on Form 20-F in respect of the year ended December 31, 2002, the consolidated financial statements included in our Annual Reports on Form 20-F filed with the U.S. Securities and Exchange Commission, or U.S. SEC, were prepared in conformity with PFRS. PFRS varies in certain significant respects from U.S. GAAP. A description of the significant differences between U.S. GAAP and PFRS and a quantitative reconciliation of such differences in the net loss and stockholders' equity to U.S. GAAP was disclosed in a note to our previously filed consolidated financial statements.

**Consolidated Financial Data
Years Ended December 31,**

2006 2006(1) 2005 2004 2003 2002
(in millions, except operating income per share, earnings per common share, ratio of earnings to fixed charges and dividends declared per common share)

Amounts in conformity with U.S. GAAP:

Statements of Operating Data:

| | | | | | | |
|---|------------|-----------|------------|------------|------------|-----------|
| Operating Revenues | Php127,536 | US\$2,600 | Php123,335 | Php121,173 | Php111,200 | Php93,831 |
| Service | 125,004 | 2,549 | 120,348 | 114,904 | 100,486 | 81,686 |
| Non-service | 2,532 | 52 | 2,987 | 6,269 | 10,714 | 12,145 |
| Operating Expenses | 79,357 | 1,618 | 74,821 | 72,634 | 77,821 | 81,802 |
| Operating Income | 48,179 | 982 | 48,514 | 48,539 | 33,379 | 12,029 |
| Operating income per share | | | | | | |
| Basic | 253.95 | 5.18 | 263.81 | 266.73 | 179.04 | 55.47 |
| Diluted | 253.95 | 5.18 | 255.15 | 252.20 | 165.37 | 52.23 |
| Net income (loss) | 33,598 | 685 | 40,603 | 28,101 | 11,045 | (6,158) |
| Earnings per common share(2) | | | | | | |
| Basic | 174.90 | 3.57 | 217.84 | 146.32 | 47.20 | (52.08) |
| Diluted | 174.90 | 3.57 | 211.93 | 145.30 | 45.72 | (52.08) |
| Balance Sheets Data: | | | | | | |
| Cash and cash equivalents | 16,870 | 344 | 30,059 | 27,321 | 19,372 | 10,974 |
| Total assets | 264,195 | 5,387 | 269,709 | 279,041 | 276,362 | 269,387 |
| Total long-term debt - net of current portion | 69,542 | 1,418 | 93,516 | 131,377 | 160,464 | 171,283 |
| Total debt(3) | 86,059 | 1,755 | 112,313 | 159,455 | 186,407 | 191,668 |
| Total liabilities(4) | 154,607 | 3,152 | 176,980 | 215,145 | 236,630 | 240,622 |
| Total stockholders' equity | 106,173 | 2,165 | 79,595 | 48,079 | 24,746 | 16,413 |
| Other Data: | | | | | | |
| Depreciation and amortization | 28,130 | 574 | 27,855 | 20,098 | 21,812 | 17,566 |
| Ratio of earnings to fixed charges(5) | 8.1x | 8.1x | 5.9x | 4.1x | 2.0x | |
| Net cash provided by operating activities | 61,201 | 1,248 | 66,280 | 63,107 | 42,582 | 39,722 |
| Net cash used in investing activities | 36,764 | 750 | 13,080 | 24,764 | 20,021 | 17,167 |
| Net cash used in financing activities | 36,916 | 753 | 49,470 | 30,325 | 14,135 | 15,954 |
| Dividends declared to common shareholders | 14,459 | 295 | 9,624 | | | |
| Dividends declared per common share | 78.00 | 1.59 | 56.00 | | | |

(1) We maintain our accounts in Philippine peso. For convenience, the peso financial information as at and for the year ended December 31, 2006, has been translated into U.S. dollars at the exchange rate of Php49.045 to US\$1.00, the rate quoted through the Philippine Dealing System as at December 31, 2006. This translation should not be construed as a representation that the Philippine peso amounts represent, or have been or could be converted into, U.S. dollars at that rate or any other rate.

(2) In 2006 and 2002, our convertible preferred shares were deemed anti-dilutive based on a calculation of the required dividends on preferred shares for each series of convertible preferred shares divided by the number of equivalent common shares assuming such preferred shares were converted into common shares and compared against the basic earnings per share. Since the amount of dividends on preferred shares over the equivalent number of common shares were greater than the basic earnings per share, the amounts for basic and diluted earnings per share

are the same.

(3) Total debt represents current portion of long-term debt, long-term debt net of current portion and notes payable.

(4) Total liabilities on a consolidated basis represent the difference between total assets and minority interest in consolidated subsidiaries, preferred stock subject to mandatory redemption and stockholders equity.

(5) For purposes of this ratio, Earnings consist of income before provision for income tax (excluding PLDT's share in undistributed income of less than 50% owned affiliates) and fixed charges (excluding capitalized interest). Fixed charges consist of interest (including capitalized interest, discounts and other financing costs) on all indebtedness, amortization of deferred financing costs and the estimated financing component of rent expense (i.e., one-third of rent expense).

Due to PLDT's net losses in 2002, the coverage ratio on a consolidated basis was less than 1.0x in that year. In order to achieve a coverage ratio of 1.0x, we would have had to generate additional consolidated earnings of Php2,463 million for the year ended December 31, 2002.

Capital Stock

The following table summarizes PLDT's capital stock outstanding as at December 31, 2006, 2005 and 2004.

| | December 31, | | |
|--|---------------------|----------|----------|
| | 2006 | 2005 | 2004 |
| | (in millions) | | |
| Serial Preferred Stock | | | |
| 10% Cumulative Convertible Preferred Stocks | | | |
| A to EE | Php4,064 | Php4,073 | Php4,091 |
| Series III | | | 46 |
| Convertible Preferred Stocks Subject to Mandatory Redemption | | | |
| Series V(1) | | 2 | 22 |
| Series VI(1) | 9 | 44 | 47 |
| Series VII(2) | | 38 | 38 |
| Cumulative Non-convertible Redeemable Preferred Stock | | | |
| Series IV | 360 | 360 | 360 |
| | Php4,433 | Php4,517 | Php4,604 |
| Common Stock | Php942 | Php904 | Php851 |

(1) Preferred stock subject to mandatory redemption in 2008 (see Note 14 Preferred Stock Subject to Mandatory Redemption to the accompanying consolidated financial statements in Item 18 for further discussion).

(2) All shares of the Series VII Convertibles Preferred Stock were converted in 2006 (see Note 14 Preferred Stock Subject to Mandatory Redemption to the accompanying consolidated financial statements in Item 18 for further discussion).

Dividends Declared

The table sets forth dividend declarations on shares of PLDT's common stock in 2006:

| Class | Declaration | Date | | Payable | Per Share | Amount | |
|--------------|-------------------|-----------------|--|--------------------|-----------|--------------------|--|
| | | Record | | | | (in million pesos) | |
| Common Stock | February 27, 2006 | March 20, 2006 | | April 20, 2006 | Php28.00 | Php5,080 | |
| | August 8, 2006 | August 21, 2006 | | September 21, 2006 | 50.00 | 9,379 | |

In addition, on March 6, 2007, PLDT declared cash dividend of Php50 per share to common shareholders of record as at March 20, 2007 which was paid on April 20, 2007.

Our current policy is to declare and pay dividends taking into consideration the interests of our shareholders as well as our working capital, capital expenditures and debt servicing requirements. Also taken into consideration are our ability to meet loan covenant requirements and the required prior written consents of certain creditors and preferred stockholders (for stock dividends), under certain conditions, in the declaration and payment of dividends as discussed in Note 12 Interest-bearing Financial Liabilities and Note 15 Stockholders Equity to the accompanying consolidated financial statements in Item 18. The retention of earnings is necessary to meet the funding requirements of our business expansion and development programs. Unappropriated retained earnings of PLDT include undistributed earnings representing accumulated equity in the net earnings of our subsidiaries, which are not available for distribution as dividends until received in the form of dividends from such subsidiaries (see Note 15 Stockholders Equity to the accompanying consolidated financial statements in Item 18). Dividends are generally paid in Philippine pesos. In the case of shareholders residing outside the Philippines, PLDT's transfer agent in Manila, which acts as the dividend-disbursing agent, converts the peso dividends into U.S. dollars at the prevailing exchange rates, and remits the dollar proceeds abroad, net of withholding tax.

Dividends Paid

A summary of dividends paid per share of PLDT's common stock stated in both Philippine peso and U.S. dollars follows:

In Philippine Peso In U.S. Dollars

| | | |
|-------------------------------|-------|-------|
| 2002 | | |
| 2003 | | |
| 2004 | | |
| 2005 | 56.00 | 1.142 |
| 2006 | 78.00 | 1.590 |
| April 20 | 28.00 | 0.545 |
| September 21 | 50.00 | 0.998 |
| 2007 (through April 20, 2007) | 50.00 | 1.051 |

(Note: Dividends on PLDT's common stock were declared and paid in Philippine peso. For the convenience of the reader, the peso dividends are translated into U.S. dollars based on exchange rates on the respective dates of dividend payments).

Exchange Rates

The Philippine government does not administratively fix the exchange rate between the Philippine peso and the U.S. dollar. Since August 1, 1992, a market average rate has been determined daily in inter-bank trading using the Philippine Dealing System, known as the Philippine Dealing System Reference Rate. The Philippine Dealing System is a specialized off-floor direct dealing service for the trading of Philippine pesos-U.S. dollars by member banks of the Bankers Association of the Philippines and BSP, the central bank of the Philippines. All members of the Bankers Association of the Philippines are required to make their Philippine peso-U.S. dollar trades through this system, which was established by Telerate Financial Information Network of Hong Kong.

The following shows the exchange rates between the Philippine peso and the U.S. dollar, expressed in pesos per U.S. dollar, for the periods indicated, based on the volume-weighted average exchange rate for each business day in each of the periods presented:

| | Year Ended December 31, | | | |
|------------------------------|-------------------------|------------|-----------|-----------|
| | Period End | Average(1) | High(2) | Low(3) |
| 2002 | Php53.254 | Php51.583 | Php49.336 | Php53.841 |
| 2003 | 55.586 | 54.215 | 52.021 | 55.767 |
| 2004 | 56.341 | 56.044 | 55.142 | 56.443 |
| 2005 | 53.062 | 55.085 | 53.062 | 56.321 |
| 2006 | 49.045 | 51.832 | 50.106 | 53.587 |
| 2007 (through June 26, 2007) | 46.222 | 47.803 | 45.718 | 49.156 |

Source: Philippine Dealing System Reference Rate

(1) Simple average of exchange rates for the period.

(2) Highest exchange rate for the period.

(3) Lowest exchange rate for the period.

| | | Month | | |
|------------------------------|-------------------|-------------------|----------------|---------------|
| | Period End | Average(1) | High(2) | Low(3) |
| 2006 | | | | |
| December | 49.045 | 49.431 | 49.045 | 49.659 |
| 2007 | | | | |
| January | 48.902 | 48.908 | 48.706 | 49.156 |
| February | 48.583 | 48.365 | 48.054 | 48.781 |
| March | 48.217 | 48.501 | 48.077 | 48.864 |
| April | 47.536 | 47.785 | 47.449 | 48.294 |
| May | 46.178 | 46.749 | 45.922 | 47.673 |
| June (through June 26, 2007) | 46.222 | 46.130 | 45.718 | 46.594 |

Source: Philippine Dealing System Reference Rate

(1) Simple average of exchange rates for the month.

(2) Highest exchange rate for the month.

(3) Lowest exchange rate for the month.

This report contains conversions of Philippine peso amounts into U.S. dollars for your convenience. Unless otherwise specified, these conversions were made at the exchange rate as at December 31, 2006 of Php49.045 to US\$1.00. You should not assume that such peso amounts represent such U.S. dollar amounts or could have been or could be converted into U.S. dollars at the rate indicated, or at any particular rate. As at June 26, 2007, the exchange rate quoted through the Philippine Dealing System was Php46.222 to US\$1.00.

Risk Factors

Risks Relating to Us

We face competition from well-established telecommunications operators and may face competition from new entrants that may adversely affect our business, results of operations, financial condition and prospects

The Philippine government has liberalized the Philippine telecommunications industry and opened up the Philippine telecommunications market to new entrants. Including the PLDT Group, there are nine major local exchange carriers, seven international gateway facility providers and five cellular service providers in the country. Many new entrants into the Philippine telecommunications market have entered into strategic alliances with foreign telecommunications companies, which provide them access to technological and funding support as well as service innovations and marketing strategies. Consequently, we are facing increasing competition in major segments of the telecommunications industry, particularly data and other network services segments. We cannot assure you that the number of providers of telecommunication services will not further increase or that competition for telecommunications customers will not lead our cellular and fixed line subscribers to switch to other operators or lead us to increase our marketing expenditures or reduce our rates, resulting in a reduction in our profitability.

Competition in the cellular telecommunications industry in the Philippines is based primarily on factors such as network coverage, quality of service and price. Recently, competition has increased as operators sought to develop and maintain market share and to attract new subscribers. Our principal cellular competitors, Globe Telecom, Inc., or Globe, and Digital Telecommunications Philippines, Inc., or Digitel, have introduced aggressive marketing campaigns and promotions. In addition, the government may allocate additional frequencies and award additional cellular telecommunications licenses in the future which could lead to increased competition.

As a result of the competitive environment, Smart has not increased its cellular rates since November 1998. Moreover, the level of competition requires Smart to continuously innovate its products and to conduct promotions, which may affect its cellular revenues and revenue growth. For example, in order to test the market demand for fixed rate or bucket plans for voice and text services and in response to similar types of promotions launched by its competitors, Smart launched, in March 2005, the *Smart 258 Unlimited Call and Text promotions* pursuant to which Smart and *Talk N Text* prepaid subscribers had the option to avail themselves of unlimited on-network (Smart-to-Smart) voice calls or unlimited on-network (Smart-to-Smart) text messages at a fixed rate.

There can be no assurance that incurring additional marketing expenses for these promotions and responding to rate pressures and the potential loss of customers will not have a material adverse effect on our financial performance.

Rapid changes in telecommunications technology may adversely affect the economics of our existing businesses and the value of our assets, increase our required capital expenditures and create new competition

The telecommunications sector has been characterized recently by rapid technological changes. We cannot assure you that these developments will not result in competition from providers of new services or the need to make substantial capital expenditures to upgrade our facilities. Furthermore, the NTC has issued to Smart and our competitors the license covering 3G cellular services, and we have incurred significant expenses in the roll out of these services. We are also continuing to upgrade to a next generation, all-IP network and rolling out a wireless broadband network in order to expand our capability to provide broadband services. These projects will require significant capital expenditures over the next few years.

Our future success will depend, in part, on our ability to anticipate or adapt to such changes and to offer services that meet customer demands on a competitive and timely basis. We may be unable to obtain new technologies on a timely basis or on satisfactory terms or implement them in an appropriate or effective manner. Future development of new technologies, services or standards could require significant changes to our business model which could necessitate new investments. In addition, new products and services may be expensive to develop and may result in increased competition. Such strategic initiatives and technological developments could require us to incur significant additional capital expenditures. There can be no assurance that we would be able to adopt and successfully implement new technologies. In addition, there can be no assurance on how emerging and future technological changes will affect our operations or the competitiveness of our services.

Our results of operations have been, and may continue to be, adversely affected by competition in international long distance service

The international long distance business has historically been one of our major sources of revenue. However, due to competition and the steep decline in international settlement rates that are paid to us by foreign telecommunications carriers for termination of international calls on our network, revenues generated from our international long distance business have overall declined in recent years.

We anticipate that revenues from international long distance and international data services, including our services, will continue to decline in the future, due primarily to:

- increased competition from other domestic and international telecommunications providers;
- advances in technology;
- alternative providers offering Internet telephony, also known as Voice over Internet Protocol, or VoIP, and broadband capacity; and

- unauthorized traffic termination and bypass routings by international simple resale operators.

We cannot assure you that these declines will not materially and adversely affect our financial performance.

Net settlement payments between PLDT and other foreign telecommunications carriers for origination and termination of international call traffic between the Philippines and other countries have been our predominant source of foreign currency revenues. However, in U.S. dollar terms, these payments have been declining in recent years. A continued decline in our foreign currency revenues could increase our exposure to risks from declines in the value of the Philippine peso against the U.S. dollar. We cannot assure you that we will be able to achieve adequate increases in our other revenues to make up for any adverse impact of a further decline in our net settlement payments.

Our debt instruments contain restrictive covenants which require us to maintain certain financial tests and our substantial indebtedness could impair our ability to fulfill our financial obligations, service our other debt and carry out new financings or pay dividends

As at December 31, 2006, we had consolidated total indebtedness of approximately Php86,059 million (US\$1,755 million), and a consolidated ratio of debt to equity (total debt on a consolidated basis divided by total equity) of 0.79x. Our existing debt instruments contain covenants which, among other things, require PLDT to maintain certain financial ratios calculated on the basis of PFRS on a consolidated and non-consolidated basis, limit our ability to incur indebtedness, make investments and pay dividends. Financial statements prepared in conformity with PFRS differ in some material respects from financial statements prepared in conformity with U.S. GAAP. For a description of some of these covenants, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Financing Activities Debt Financing Debt Covenants.

Our substantial indebtedness and the requirements and limitations imposed by our debt covenants could have important consequences. For example, they could:

- require us to dedicate a substantial portion of our cash flow to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate requirements; and
- limit the availability and amount of dividend payments to our common shareholders.

The principal factors that can negatively affect our ability to comply with the financial ratios and other financial tests under our debt instruments are depreciation of the Philippine peso relative to the U.S. dollar, poor operating

performance of PLDT and our consolidated subsidiaries, impairment or similar charges in respect of investments or other long-lived assets that may be recognized by PLDT and its consolidated subsidiaries and increases in our interest expenses. Since approximately 96% of our total consolidated debts were denominated in foreign currencies, principally in U.S. dollars, many of these financial ratios and other tests are negatively affected by any weakening of the peso.

The peso has been subject to significant fluctuations in recent years. From 2002 to 2004, the peso has generally been depreciating from a high of Php49.336 on May 20, 2002 to a low of Php56.443 on October 14, 2004. In 2005, the peso fluctuated significantly from a low of Php56.321 on July 8, 2005 to a high of Php53.062 on December 29, 2005. While the peso continued to appreciate in 2006, there can be no assurance that the peso will not depreciate and be subject to significant fluctuations going forward.

We have maintained compliance with all of our financial ratios and covenants, as measured under PFRS, under our loan agreements and other debt instruments. However, if negative factors adversely affect our financial ratios, we may be unable to maintain compliance with these ratios and covenants or be unable to incur new debt. Inability to comply with the financial ratios and covenants or raise new financing could result in a declaration of default and acceleration of some or all of our indebtedness. The terms of some of our debt instruments have no minimum amount for cross-default.

If we are unable to meet our debt service obligations or comply with our debt covenants, we could be forced to restructure or refinance our indebtedness, seek additional equity capital or sell assets. An inability to effect these measures successfully could result in a declaration of default and an acceleration of some or all of our indebtedness.

In addition, we may have difficulty meeting debt payment obligations if we do not continue to receive cash dividends from Smart.

Creditors of our subsidiaries will have superior claims to our subsidiaries' cash flow and assets

A growing portion of our consolidated operating revenues and cash flow from operations is derived from our subsidiaries, particularly Smart. Smart and some of our other subsidiaries have significant internal cash requirements for debt service, capital expenditures and operating expenses and so may be financially unable to pay any dividends to PLDT. Although Smart made dividend payments to PLDT since December 2002, we cannot assure you that PLDT will continue to receive dividends or other distributions, or otherwise be able to derive liquidity from Smart or any other subsidiary or investee in the future.

Creditors of our subsidiaries will have prior claims to our subsidiaries' assets and cash flows. We and our creditors will effectively be subordinated to the existing and future indebtedness and other liabilities, including trade payables, of

our subsidiaries, except that we may be recognized as a creditor on loans we have made to subsidiaries. If we are recognized as a creditor of a subsidiary, our claim will still be subordinated to any indebtedness secured by assets of the subsidiary and any indebtedness of the subsidiary otherwise deemed senior to the indebtedness we hold.

Our businesses require substantial capital investment, which we may not be able to finance

Our projects under development and the continued maintenance and improvement of our networks and services, including Smart's projects, networks and services, require substantial ongoing capital investment. Our consolidated capital expenditures in 2006 and 2005 totaled Php20,348 million and Php15,864 million, respectively. Our 2007 budget for consolidated capital expenditures is approximately Php21,400 million, of which approximately Php11,100 million is budgeted to be spent by PLDT and approximately Php8,800 million is budgeted to be spent by Smart; the balance represents the budgeted capital spending of our other subsidiaries. PLDT's capital spending is intended principally to finance the continued build-out and upgrade of its data and Internet protocol infrastructures and for its fixed line data services and the maintenance of its network. Smart's capital spending is focused on expanding and upgrading its transmission network facilities to meet increased demand for cellular services.

Future strategic initiatives could require us to incur significant additional capital expenditures. We may be required to finance a portion of our future capital expenditures from external financing sources, which have not yet been fully arranged. We cannot assure you that financing for new projects will be available on terms acceptable to us or at all. If we cannot complete our development programs and other capital projects, our growth, results of operations and financial condition could be materially and adversely affected.

Our financial position could be materially and adversely affected if the peso significantly fluctuates against the U.S. dollar

Substantially all of our indebtedness and related interest expense, a substantial portion of our capital expenditures and a portion of our expenses are denominated in U.S. dollars and other foreign currencies, but a significant portion of our revenues is denominated in pesos. As at December 31, 2006, 96% of our total consolidated indebtedness was denominated in U.S. dollars. As at December 31, 2006, approximately 43% of our consolidated foreign currency-denominated debts were unhedged. A depreciation of the peso against the U.S. dollar increases the amount of our debt obligations and operating and interest expenses in peso terms. In the event that the peso depreciates against the U.S. dollar, we may be unable to generate enough funds through operations (such as by raising our service rates, including through adjustments to rates for local exchange service based on movements in the peso-to-dollar exchange rate) and other means to offset the resulting increase in our obligations in peso terms. Further, these changes could cause us not to be in compliance with the financial covenants imposed by our lenders under certain loan agreements and other indebtedness.

On the other hand, approximately 33% of PLDT Group's consolidated service revenues are either denominated in U.S. dollars or is linked to the U.S. dollar. In this respect, an appreciation of the peso against the U.S. dollar reduces our

revenues in peso terms and reduces our cash flow from operations.

During the last decade, the peso has generally depreciated against most foreign currencies. In addition, during this period, the Philippine economy has also, from time to time, experienced periods of concentrated peso devaluation and limited availability of foreign currency. Since June 30, 1997, when the Bangko Sentral ng Pilipinas, or BSP, announced that it would let market forces determine the value of the peso, the peso has experienced a significant decline against the U.S. dollar. It depreciated from Php26.376 to US\$1.00 on June 30, 1997, to Php56.341 to US\$1.00 as at December 31, 2004.

The peso has been subject to significant fluctuations in recent years. From 2002 to 2004, the peso has generally been depreciating from a high of Php49.336 on May 20, 2002 to a low of Php56.443 on October 14, 2004. In 2005, the peso fluctuated significantly from a low of Php56.321 on July 8 to a high of Php53.062 on December 29, 2005. While the peso continued to appreciate in 2006, there can be no assurance that the peso will not depreciate and be subject to significant fluctuations going forward.

The peso may again be subject to significant fluctuations and may depreciate due to a range of factors, including:

- political and economic developments affecting the Philippines;
- the volatility of regional currencies, particularly the Japanese yen;
- any interest rate increases by the Federal Reserve Bank of the United States;
- higher demand for U.S. dollars by both banks and domestic businesses to service their maturing U.S. dollar obligations; and
- foreign exchange traders including banks covering their short U.S. dollar positions.

The cellular telecommunications industry may not continue to grow

The majority of our consolidated revenues is currently derived from cellular services. As a result, we depend on the continued development and growth of the cellular telecommunications industry. The cellular penetration rate in the Philippines is estimated to have reached approximately 48%. As such, our cellular business is expected to grow at a slower rate as penetration rate increases and Smart moves further into the lower-income segments of the market. The growth of the cellular communications market depends on many factors beyond our control, including the continued introduction of new and enhanced cellular devices, the price levels of cellular handsets, consumer preferences and amount of disposable income of existing and potential subscribers. Any economic, technological or other developments resulting in a reduction in demand for cellular services may harm our business.

Our businesses depend on the reliability of our network infrastructure, which is subject to physical, technological and other risks

We depend to a significant degree on an uninterrupted operation of our network to provide our services. We also depend on robust information technology systems to enable us to conduct our operations. The development and operation of telecommunications networks are subject to physical, technological and other risks, which may cause interruptions in service or reduced capacity for customers. These risks include:

- physical damage;
- power loss;
- capacity limitation;
- cable theft;
- software defects; and
- breaches of security by computer viruses, break-ins or otherwise.

The occurrence of any of these risks could have a material and adverse effect on our ability to provide services to customers. While we are undertaking initiatives to prevent and/or mitigate the occurrence of said risks, including the preparation of a disaster recovery plan that aims to allow restoration of service at the soonest possible time from occurrence of an incident. We cannot assure you that these risks will not occur or that our initiatives will be effective should such risks occur.

A significant number of PLDT's shares are held by three separate shareholders, which may not act in the interests of other shareholders or stakeholders in PLDT

The First Pacific Group has beneficial ownership of approximately 28% in PLDT's outstanding common stock as at May 31, 2007. This is the largest block of PLDT's common stock that is directly or indirectly under common

ownership.

NTT Communications, which owned 14% of PLDT's common stock as at December 31, 2005, transferred on March 14, 2006 approximately 12.6 million shares of PLDT's common stock, representing approximately 7% of the outstanding shares of PLDT's common stock, to DoCoMo pursuant to a stock sale and purchase agreement dated January 31, 2006. NTT Communications is a wholly-owned subsidiary, and DoCoMo a majority-owned subsidiary of NTT. In connection with this transaction, First Pacific and certain of its affiliates, or the FP Parties, NTT Communications, DoCoMo and PLDT entered into a Cooperation Agreement, dated January 31, 2006, or the Cooperation Agreement, pursuant to which, among other things, certain rights of NTT Communications under the Stock Purchase and Strategic Investment Agreement dated September 28, 1999 and the Shareholders Agreement dated March 24, 2000 were extended to DoCoMo. As a result, NTT Communications and DoCoMo, in coordination with each other, have contractual veto rights over a number of major decisions and transactions that PLDT could make or enter into, including:

- capital expenditures in excess of US\$50 million;

- any investments, if the aggregate amount of all investments for the previous 12 months is greater than US\$25 million in the case of all investments to any existing investees and US\$100 million in the case of all investments to any new or existing investees, determined on a rolling monthly basis;

- any investments in a specific investee, if the cumulative value of all investments made by us in that investee is greater than US\$10 million in the case of an existing investee and US\$50 million in the case of a new investee;

- issuance of common stock or stock that is convertible into common stock;

- new business activities other than those we currently engage in;

- merger or consolidation; and

- the provision of financial support to Piltel in excess of that remaining available under the PLDT Letter of Support, or LOS.

Moreover, as a result of the Shareholders Agreement, the Cooperation Agreement and their respective stockholdings, the FP Parties, NTT Communications and/or DoCoMo are able to influence our actions and corporate governance, including:

- elections of PLDT's directors; and
- approval of major corporate actions, which require the vote of common stockholders.

The FP Parties and/or NTT Communications and/or DoCoMo may exercise their respective influence over these decisions and transactions in a manner that could be contrary to your interests.

If a major shareholder sells its interest in PLDT, the transaction may result in an event of default under certain circumstances

If First Pacific Group or NTT Communications sell all or a portion of their equity interest in PLDT, in certain circumstances, such sale may give rise to an obligation for PLDT to make an offer to purchase its outstanding debt under its US\$250 million 11.375% notes due 2012, and may result in a default under certain of Smart's loan agreements. As at December 31, 2006, Php13,208 million in principal amount of PLDT's indebtedness is directly subject to a change in major shareholding or offer to purchase requirement and Php1,273 million in principal amount of Smart's indebtedness is subject to an event of default in the event of a change in major shareholding of PLDT. In such event, if PLDT fails to complete an offer to purchase the affected debts, all of its debt could become immediately due and payable as a result of various cross-default provisions.

The franchise of Smart may be revoked due to its failure to conduct a public offering of its shares

Smart has publicly stated that it believes that it had ten years from the commencement of its operations, or until August 2004, to conduct a public offering of its shares required under the Public Telecommunications Policy Act, or R.A. 7925. As Smart has not conducted a public offering of its shares, the Philippine Congress may revoke the franchise of Smart for its failure to comply with the requirement under R.A. 7925 on the public offering of its shares. A quo warranto case may also be filed against Smart by the Office of the Solicitor General of the Philippines for the revocation of the franchise of Smart on the ground of violation of R.A. 7925. In September 2004, Senate Bill No. 1675 was filed seeking to amend Section 21 of R.A. 7925. The bill seeks to declare that a telecommunications entity shall be deemed to have complied with the requirement of making a public offering of its shares if two-third of its outstanding voting stock are owned and controlled directly or indirectly, by a listed company. The bill is currently pending in the Philippine Senate. However, we cannot assure you that such bill will be enacted and that the franchise of Smart will not be revoked due to Smart's failure to timely conduct a public offering of its shares.

Our business is significantly affected by governmental laws and regulations, including regulations in respect of our franchises, rates and taxes

We operate our business under franchises, each of which is subject to amendment, termination or repeal by the Philippine Congress. Additionally, PLDT operates pursuant to various provisional authorities and certificates of public convenience and necessity, or CPCNs, which are granted by the NTC and expire between now and 2028. Some of PLDT's CPCNs and provisional authorities have already expired. However, PLDT filed applications for extension of these CPCNs and provisional authorities prior to their respective expiration dates and is therefore entitled to continue to conduct its business under its existing CPCNs and provisional authorities pending the NTC's decisions on these extensions. Smart also operates its cellular, international long distance, national long distance and global mobile personal communications via satellite services pursuant to CPCNs, which will expire upon the expiration of its franchise. Smart's franchise is due to expire on March 27, 2017, 25 years after the date on which its current franchise was granted. Smart operates international private leased circuits under a provisional authority, which expired on November 6, 2006. Smart applied for an extension of this provisional authority or for the issuance of a CPCN prior to its expiration. The NTC has not yet acted on the motion. Because PLDT and Smart filed the applications for extension on a timely basis, we expect that these extensions will be granted. However, we cannot assure you that the NTC will grant these extensions. If a CPCN has not been issued, the NTC may permit an operator to provide services pursuant to a provisional authority. Provisional authorities are typically granted for a period of 18 months. The Philippine Revised Administrative Code of 1987 provides that if the grantee of a license or permit, such as a CPCN or provisional authority, has made timely and sufficient application for the extension thereof, the existing CPCN or provisional authority will not expire until the application is finally decided upon by the administrative agency concerned. However, we cannot assure you that our franchises, CPCNs and provisional authorities will be renewed. For a description of our licenses, see Item 4. Information on the Company Licenses and Regulation.

The NTC also regulates the rates we are permitted to charge for services that have not yet been deregulated, such as local exchange services. We cannot assure you that the NTC will not impose additional obligations on us that could lead to the revocation of our licenses if not adhered to and/or reduction in our revenues and other income or profitability. In addition, the NTC could adopt changes to the regulations governing our interconnection with other telecommunications companies or the rates and terms upon which we provide services to our customers that could have a material and adverse effect on our results of operations.

In the first quarter of 2005, House Bill, or HB, No. 926 was filed and is now pending in the House of Representatives of the Philippines. The proposed bill provides for the cancellation of the currency exchange rate mechanism pursuant to which utility companies, including us, are permitted to adjust their monthly local exchange service rates according to changes in the peso-to-U.S. dollar exchange rate. If this bill is passed into law or if the NTC issues guidelines to change the basis of the currency exchange rate mechanism, our ability to generate U.S. dollar-linked revenues from our local exchange business could be adversely affected. A decline in our foreign currency-linked revenues could increase our exposure to risks from declines in the value of the Philippine peso against the U.S. dollar.

The PLDT Group is also subject to a number of national and local taxes. On May 24, 2005, the president of the Philippines signed into law Republic Act No. 9337, or R.A. 9337, amending certain sections of the National Internal

Revenue Code, which took effect on November 1, 2005. R.A. 9337, among others, introduced the following changes:

- a. The regular corporate income tax rate for domestic corporations and resident/non-resident foreign corporations increased from 32% to 35% effective November 1, 2005 and will be reduced to 30% effective January 1, 2009.
- b. The VAT rate increased from 10% to 12% effective February 1, 2006.
- c. The input VAT on capital goods should be spread evenly over the estimated useful life or sixty months, whichever is shorter, if the acquisition cost, excluding the VAT component thereof, exceeds one million pesos.

There can be no assurance that the increase in taxes will not have a material adverse effect on PLDT Group's revenues, profitability and cash flows. In addition, there can be no assurance that PLDT Group will not be subject to new and/or additional taxes and that PLDT Group will be able to impose additional charges or fees to compensate for the imposition of such taxes.

There are also various bills pending in the Philippine Congress which propose to impose a franchise tax on telecommunication companies and to tax telecommunications services, among them, the imposition of a tax on mobile phone companies on all text entries to text games; the imposition of a Php0.50 specific tax on each SMS to be borne by the cellular phone companies; and the imposition of a 10% ad valorem tax on all cellular phone calls using 3G. We cannot assure you that we would be able to impose additional charges or fees to compensate for the imposition of such taxes.

The NTC may implement proposed changes in existing regulations and introduce new regulations which may result in increased competition and may have negative implications for our revenues and profitability

On June 16, 2000, the NTC issued Memorandum Circular No. 13-6-2000 proposing that cellular operators, including Smart and Piltel, be required, among other things:

- to bill their subscribers for cellular calls on a six-second pulse basis instead of the current per minute basis;
- not to bill calls directed to recorded voice messages; and

- to extend the expiration date of prepaid cards from the current two months to two years.

Along with the other Philippine cellular operators, Smart filed a complaint for the nullification of this memorandum circular before the regional trial court of Quezon City and sought for the issuance of a preliminary injunction while proceedings are ongoing. The regional trial court issued the preliminary injunction, which restrained the implementation of the memorandum circular. The complaint of the Philippine cellular operators is being heard by the regional trial court of Quezon City.

In December 2005, the NTC issued a consultative document on the development of competition policy framework for the information communications sector. The consultative paper contains eleven questions which cover the following key areas:

- a review of market trends deemed to impinge on current and future state of competition in the sector;
- an exploration of major policies that may change the balance of market power, hence the nature and degree of competition;
- an assessment of the quality of current regulation, identifying major handicaps of the NTC; and
- a discussion of the urgent tasks for the NTC to effectively govern a dynamic and complex industry.

The NTC invited public comment from industry stakeholders and other interested parties in relation to the issues raised in the paper. On January 31, 2006, we submitted a comprehensive response to the consultative paper. On August 24, 2006, the NTC issued another consultative document specifically focusing on its proposal to impose asymmetric regulations on carriers with significant market power, or SMP, including a discussion on its proposed roadmap for implementing such SMP obligations. On October 23, 2006, we submitted our response to the second consultative paper to the NTC.

In formulating both our responses, we took into account both industry interests and the broader context of our nation's economic development, drawing on the experience in other countries. We believe that the basis for the need for regulatory reform is unclear and the envisioned SMP regime is inappropriate for the Philippines, as the market is highly competitive and well-functioning. In addition, the imposition of SMP and its attendant obligations would discourage capital investments in a sector on which the Philippine economy is highly dependent. We have therefore

proposed that the NTC explore its full range of options available on a cost-benefit basis, taking into consideration the specific local context of the Philippine marketplace.

There can be no assurance that the NTC will not impose changes to the current regulatory framework which may lead to increased competition. Any such changes may have an adverse effect on our business, results of operations and prospects.

If we are unable to install and maintain telecommunications facilities and equipment in a timely manner, we may not be able to keep up with our principal competitors, which may have negative implications for our revenue and profitability

Our business requires the regular installation of new, and the maintenance of existing, telecommunications transmission and other facilities and equipment, which are being undertaken. The installation and maintenance of these facilities and equipment are subject to risks and uncertainties relating to:

- shortages of equipment, materials and labor;
- work stoppages and labor disputes;
- interruptions resulting from inclement weather and other natural disasters;
- unforeseen engineering, environmental and geological problems; and
- unanticipated cost increases.

Any of these factors could give rise to delays or cost overruns in the installation of new facilities or equipment or could prevent us from properly maintaining the equipment used in our networks, and could have a material and adverse effect on our results of operations and financial condition.

We may not be successful in our acquisitions of and investments in other companies and businesses, and may therefore be unable to implement fully our business strategy

As part of our growth strategy, we may, from time to time, make acquisitions and investments in companies or businesses, which may or may not be significant. The success of our acquisitions and investments depends on a number of factors, including:

- our ability to identify suitable opportunities for investment or acquisition;
- our ability to reach an acquisition or investment agreement on terms that are satisfactory to us or at all;
- the extent to which we are able to exercise control over the acquired company;
- the economic, business or other strategic objectives and goals of the acquired company compared to those of the PLDT Group; and
- our ability to successfully integrate the acquired company or business with our existing businesses.

Any of our contemplated acquisitions and investments may not be consummated due to reasons or factors beyond its control. Even if any contemplated acquisitions and investments are consummated, we may not be able to realize any or all of the anticipated benefits of such acquisitions and investments. Moreover, if we are unsuccessful in our contemplated acquisitions and investments, we may not be able to implement fully our business strategy to maintain or grow certain of our businesses.

Failure to achieve and maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 could adversely impact investor confidence and the market price of our common shares and ADSs

Effective internal controls over financial reporting are necessary for us to provide reasonable assurance with respect to our financial reports and to effectively prevent fraud. If we are unable to provide reasonable assurance with respect to our financial reports and effectively prevent fraud, our reputation and results of operations could be harmed.

We are required to comply with various Philippine and U.S. laws and regulations on internal controls. For example, pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, beginning with this Annual Report on Form 20-F for the fiscal year ending December 31, 2006, we are required to include a report by our management on our internal control over financial reporting in our Annual Reports on Form 20-F that contains an assessment by our management of the effectiveness of our internal control over financial reporting. In addition, our independent registered public accounting firm must attest to and report on our management's assessment of the effectiveness of our internal control over financial reporting.

Internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Therefore, even

effective internal control over financial reporting can provide reasonable assurance with respect to the preparation and fair presentation of financial statements. If we fail to maintain the adequacy of our internal control over financial reporting, including through a failure to implement required new or improved controls, or if we experience difficulties in their implementation, our business and operating results could be harmed, we could fail to meet our reporting obligations and there could be a material adverse effect on the market prices of our common shares and ADSs.

Risks Relating to the Philippines

PLDT's business may be affected by political or social or economic instability in the Philippines

On May 10, 2004, the Philippines held a presidential election which resulted in a victory by the incumbent President Arroyo who successfully retained her post. Shortly after the elections, allegations of irregularities in the presidential elections, such as stolen ballots and vote buying intensified. The Philippine Congress commenced an inquiry into a wire tapped audio tape which contains a conversation allegedly between President Gloria Macapagal-Arroyo and a commissioner of the Commission on Elections discussing the vote count on the presidential election. On June 27, 2005, President Gloria Macapagal-Arroyo publicly stated that she did speak to a commissioner of the Commission on Elections in order to protect her votes, but not to influence the outcome of the election. Impeachment complaints based on allegations of culpable violation of the Constitution, graft and corruption and betrayal of public trust were filed against President Arroyo with the Philippine Congress. On September 6, 2005, the Philippine Congress voted to reject the impeachment complaints against President Arroyo.

Other recent developments include coup d'état attempts against the administration of President Arroyo. On February 24, 2006, President Arroyo declared a state of emergency allowing for warrantless arrests and a temporary take-over of privately-owned utility companies. On March 3, 2006, President Arroyo lifted the state of emergency.

In June 2006, President Arroyo proposed to amend the Constitution of the Philippines to implement a unicameral federal, parliamentary system patterned after the German constitution. Under said system, the country would be split into states with each state granted a local legislature. There were also plans to remove or ease the current ban on foreign ownership of property, land and commercial organizations in the Philippines. A group of local leaders have joined together in what was known as the People's Initiative which caused to further the amendment of the Constitution. In addition to nationwide campaigns and rallies, a petition was filed with the Supreme Court, or SC, to reform the Constitution. This petition was rejected by the SC on October 25, 2006. Nevertheless, the People's Initiative continues to advocate amendments to the Constitution.

Furthermore, the Philippine economy has experienced periods of slow growth, high inflation and significant devaluation of the peso. The Philippine government is also facing a fiscal deficit that the government is aiming to eliminate by 2008 by implementing a number of economic reforms.

The fiscal deficit position of the Philippine government and the ongoing political uncertainty have resulted in increased concerns about the political and economic stability of the country. This, in turn, has resulted in the volatility of the peso against the dollar. There can be no assurance that the political environment in the Philippines will be stable or that the current or any future government will adopt economic policies conducive to sustained economic growth or which do not impact adversely on the current regulatory environment for telecommunications or other companies.

If foreign exchange controls were to be imposed, our ability to meet our foreign currency payment obligations could be adversely affected

Approval from or registration with the BSP for the issuance and guarantee of foreign currency-denominated borrowings is not required in order to make our foreign currency payment obligations legally valid and binding. However, receiving this approval and registration will enable a borrower to access the banking system to obtain foreign currency to service its debt obligations rather than using other sources of foreign currency, for example, foreign currency revenue streams.

The Philippine government has, in the past, instituted restrictions on the conversion of the peso into foreign currency and the use of foreign exchange received by Philippine companies to pay foreign currency-denominated obligations. The Monetary Board of the BSP has statutory authority, with the approval of the President of the Philippines, during a foreign exchange crisis or in times of national emergency, to:

- suspend temporarily or restrict sales of foreign exchange;
- require licensing of foreign exchange transactions; or
- require the delivery of foreign exchange to the BSP or its designee banks.

We cannot assure you that foreign exchange controls will not be imposed in the future. If imposed, these restrictions could materially and adversely affect our ability to obtain foreign currency to service our foreign currency obligations.

The occurrence of natural catastrophes may materially disrupt our operations

The Philippines has experienced a number of major natural catastrophes over the years including typhoons, volcanic eruptions and earthquakes that may materially disrupt and adversely affect our business operations. The recent

earthquake that hit Taiwan in December 26, 2006 severed cable systems linking the Philippines to other Asian and American countries, causing major slowdown of voice and non-voice data traffic exchange. There can be no assurance that the insurance coverage PLDT maintains for these risks will adequately compensate it for all damages and economic losses resulting from natural catastrophes.

Item 4. Information on the Company

Overview

We are the leading national telecommunications service provider in the Philippines. Through our three principal business groups – wireless, fixed line, and information and communications technology – we offer a wide range of telecommunications services to approximately 26 million subscribers in the Philippines across the nation's most extensive fiber optic backbone and fixed line, cellular and satellite networks.

We are the leading fixed line provider in the Philippines with approximately 63% of the total reported fixed line subscribers nationwide as at December 31, 2006. Smart, our wholly-owned subsidiary, is the leading cellular service provider in the country, with approximately 41% of total reported cellular subscribers as at December 31, 2006. Piltel, Smart's 92.1%-owned subsidiary, had approximately 17% of total reported cellular subscribers as at December 31, 2006. We have interests in the information and communications technology sectors, including the operation of our *Vitro*™ data center, call center and business process outsourcing, or BPO, businesses.

Our common shares are listed and traded on the Philippine Stock Exchange, or PSE, and our American Depositary Shares, or ADSs, evidenced by American Depositary Receipts, or ADRs, are listed and traded on the New York Stock Exchange in the United States.

We had a market capitalization of approximately Php481,948 million (US\$10,437 million) as at May 31, 2007, representing one of the largest market capitalizations among Philippine-listed companies. For the year ended December 31, 2006, we had consolidated operating revenues of Php127,536 million (US\$2,600 million).

Our principal executive offices are located at the Ramon Cojuangco Building, Makati Avenue, Makati City, Philippines and our telephone number is (632) 816-8556. Our website address is www.pldt.com.ph. The contents of our website are not a part of this annual report.

Historical Background and Development

PLDT was incorporated under the old Corporation Law of the Philippines (Act 1459, as amended) on November 28, 1928, following the merger of four telephone companies under common U.S. ownership. In 1967, effective control of PLDT was sold by General Telephone and Electronics Corporation (a major shareholder since PLDT's incorporation) to a group of Filipino businessmen. In 1981, in furtherance of the then existing policy of the Philippine government to integrate the Philippine telecommunications industry, PLDT purchased substantially all of the assets and liabilities of the Republic Telephone Company, which at that time was the second largest telephone company in the Philippines. In 1998, the First Pacific Group acquired a significant interest in PLDT. On March 24, 2000, NTT Communications, through its wholly-owned subsidiary NTT Communications Capital (U.K.) Limited, or NTTC-UK, became PLDT's strategic partner with approximately 15% economic and voting interest in the issued and outstanding common stock of PLDT. Simultaneous with NTT Communications' investment in PLDT, we acquired 100% of Smart. On March 14, 2006, NTT DoCoMo acquired from NTT Communications approximately 7% of PLDT's outstanding common shares held by NTT Communications with NTT Communications retaining ownership of approximately 7% of PLDT's common shares. On February 28, 2007, Metro Pacific Asset Holdings, Inc., a Philippine affiliate of First Pacific, completed the acquisition of an additional interest of approximately 46% in PTIC. This additional investment in PTIC, a shareholder of PLDT, represents an attributable interest of approximately 6.4% of the issued common shares of PLDT and thereby raised the First Pacific Group's beneficial ownership to approximately 28% of PLDT's shares of common stock as at that date. See Item 7. Major Shareholders and Related Party Transactions for further discussion.

PLDT's original franchise was granted in 1928 and was last amended in 1991, extending its effectiveness until 2028 and broadening PLDT's franchise to permit PLDT to provide virtually every type of telecommunications service. PLDT's franchise covers the business of providing basic and enhanced telecommunications services in and between the provinces, cities and municipalities in the Philippines and between the Philippines and other countries and territories including mobile, cellular, wired or wireless telecommunications system, fiber optics, multi-channel transmission distribution systems and their value-added services such as but not limited to transmission of voice, data, facsimile, control signals, audio and video, information services bureau and all other telecommunications systems technologies, as are at present available or can be made available through technical advances or innovations in the future. See Item 8. Financial Information Legal Proceedings Quo Warranto Action for information regarding legal proceedings initiated by the Solicitor General with respect to PLDT's franchise.

Since the implementation of its Subscriber Investment Plan, or SIP, in 1973 pursuant to Presidential Decree No. 217, which in the past required telephone subscribers to purchase shares of PLDT's preferred stock, PLDT has developed a broad base of public ownership with 2,189,374 common and preferred stockholders of record as at December 31, 2006. As approved by the NTC, the SIP was made optional beginning in April 2003, from being compulsory in earlier years. Of these stockholders, 2,172,964 are Philippine persons representing approximately 86% of PLDT's outstanding common and preferred shares. For purposes of this paragraph, all the ADSs, each representing one PLDT common share and evidenced by American Depositary Receipts, or ADRs, are considered to be held of record in the United States.

Our consolidated capital expenditures amounted to Php20,348 million, Php15,864 million and Php19,268 million in 2006, 2005 and 2004, respectively. Of these amounts, Php8,573 million, Php6,389 million and Php3,917 million were attributable to PLDT for 2006, 2005 and 2004, respectively, while Php10,506 million, Php8,785 million and Php14,735 million were spent by Smart for 2006, 2005 and 2004, respectively. The remaining balances were spent by our other subsidiaries, principally ePLDT and its subsidiaries.

Organization

PLDT Group includes the following significant subsidiaries:

| Name of Subsidiary | Place of Incorporation | Principal Activity | Percentage of Ownership | |
|---|------------------------|---|-------------------------|----------|
| | | | Direct | Indirect |
| Wireless | | | | |
| Smart | Philippines | Cellular mobile services | 100.0 | |
| Smart Broadband | Philippines | Internet broadband and distributor | | 100.0 |
| Wolfpac | Philippines | Mobile applications developer and service provider | | 100.0 |
| Piltel | Philippines | Providing cellular and fixed line services | | 92.1 |
| Telesat | Philippines | Satellite communications services | 94.4 | |
| ACeS Philippines | Philippines | Satellite phone services | 88.5 | 11.5 |
| Mabuhay Satellite | Philippines | Satellite communications services | 67.0 | |
| Fixed Line | | | | |
| ClarkTel | Philippines | Telecommunications services | 100.0 | |
| SubicTel | Philippines | Telecommunications services | 100.0 | |
| | British Virgin Islands | Telecommunications services | 100.0 | |
| PLDT Global | | | | |
| SNMI | Philippines | Data and network services | 100.0 | |
| Maratel | Philippines | Telecommunications services | 97.5 | |
| BCC | Philippines | Telecommunications, infrastructure and related value-added services | 75.0 | |
| Information and Communications Technology | | | | |
| ePLDT | Philippines | Information and communications infrastructure for internet-based services, e-commerce, call centers and IT-related services | 100.0 | |
| Vocativ | Philippines | Call center services | | 100.0 |
| Parlance | Philippines | Call center services | | 100.0 |
| Ventus | Philippines | Call center services | | 100.0 |
| SPi and Subsidiaries (including CyMed) | Philippines | Business process outsourcing, or BPO, services | | 100.0 |
| Infocom | Philippines | Internet services | | 99.6 |
| netGames | Philippines | Publisher of online games | | 80.0 |
| Digital Paradise (formerly Netopia Computer Technologies, Inc.) | Philippines | Internet access services | | 75.0 |
| Level Up! | Philippines | Publisher of online games | | 60.0 |

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| | | | |
|---------------------------|-------------|----------------------------|------|
| Digital Paradise Thailand | Thailand | Internet access services | 51.0 |
| Airborne Access | Philippines | Wireless internet services | 51.0 |

As described below, SPi, CyMed and Level Up! were all acquired in 2006 and included in our 2006 consolidated financial statements. See *Note 9 Goodwill and Other Intangible Assets* to the accompanying consolidated financial statements in Item 18 for further discussion.

On September 2, 2004, Smart entered into a sale and purchase agreement to acquire 100% of Smart Broadband, a company primarily engaged in providing wireless broadband and data services to small and medium-scale enterprises in the Philippines, for a total consideration of US\$45 million, of which payments of US\$11 million and US\$7 million for an equity interest of 40% in Smart Broadband were made in 2004 and payment of US\$4 million for an additional equity interest of 9% was made in January 2005. The balance of US\$23 million in respect of the remaining 51% equity interest in Smart Broadband was paid on March 7, 2006. The acquisition aims to strengthen Smart's position in the wireless data segment and is in line with Smart's overall strategy of providing the widest range of innovative wireless services.

With Smart and PLDT owning 85.6% and 6.5% as at the year ended December 31, 2004, respectively, of Piltel's common equity, Piltel was reconsolidated into the PLDT group's wireless financial position and results of operations starting the year ended December 31, 2004. On April 25, 2005, PLDT and Smart entered into a subscription and assignment agreement under which PLDT assigned and transferred to Smart its 767 million Piltel common shares in exchange for 11 million of Smart's preferred shares. As a result, Smart's shareholdings in Piltel now represents 92.1% of Piltel's outstanding common shares and PLDT no longer owns any shares of Piltel's common stock.

Following its acquisition in October 2003 of an 80% equity interest in Wolfpac, a company engaged in the business of consumer mobile applications software development and content development, Smart acquired in July 2006 the remaining 20% equity interest in Wolfpac.

On February 16, 2006, ePLDT acquired a 60% equity interest in Level Up!, a leading publisher of online games in the Philippines. The acquisition of Level Up!, together with netGames, ePLDT's online gaming subsidiary, is expected to strengthen ePLDT's online gaming business in the Philippines.

On July 11, 2006, ePLDT acquired 100% of SPi Technologies, Inc., or SPi, and its direct and indirect Philippine and offshore subsidiaries for a cash consideration of US\$135 million. SPi is the second largest pure-play BPO and the ninth largest independent BPO service provider worldwide. It has operations in 19 locations in North America, Europe and Asia. On August 11, 2006, SPi acquired 100% of CyMed, a leading medical transcription company based in Richmond, Virginia and on April 16, 2007, SPi acquired 100% of Springfield Service Corporation, one of the ten largest U.S. medical billing and revenue cycle management companies.

Wireless

We provide cellular, and wireless broadband, satellite, VSAT and other services under our wireless business, contributing about 96% and 4% of our wireless service revenues, respectively, in 2006. The rapid growth in the cellular market has resulted in a change in our revenue composition and sources of our revenue growth. Starting with 2003, cellular service was our major revenue source surpassing fixed line revenues. Cellular data services, which include all text messaging and text-related services ranging from ordinary text to value-added services, contributed significantly to our revenue increase. Our wireless operating revenues accounted for 63%, 62% and 61% of our consolidated operating revenues for the years ended December 31, 2006, 2005 and 2004, respectively. For the years ended December 31, 2006, 2005 and 2004, cellular service revenues accounted for 96%, 96% and 97%, respectively, of our wireless business operating revenues.

We provide cellular services (including handset sales), through Smart and its subsidiary, Piltel. Smart is the leading cellular services provider in the Philippines, with 17,201,005 subscribers as at December 31, 2006, representing an estimated market share of approximately 41%. Piltel, a reseller of Smart's GSM network with its own branding, had 6,974,379 subscribers as at December 31, 2006, representing an estimated market share of approximately 17%. In 2006, the combined number of Smart's and Piltel's subscribers increased by 3,766,763, or 18%, to 24,175,384. As at December 31, 2006, cellular penetration in the Philippines reached approximately 48%, which was nearly 14 times the country's fixed line penetration, although the existence of subscribers owning multiple SIMs has likely overstated this penetration rate to a certain extent.

Smart's and Piltel's cellular subscriber gains were predominantly attributable to their respective prepaid services. Approximately 99% of Smart's and all of Piltel's cellular subscribers were prepaid as at December 31, 2006. The predominance of prepaid service reflects one of the distinguishing characteristics of the Philippine cellular market. The growth in our prepaid service has enabled us to increase and broaden our subscriber base rapidly while controlling credit risk and reducing billing and administrative costs on a per-subscriber basis.

Our cellular subscriber growth has also been driven by text messaging. Text messaging is extremely popular in the Philippines, particularly on the prepaid platform, as it provides a convenient and inexpensive alternative to voice and e-mail based communications. Text messaging contributed significantly to Smart's cellular data service revenue growth in 2006, generating revenues of Php34,403 million, an increase of Php3,594 million, or 12%, over 2005.

Smart's Nokia-provided cellular network is the most extensive in the Philippines, covering substantially all of Metro Manila and most of the other major population centers in the Philippines. Its dual-band GSM network allows it to efficiently deploy high capacity 1800 MHz base transceiver stations, or BTS, in dense urban areas while its 900 MHz BTS can be much more economically deployed in potentially high growth, but less densely populated provincial areas. With 6,099 GSM base stations as of the end of December 2006, Smart's cellular network covers approximately 99% of all towns and municipalities in the Philippines, accounting for approximately 99% of the population.

Fixed Line

We are the leading fixed line operator in the Philippines and the largest company providing fixed line telecommunications services throughout the country. Our fixed line business group offers local exchange, international long distance, national long distance, data and other network and miscellaneous services. We had 1,776,647 fixed line subscribers as at December 31, 2006. Operating revenues from our fixed line services accounted for 32%, 36% and 37% of our consolidated operating revenues for the years ended December 31, 2006, 2005 and 2004, respectively.

Our 6,400-kilometer long domestic fiber optic network, or DFON, is supported by an extensive digital microwave backbone. Our fixed line network reaches all of the major cities and municipalities in the Philippines, with a concentration in the Metropolitan Manila area. Our network offers the country's most extensive connections to international networks through three international gateway switching exchanges, satellite systems and various regional submarine cable systems in which we have interests.

Information and Communications Technology

Through our wholly-owned subsidiary, ePLDT, we provide broad-based integrated information and communications technology, or ICT, services focusing on infrastructure and solutions for Internet applications, Internet protocol-based solutions and multimedia content delivery. ePLDT's principal activities are the operation of an Internet data center under the brand name *Vitro*, call center business, BPO, and Internet and online gaming business. Operating revenues from our ICT services accounted for 5% of our consolidated operating revenues for the year ended December 31, 2006 and 2% for each of the years ended December 31, 2005 and 2004.

Strengths

We believe our business is characterized by the following competitive strengths:

- ***Recognized Brands.*** PLDT and Smart are strong and widely recognized brand names in the Philippines. We have built the PLDT brand name for over 75 years as the leading telecommunications provider in the Philippines. Smart is recognized in the Philippines as an innovative provider of high-quality cellular services. Piltel's *Talk N Text* brand, which is provided using Smart's network, has also gained significant recognition.
- ***Leading Market Shares.*** With approximately 26 million fixed line and cellular subscribers as at December 31, 2006, we have the leading market position in both the fixed line and cellular markets in the Philippines.

- *Diversified Revenue Sources.* As a result of the continued growth of cellular service in the country, approximately 63% of our consolidated operating revenues in 2006 were derived from our wireless business segment. Fixed line revenues, which represented 32% and 36% of our consolidated operating revenues in 2006 and 2005, respectively, have remained stable over the past three years despite pressures on traditional fixed line voice revenues, resulting from increases in our fixed line data and other network services. We continue to identify and develop new revenue sources from our cellular, fixed line and ICT businesses.
- *Advanced Integrated Network.* With one of the most advanced and extensive telecommunications networks in the Philippines, we are able to offer a wide array of communications services. We are enhancing the capabilities of our fixed line and wireless networks to allow us to better exploit this competitive strength and achieve higher levels of network efficiency in providing voice and data services. In addition, we have commenced the upgrade to Next Generation Network, or NGN, and the roll out of 3G and wireless broadband in order to increase broadband subscribers, and expand our data/broadband capabilities.
- *Innovative Products and Services.* We have successfully introduced a number of innovative and award-winning cellular products and services, including *Smart Load* and *Pasa Load*. *Smart Load* is an over-the-air electronic loading facility designed to make reloading of air time credits more convenient for, and accessible to consumers. *Pasa Load* (the term *pasa* means transfer in the vernacular), a derivative service of *Smart Load* that allows load transfers to other *Smart Buddy* and *Talk N Text* subscribers.
- *Strong Strategic Relationship.* We have important strategic relationships with NTT Communications, DoCoMo and First Pacific. The technological support, international experience and management expertise made available to us through these strategic relationships enhance our market leadership and ability to provide and cross-sell a more complete range of products and services.

Strategy

The key elements of our business strategy are:

- *Build on our leading positions in the fixed line and wireless businesses.* We plan to build on our position as the leading provider of fixed line service in the Philippines by continuing to launch new products and services to increase subscriber value and utilization of our existing facilities and equipment at reduced cost. We plan to build on our position as the leading wireless service provider in the Philippines by continuing to introduce new products and services to increase our subscribers' use of our network for both voice and data, as well as their reliance on our services. We are currently upgrading our fixed line facilities to NGN, and have rolled out a 3G network based on a W-CDMA technology as well as expanding our DSL and wireless broadband facilities. Our operating target is to continue growth in profitability by increasing our revenues while controlling our costs.

- *Capitalize on our strength as an integrated provider of telecommunications services.* We offer the broadest range of telecommunications services among all operators in the Philippines. We plan to capitalize on this position to maximize revenue opportunities by bundling and cross-selling our products and services between, and by developing convergent products that feature the combined benefits of voice and data, fixed line, wireless and ICT services utilizing our network and business platforms. We are also lowering our costs by integrating the operations of our different businesses.
- *Strengthen our leading position in the data market.* Leveraging on the inherent strength of our fixed line business, we are committed to further develop, enhance and lead our fastest growing business segment data and other network services. Consistent with our strategy of introducing innovative products and services using advanced technology, we have launched various products and services that address different market needs.
- *Maintain a strong financial position and improve shareholder returns.* Since 2002, we have significantly improved our financial position by utilizing our cash flows principally for debt reduction. As the cash flows generated by our businesses have increased and our leverage ratios have improved, we were able to restore the payment of common dividends to our shareholders beginning 2005. Since then, we have increased our dividend payout to common shareholders from 10% of 2004 earnings to 40% of 2005 earnings and to 60% of 2006 earnings. We expect that a greater proportion of our free cash flows in succeeding years will be utilized for the payment of common dividends and investments in new growth areas while continuing to maintain a healthy balance sheet position.

Business

Wireless

We provide cellular, wireless broadband, satellite, VSAT and other services through our wireless business segment.

Cellular Service

Overview

Our cellular business, which we provide through Smart and Piltel to over 24 million subscribers, approximately 99% of whom are prepaid subscribers, is focused on providing wireless voice communications, wireless data communications (primarily through text messaging) and a variety of other value-added services, which includes (a)

Mobile Banking (banking services delivered over the cellular network); (b) specialized content such as ringtones, logos, caller ringback tunes; (c) *Smart Money*; (d) international roaming; and (e) games and other VAS developed on Smart's platform. Smart services approximately seven million subscribers of Piltel on its GSM network through a facilities service agreement with Piltel, under the brand name *Talk N Text*.

The following table summarizes key measures of Smart's and Piltel's cellular business as at and for the years ended December 31, 2006, 2005 and 2004:

| | Years Ended December 31, | | |
|---|--------------------------|------------|------------|
| | 2006 | 2005 | 2004 |
| Systemwide cellular subscriber base | 24,175,384 | 20,408,621 | 19,208,232 |
| Smart | 17,201,005 | 15,424,196 | 14,595,782 |
| Prepaid | 16,882,442 | 15,144,118 | 14,321,288 |
| Postpaid | 318,563 | 280,078 | 274,494 |
| Piltel(1) | 6,974,379 | 4,984,425 | 4,612,450 |
| Growth rate of cellular subscribers | 18% | 6% | 48% |
| Smart | 12% | 6% | 45% |
| Piltel(1) | 40% | 8% | 61% |
| Cellular revenues (in millions) | Php77,627 | Php74,229 | Php72,532 |
| Service | 75,605 | 71,518 | 66,421 |
| Non-service | | | |
| Cellular handset sales | 2,022 | 2,711 | 6,111 |
| Percentage of cellular revenues to total service revenues | 58% | 59% | 61% |

(1) Represents *Talk N Text*, a prepaid service provided by Piltel using Smart's network. Piltel's revenue is net of service fees payable to Smart for using Smart's network. Piltel does not offer postpaid service.

Service Plans. Smart and its service brands are strong and widely recognized brand names in the Philippines. Smart's approach has been to methodically segment the market and tailor services and content appropriate to each particular niche. One of the best examples of Smart's successful market segmentation strategy is *Talk N Text*, the brand carried by Smart's subsidiary, Piltel. *Talk N Text* is aimed at the lower-income markets with the objective of serving as a flanker brand against our competition. Capitalizing on the Filipino's love for pop culture, *Talk N Text* extensively uses local celebrities as its endorsers and the vernacular in its advertising and promotional campaigns. With approximately seven million subscribers, *Talk N Text* has the third-largest GSM subscriber base in the Philippines.

On the postpaid side, we have *Smart Gold*, which serves the broad postpaid market, and *Smart Infinity*, a premium postpaid plan targeting affluent individuals 35 years and above who are highly mobile locally and internationally. *Smart Infinity* offers around-the-clock dedicated personal concierge service, international assistance services, premium handset packages and exclusive lifestyle content.

Voice Services. Cellular voice services comprise local (including Smart-and Piltel-to-fixed lines calls and Smart-and Piltel-to-other mobile operators calls), national long distance and international long distance calls. Voice services remains a major contributor to revenues, generating a total of Php35,221 million, or 45%, and Php35,444 million, or 48%, of cellular service revenues in 2006 and 2005, respectively. Local calls continue to dominate outbound traffic with 67% of all outbound minutes originating from our cellular service. In 2006, traffic volumes from local calls totaled 3,362 million minutes compared to 3,658 million minutes in 2005. National long distance traffic volumes for 2006 stood at 73 million minutes compared to 80 million minutes in 2005. Outbound international long distance decreased to 2% from 4% in 2005 of total outbound traffic with 165 million minutes and 169 million minutes generated in 2006 and 2005, respectively. The ratio of inbound-to-outbound international long distance minutes was 12.5:1 for 2006, compared to 9.2:1 in 2005.

Text Messaging Service and Other Value-added Services. The Philippines cellular market is one of the most text messaging-intensive markets in the world, totaling approximately a billion text messages per day. Text messaging is extremely popular in the Philippines, particularly on the prepaid platform, as it provides a convenient and inexpensive alternative to voice and e-mail based communications. Text messaging also utilizes less network capacity than voice, thereby increasing network efficiency.

Text messaging has been one of the key drivers for our cellular subscriber growth. Strong volume growth in text messaging contributed significantly to Smart's cellular revenue growth in 2006, generating revenues of Php34,403 million, an increase of Php3,594 million, or 12%, over 2005. During 2006, Smart and Piltel's text messaging systems handled over 32,052 million outbound messages on standard SMS services and another 203,669 million messages generated through bucket-priced text services. This compares to 40,781 million outbound messages on standard SMS services in 2005 and 52,373 million outbound messages generated through bucket-priced text services. Unlimited and bucket-priced SMS services were only made available in March 2005.

In 2005, Smart launched a series of promotions to test the market demand for fixed rate or bucket plans for voice and text. Bucket pricing promotions have now become a key driver for subscriber activations and usage stimulation.

In addition, in 2006, Smart focused on segmenting its market by offering sector-specific, value-driven packages providing a fixed number of messages with prescribed validity periods.

The success of text messaging is a strong indicator of future data usage potential in this market. In 2006, approximately 51% of Smart's cellular revenues were derived from data usage, compared to 48% in 2005.

Smart has recognized early the importance of diversified and innovative products and services as a competitive advantage in gaining and retaining market share as well as improving profitability. Smart has diversified its wireless data revenues beyond text messaging and leads the market in terms of enhanced data services. Its catalog of

innovations include the award-winning *Smart Money* (a mobile cash card) and *Smart Load* (an over-the-air electronic loading facility), both of which were honored by the World GSM Congress in 2001 and 2004, respectively, as Most Innovative Service for Consumers. *Smart Load* has revolutionized the mobile industry with its adaptation of the sachet concept in consumer goods to air time reloads. The concept has since been emulated by other Asian operators and is regionally referred to as micro prepaid reloads. Smart subsequently introduced *Pasa Load*, a derivative service of *Smart Load*, which allows for air time load transfers between subscribers. Smart also offers the following value-added cellular services:

- *Mobile Banking*, launched in collaboration with various banks, allows subscribers to execute banking transactions such as balance inquiries and transfers over their mobile telephones;
- *Smart Money*, launched in conjunction with MasterCard, enables subscribers to pay for their purchases by transferring money from their bank accounts to their Smart Money cards as well as reload their prepaid cards electronically; and
- *Smart Padala*, one of the many innovative initiatives from our *Smart Money* platform, is the first cash remittance service through text and is faster and cheaper than traditional remittance arrangements. It was launched initially as an international remittance service for overseas Filipino workers but is now available for domestic remittances as well.

We also offer value-added services such as voice mail, information-on-demand, which is a service that allows subscribers to order information from our content providers whenever desired, *TextMail*, which is a service that allows subscribers to send and receive text messages through their personal computers and location-based services, and *Voice Text*, which allows subscribers to record a voice message of up to 30 seconds and send it as a text message. In addition, Smart has a number of interactive activities, such as text games and chat services, developed on its own platforms.

Consistent with Smart's objective to develop new businesses, Smart introduced in 2006 a fixed wireless broadband service under the brand *SmartBro* to complement PLDT's DSL in areas that are currently not covered by the fixed line network. *SmartBro* is rapidly increasing network coverage in order to retain first mover advantage in areas with limited or no fixed line or broadband coverage. *SmartBro* is also pioneering a shared access model in order to propagate broadband and address affordability barriers.

Also, Smart rolled out *Smart Click*, a chain of mobile Internet cafés. *Smart Click* Internet cafés are housed in air-conditioned 40-foot container vans designed to provide remote communities with high-speed, wireless Internet access nationwide. *Smart Click* has established 19 mobile Internet cafés as at December 31, 2006.

Due to the high level of text messaging service usage, we believe that the Philippine market is well suited for text-based informational and e-commerce services. Our current approach is to continue maximizing our GSM, or 2G, services while upgrading our network to Enhanced Data for GSM Evolution, or EDGE. EDGE is a technology that would further increase the speed and data capability of our GSM network. In addition, on December 29, 2005, Smart was awarded a 3G license by the NTC after being ranked highest by the NTC in garnering a perfect score on a 30-point grading system designed to gauge the capability of telecommunication operators to effectively provide extensive 3G services. As a result of the perfect ranking, Smart received the largest radio frequency allocation of 15 MHz as well as first choice of frequency spectrum. Smart chose the 1920-1935 MHz and 2110-2125 MHz spectrum, the range that would best enable it to rapidly deploy its 3G network nationwide and at the same time offer the highest quality of 3G service.

Smart further expanded its roster of services with the commercial launch of its 3G services in May 2006. These services include video calling, video streaming, high speed Internet browsing and special 3G content downloads, each offered at rates similar to those of 2G services, and make Smart the first mobile operator in the Philippines to offer 3G services to the public.

Rates and Discounts

Our current policy is to recognize a prepaid subscriber as active only when the subscriber activates and uses the SIM card and reloads it at least once during the month of initial activation or in the immediately succeeding month. A prepaid cellular subscriber is disconnected if the subscriber does not reload within four months after the full usage or expiry of the last reload.

Our prepaid cards are sold in denominations of Php300, Php500 and Php1,000, respectively. The stored value of a prepaid card generally remains valid for a period of two months from the time a subscriber activates the card. In 2003, we introduced *Smart Load*, an over-the-air electronic loading facility, which allows consumers to reload prepaid cards with denominations ranging from Php10 to Php 300 and with different expiration periods depending on the denomination of the reload. Moreover, *Pasa Load*, a derivative service, allows prepaid subscribers to transfer even smaller denominations to other prepaid subscribers. Our prepaid subscribers are charged between Php5.50 per minute and Php6.50 per minute for calls within our wireless network and between Php5.50 per minute and Php6.50 per minute for calls terminating to other cellular or fixed line networks. Voice tariffs on our various prepaid voice packages range from a low of Php5.50 for four 15-second on-net calls to Php20 for three 3-minute on-net calls, valid for one day.

We offer both flat rate, or regular, and consumable postpaid plans with monthly service fees ranging from Php500 to Php8,000. These plans are available with varying amounts of free air time and text messages and different rates beyond the free minutes and text messages, depending on the monthly service fee. Monthly service fees for flat rate, or regular, plans are applicable only to local calls and text messages and for consumable plans to all voice calls, text messages (both local and international) and value-added services.

Smart is permitted to adjust its cellular air time and national direct dial rates according to changes in the peso-to-U.S. dollar exchange rate. Under the authorization granted to Smart by the NTC, Smart is permitted to increase and is required to decrease its air time and national direct dial rates by 1% for every Php0.25 change in the exchange rate relative to a base rate of Php24.726 to US\$1.00. However, Smart has not implemented any foreign currency adjustments to its rates since November 4, 1998 because of the concern that increased rates may result in decreased usage or switching to other cellular providers by its subscribers.

All Smart subscribers pay an international direct dialing rate of US\$0.40 per minute. This rate applies to 201 destinations, including the United States, Hong Kong, Japan, Singapore, the United Kingdom and the United Arab Emirates. Smart charges US\$0.98 per minute for 27 other destinations and US\$2.18 per minute for another ten destinations.

We also launch from time to time various promotions to stimulate usage and subscriber growth.

We sell our cellular services primarily through a network of independent dealers and distributors that generally have their own retail networks, direct sales forces and sub-dealers. We currently have nine major dealers, two of which are exclusive. These dealers include major distributors of cellular handsets whose main focus are telecommunications outlets. Account managers from our sales force manage the distribution network and regularly update these business partners on upcoming marketing strategies, promotional campaigns and new products introductions. With the introduction of *Smart Load* in May 2003, Smart moved into a new realm of distribution. These over-the-air reloads, which were based on the sachet marketing concept of consumer goods such as shampoo and ketchup, required a distribution network that approximates those of fast-moving consumer goods companies. Starting with just 50,000 outlets when it was launched, *Smart Load*'s distribution network now encompasses over 800,000 retail agents, 80% of which are micro businesses (e.g., neighborhood stores, individual entrepreneurs, individual roving agents). These micro-retailers must be affiliated with any of Smart's authorized dealers, distributors, sub-dealers or agents. With the prepaid reloading distribution network now extended to corner store and individual retailer levels and minimum reloading denominations as low as Php10, Smart's prepaid service becomes even more affordable and accessible to subscribers.

For prepaid services, we grant discounts to dealers for prepaid phone kits, air time cards and over-the-air reloads sold. Smart and Piltel compensate dealers with Php800 in cash per prepaid phone kit sold. An additional 1% discount based on the suggested retail price is given on cash purchases. Air time cards and over-the-air reloads are sold to distributors at volume discounts determined by the value of the cards purchased by the distributors. Discounts given for air time cards sold range from 8% to 8.4% while discounts on over-the-air reloads range from 2.5% to 5%. Air time cards cannot be returned or refunded and normally expire within six to 12 months after release from the Smart warehouse.

Wireless Broadband, Satellite, VSAT and Other Services

Overview

We currently provide wireless broadband, satellite, VSAT and other services through Mabuhay Satellite and Telesat, ACeS Philippines, our satellite phone service provider, Smart Broadband, our wireless broadband provider, and Wolfpac, our wireless content operator.

Mabuhay Satellite

Mabuhay Satellite is engaged in the control and operation of the Agila II satellite. Commencing commercial operations in January 1998, Agila II is the Philippines' first communication satellite. Mabuhay Satellite leases satellite space segments in both the C and Ku bands on Agila II. Through Agila II, Mabuhay Satellite also offers Internet backbone access, video and data broadcasting, and bandwidth-on-demand, facilitating communication links between telecommunications, broadcast and other public utility companies operating in the Asia-Pacific region. In 2006, Mabuhay Satellite generated revenues of Php1,157 million and posted a net loss of Php1,499 million.

Telesat

Telesat operates a nationwide communications satellite network using VSAT technology. Telesat offers voice, facsimile and data transmission services throughout the Philippines, including areas that are underserved or unserved by local fixed line operators. In 2006, Telesat generated revenues of Php9 million and posted a net loss of Php51 million.

Using VSAT technology, we also provide the following services:

- point-to-multipoint data transmission services, usually for intercompany communication for corporate customers;
- private point-to-point services; and
- connectivity for the cell sites of our wireless network in outlying locations.

We lease transponder capacity on Agila II satellite to provide VSAT services.

ACeS Philippines

ACeS Philippines currently owns approximately 36.99% of AIL. In 2006, ACeS Philippines generated revenues of Php430 million and posted a net income of Php159 million. AIL aims to develop and implement a satellite-based communications system to provide services to users in the Asia-Pacific region through the Garuda I satellite, or ACeS System and ACeS Service. AIL has entered into interconnection agreements and roaming service agreements with PLDT and other major telecommunications operators that will allow ACeS service subscribers to access GSM terrestrial cellular systems in addition to the ACeS system. Further, AIL has an Air Time Purchase Agreement, or ATPA, with National Service Providers in Asia, including PLDT. For further discussion regarding the ATPA, please see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Contractual Obligations and Commercial Commitments Contractual Obligations Unconditional Purchase Obligations Air Time Purchase Agreement with AIL below and *Note 16 Related Party Transactions* to the accompanying consolidated financial statements in Item 18.

As part of the consolidation process of the PLDT Group's wireless business, ACeS Philippines' operations has been integrated into Smart. This operational integration effectively gives Smart the widest service coverage in the Philippines through the combination of ACeS Philippines satellite phone service and Smart's cellular service.

Smart Broadband

Smart Broadband is engaged in providing wireless broadband and data services to residential consumers as well as small and medium-scale enterprises in the Philippines. As of December 31, 2006, Smart Broadband had 121,867 wireless broadband subscribers, of which 120,659 residential subscribers are under the brand name *Smart Bro* (formerly *Smart WiFi*). *Smart Bro* aims to strengthen Smart's position in the wireless data segment and complements PLDT's *myDSL* service in areas where the latter is not available.

Smart Bro offers two packages for its wireless broadband service:

- *Smart Bro* Plan 999, which is geared towards consumers and provides Internet speeds of up to 384 kbps; and
- *Smart Bro* Computer Station Plan 2600, which is geared towards entrepreneurs and includes a monthly subscription, hardware, software and merchandising materials.

Wolfpac

Wolfpac is primarily engaged in the business of consumer mobile applications software development and consumer mobile content development and other allied services. Wolfpac is one of the leading content providers and the only Philippine content provider to have been nominated twice at the annual GSM Congress for successes in application developments. Wolfpac generated revenues of Php7 million and posted a net loss of Php119 million in 2006. It aims to provide Smart to have a direct link to the content development community, a key differentiator in wireless communication service. The company has various agreements with third parties for musical compositions, original sound recordings, original movies, caller ringtone and other services.

PLDT WeRoam

We also offer *PLDT WeRoam*, or *WeRoam*, a wireless broadband service offering running on Smart's nationwide wireless network (using GPRS, EDGE and WiFi technologies) and PLDT's extensive IP infrastructure. *WeRoam* provides workers and remote offices, of large, medium and small businesses, with continuous wireless data connectivity from wherever the users may be to their corporate headquarters Intranet and/or the global Internet. In addition, we expanded the *PLDT Innovation Laboratory*, or *PLDT Innolab*, in Manila in partnership with the leading technology companies in the country. With the expanded *PLDT Innolab*, more clients as well as people from the academe and government can now be accommodated and can experience more on-line industry solutions.

In February 2006, *WeRoam* introduced a prepaid option with bundled laptops featuring easy payment plans in alliances with PC vendors across the country. In July 2006, *WeRoam* also made higher speed wireless broadband available to the market with the launch of the *WeRoam 3G/HSDPA* service.

Revenues

Our wireless broadband, satellite, VSAT and other service revenues consist of:

- lease payments from the rental of Mabuhay Satellite's C-band and Ku-band transponders;
- revenues generated from Telesat's nationwide satellite network;
- revenues generated from ACeS Philippines' satellite phone service;

- revenues generated from Smart Broadband's wireless broadband and data services; and
- revenues generated from Wolfpac for wireless data content.

Rates

Mabuhay Satellite leases its transponders to third parties at average annual rates of approximately US\$0.9 million and approximately US\$0.7 million for its C-band and Ku-band transponders, respectively. Telesat provides its VSAT services on a cost plus mark-up basis. ACeS service mobile subscribers are charged Php13.84 per minute for local and cell-to-cell calls and for national direct dial services, while residential subscribers are charged peak-hour rates of Php13.00 per minute and off-peak hour rates of Php8.00 per minute for domestic calls regardless of destination. For ACeS system public calling offices, callers are charged Php4.50 and Php7.00 per minute for calls terminating to fixed line and cellular networks, respectively. Rates for international long distance calls depend on the country of termination and range from US\$0.35 per minute for frequently called countries to US\$0.85 per minute for less frequently called countries.

Smart Broadband offers its wireless broadband and data services for residential consumers as well as small and medium-scale enterprises. The wireless broadband service for residential consumers is branded as *Smart Bro* and offers a maximum speed of 384 kbps for Php999 per month. Monthly service fees for corporate data services range from Php2,200 to Php48,000 depending on the connection speed requirements.

Wolfpac generates revenues from SMS subscriptions, institutional services and downloadable contents. The subscription price for the SMS subscription and institutional services is pegged at Php2.50 per SMS, while downloadable contents range from Php10.00 to Php45.00.

WeRoam postpaid offers several packages for its wireless broadband service that include unlimited Internet access with speeds ranging from 40 kbps to 1.8 Mbps with monthly recurring fees of Php1,000 to Php1,700 depending on the type of plan selected.

WeRoam prepaid offers several packages that include the GPRS/EDGE card and an air time value for three, six and 12 months with monthly subscription fees based on an initial air time value ranging from Php10,860 to Php20,940. Once the initial air time value expires, continued use of the service requires *WeLoad* or reloading of additional air time value with different denominations and expiration periods.

Fixed Line

We provide local exchange, international long distance, national long distance, data and other network and miscellaneous services under our fixed line business segment.

Local Exchange Service

Overview

Our local exchange service, which consists of our basic voice telephony business, is provided primarily through PLDT.

The following table summarizes key measures of our local exchange service segment as at and for the years ended December 31, 2006, 2005 and 2004:

| | Years Ended December 31, | | |
|--|---------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Number of fixed line subscribers (at year-end)(1) | 1,776,647 | 1,842,507 | 1,834,306 |
| Number of fixed line employees (at year-end) | 8,711 | 9,197 | 9,692 |
| Number of fixed line subscribers per employee | 204 | 200 | 189 |
| Total local exchange revenues (in millions) | Php16,993 | Php20,229 | Php20,606 |
| Local exchange revenues as a percentage of total service revenues | 13% | 16% | 17% |
| Local exchange revenues as a percentage of total fixed line service revenues | 35% | 41% | 42% |

(1) Previously set forth as number of fixed lines in service, this was restated in 2006 to reflect the effect of the change in parameters used to align with the PLDT Group's policy on subscriber count with the planned use of an integrated billing system for our subscribers.

We also provide local exchange services through our subsidiaries ClarkTel, SubicTel, Maratel and Piltel. Together, these subsidiaries account for approximately 4% of our consolidated fixed line subscribers.

We regularly adjust our rates and introduce new products and services in an effort to increase our number of subscribers, improve our churn management efforts and minimize our credit risk exposure. Since 1999, we have launched a prepaid fixed line service, introduced additional value-added services, introduced initiatives aimed at

increasing subscription in areas where we have excess capacity and reduced our installation fees, as described below in the " Rates" section below.

Initially intended as an alternative affordable telephone service for consumers under difficult economic conditions, our prepaid fixed line services now form an important part of PLDT's overall churn and credit risk exposure management and subscriber retention strategy.

Rates

As at December 31, 2006, basic monthly charges for our local exchange service in the Metropolitan Manila area were Php594.17 for a single-party residential line and Php1,237.27 for a single business line. Monthly charges vary according to the type of customer (business or residential) and location, with charges for urban customers generally being higher than those for rural/provincial customers. Regular installation charges amount to Php1,999 for residential customers and Php3,500 for business customers. New products launched on promotion or products bundled on existing services usually waive the installation fee or allow for a minimal installation fee of Php500. Other than basic monthly charges, we do not charge our postpaid subscribers for local calls.

Pursuant to a currency exchange rate mechanism authorized by the NTC, we adjust our monthly local exchange service rates according to changes in the peso-to-U.S. dollar exchange rate. Under the authorization granted to us by the NTC, we are permitted to increase and are required to decrease these rates by 1% for every Php0.10 change in the exchange rate relative to a base exchange rate of Php11 to US\$1.00. In 2006, we implemented eight downward adjustments and three upward adjustments in our monthly local service rates. During 2005, we implemented three upward and six downward adjustments in our monthly local exchange service rates.

In the first quarter of 2005, House Bill No. 926 was filed and is now pending in the House of Representatives of the Philippines. The proposed bill provides for the cancellation of the currency exchange rate mechanism currently in place. If this bill is passed into law or if the NTC issues guidelines to change the basis of the currency exchange rate mechanism, our ability to generate U.S. dollar linked revenues from our local exchange business could be adversely affected.

Our prepaid fixed line customers generally do not pay a basic monthly charge and are charged based on usage. Prepaid fixed line customers are generally charged based on usage at a rate of Php1.00 per minute for local calls. Subscribers of *TelePwede*, our upgraded prepaid fixed line service, are charged a monthly fee of Php15 per month to receive incoming calls and are charged per usage for outgoing calls with varying charges depending on the destination and network of termination. The international and national long distance rates we charge to our prepaid fixed line customers are similar to the rates we charge to our postpaid customers. (For a detailed description of these rates, see International Long Distance Service Rates and National Long Distance Service Rates.) Prepaid phone kits, each containing Php500 worth of pre-stored call credits, are sold for Php1,900 per unit.

*International Long Distance Service**Overview*

Our international long distance service consists of voice and packet-based voice and data services that go through our international gateway facilities. We also generate international long distance revenues through access charges paid to us by other Philippine telecommunications carriers for incoming international voice calls that terminate to our local exchange network. Our packet-based voice and data services are transmitted over our existing traditional circuits, VoIP systems and the network of a consortium of dominant Asian carriers in which PLDT is a member.

The following table shows certain information about our international long distance business as at and for the years ended December 31, 2006, 2005 and 2004:

| | Years Ended December 31, | | |
|---|---------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Total call volumes (million minutes) | 2,177 | 2,266 | 2,373 |
| Inbound call volumes (million minutes) | 1,984 | 2,117 | 2,216 |
| Outbound call volumes (million minutes) | 193 | 149 | 157 |
| Inbound-outbound call ratio | 10.3:1 | 14.2:1 | 14.1:1 |
| Total international long distance service revenues (in millions) | Php9,933 | Php12,245 | Php12,804 |
| International long distance service revenues as a percentage of total service revenues | 7% | 10% | 11% |
| International long distance service revenues as a percentage of total fixed line service revenues | 20% | 25% | 26% |

International long distance service historically has been a major source of our revenue. However, due to the steep decline in inbound termination and collection rates and intense competition, revenues derived from our international long distance service have been declining. We adopted a two-pronged initiative in early 2000 with respect to inbound international service to try to address this issue. First, we lowered our inbound termination rates at that time; by reducing our rates, we reduced the incentive for unauthorized traffic termination and bypass routings by toll bypass operators, and therefore were able to recover some lost traffic; and secondly, we intensified our efforts to identify and contain unauthorized traffic termination and bypass through more effective monitoring of our international trunks, leased lines and local network. International simple resale operation occurs when a company rents an international leased line from a Philippine international gateway operator, aggregates traffic outside the Philippines and carries and terminates this traffic at the local public switch telephone network in the Philippines. This termination of other unauthorized and international simple resale can be used to bypass the local access charge system and is illegal in the Philippines.

We are more selective in accepting incoming traffic from new and startup carriers, particularly second and third tier international carriers. In addition, we adopted a policy requiring prepayment from certain second and third tier international carriers as a prerequisite for accepting their incoming traffic.

We are also pursuing a number of other initiatives to further strengthen our inbound business. Through PLDT Global, we aggregate inbound call traffic to the Philippines at our points of presence and, using our capacity in submarine cable systems connected to each point of presence, transmit calls to our network. PLDT Global is also enhancing the presence of PLDT in other international markets by offering new products and services such as international prepaid cards, mobile services, SMS transit and other global bandwidth services. We believe these strategies will help us maximize the use of our existing international facilities, and develop alternative sources of revenue.

To stimulate call volume growth and prevent further erosion in our share of outbound international call traffic, we have introduced a number of marketing initiatives, including substantial cuts in international direct dialing rates, innovative pricing packages for large accounts and loyalty programs for some customers.

The table below sets forth the net settlement amounts for international calls handled by PLDT, by country, for the years ended December 31, 2006, 2005 and 2004:

| | Net Settlement | | |
|----------------------|---------------------------------|----------------|----------------|
| | Years Ended December 31, | | |
| | 2006 | 2005 | 2004 |
| | (in millions) | | |
| United States | US\$54 | US\$75 | US\$75 |
| Saudi Arabia | 27 | 21 | 18 |
| Canada | 18 | 11 | 10 |
| United Arab Emirates | 15 | 17 | 13 |
| Japan | 12 | 25 | 17 |
| Italy | 11 | 16 | 16 |
| Hong Kong | 8 | 10 | 7 |
| Kuwait | 5 | 4 | 4 |
| Taiwan | 4 | 5 | 6 |
| Others | 31 | 31 | 64 |
| Total | US\$185 | US\$215 | US\$230 |

Rates

Since February 1, 2003, a substantial portion of PLDT's international inbound traffic terminating on its fixed line network is charged US\$0.12 per minute.

Rates for outbound international long distance calls are based on type of service, whether operator-assisted or direct-dialed. Our rates are quoted in U.S. dollars and are billed in pesos. The peso amounts are determined at the time of billing. We charge a flat rate of US\$0.40 per minute to retail customers for direct-dialed calls, applicable to all call destinations at any time on any day of the week.

On September 15, 2005, we introduced *PLDT ID-DSL*, a service that allows overseas calls for registered *myDSL* plan subscribers using a regular PLDT fixed line or a voice pad dialer for as low as US\$0.10 per minute or US\$0.08 per minute, respectively, depending on a particular subscriber's DSL plan.

To address the market's demand for low-priced international calls, PLDT enhanced the *Budget Card*, a prepaid call card, offering a reduced IDD rate of Php5 per minute as a promotional offer starting September 24, 2005 for calls to 89 overseas destinations including the United States, Canada, Japan and China. Beginning March 4, 2006, the *Budget Card* IDD rates have been further adjusted to Php3, Php5 and Php8 per minute, depending on the destination, and now permits calls to 100 overseas destinations. *Budget Cards* are sold in denominations of Php200 and Php100 and must be consumed within 30 days from first use.

National Long Distance Service

Overview

Our national long distance services are provided primarily through PLDT. This service consists of voice services for calls made by our fixed line customers outside of their local service areas within the Philippines and access charges paid to us by other telecommunications carriers for calls carried through our backbone network and/or terminating to our fixed line customers.

The following table shows our national long distance call volumes and revenues as at and for the years ended December 31, 2006, 2005 and 2004:

| | Years Ended December 31, | | |
|---|---------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Total call volumes (million minutes) | 2,251 | 2,348 | 1,930 |
| Total national long distance service revenues (in millions) | Php6,920 | Php5,254 | Php6,736 |
| National long distance service revenue as a percentage of total service revenues | 5% | 4% | 6% |
| National long distance service revenue as a percentage of fixed line service revenues | 14% | 11% | 14% |

A substantial portion of our national long distance calls were direct-dialed calls. Operator-assisted calls are charged based on a minimum of three minutes plus operator charges, while direct-dialed calls are charged on a less costly per minute basis. Cellular substitution and the widespread availability and growing popularity of alternative, more economical non-voice means of communications, particularly e-mailing and cellular text messaging, have negatively affected our national long distance call volumes. The integration of some of our local exchanges into a single local calling area, as approved by the NTC, has also negatively affected our national long distance call volumes and, consequently, our revenues. Because of this integration, calls between two exchanges located within the same province are no longer considered national long distance calls but are treated as local calls.

Rates

Rates for national long distance calls are based on type of service, such as whether the call is operator-assisted or direct-dialed. In line with its move towards rate simplification, PLDT simplified these rates to a flat rate of Php4.50 per minute effective November 2, 2001. At the same time, PLDT simplified its rates for calls terminating to cellular subscribers from a range of Php10.00 per minute to Php16.00 per minute to a uniform rate of Php13.75 per minute. Effective March 1, 2003, PLDT increased the rate for calls terminating to other local exchange carriers from a flat rate of Php4.50 per minute to Php5.00 per minute. In addition, NDD calls originating from and terminating to PLDT was also adjusted to Php5.00 per minute from a flat rate of Php4.50 per minute effective June 8, 2003.

In addition, PLDT launches from time to time promotions, such as flat rate promotions for unlimited calls from PLDT subscribers terminating to PLDT and Smart and *Talk N Text* subscribers, to stimulate fixed line usage.

On January 7, 2006, the Php10 per call to PLDT, Smart and *Talk N Text* subscribers promotion was made permanent with an optional Php50 monthly service fee for those who may want to avail themselves of the service. The offer introduced a permanent shift from per minute charging and allows PLDT fixed line subscribers access to approximately 26 million PLDT, Smart and *Talk N Text* subscribers at a lower rate. The Php10 per call offer for calls to Smart and *Talk N Text* subscribers was capped, limiting enrollees to those who registered on or before February 24, 2006. PLDT fixed line subscribers, however, can still register and avail themselves of the unlimited Php10 per call service for national long distance calls within the PLDT network.

We continue to evaluate the present rate structure of fixed line from per minute toll charges to single rate for unlimited calls. This is envisioned to make fixed line rates competitive with VoIP rates and to revitalize interest in fixed line usage. We continue studying various pricing models in respect of the above new rate plan.

PLDT currently has interconnection arrangement with the majority of other local exchange carriers, pursuant to which the originating carrier pays: (1) a hauling charge of Php0.50 per minute for short-haul traffic or Php1.25 per minute for long-haul traffic to the carrier owning the backbone network; and (2) an access charge of Php1.00 per minute to

the terminating carrier. PLDT still maintains revenue-sharing arrangements with a few other local exchange carriers, whereby charges are generally apportioned 30% for the originating entity, 40% for the backbone owner and the remaining 30% for the terminating entity. For more information on these interconnection arrangements, see Interconnection Agreements.

Data and Other Network Services

Our data and other network service revenues include charges for leased lines, IP-based, packet-based and switched-based services. These services are used for domestic and international communications such as private networking, broadband and narrowband Internet-based data communications, and packet-based communication.

The following table shows our data and other network service revenues for the years ended December 31, 2006, 2005 and 2004:

| | Years Ended December 31, | | |
|--|---------------------------------|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Consolidated data and other network service revenues (in millions) | Php13,725 | Php10,394 | Php7,114 |
| Number of DSL broadband subscribers | 133,159 | 88,811 | 48,289 |
| Number of PLDT Vibe narrowband subscribers | 297,250 | 266,703 | 257,325 |

Recognizing the growth potential of data and other networking services, including IP-based services, and in light of their importance to our business strategy, we have been putting considerable emphasis on this service segment. In 2005, this segment registered the highest percentage growth in revenues among our fixed line services and continued to grow in 2006.

The continuous upgrading of our network using next-generation facilities and the completion of our domestic fiber optic backbone has enabled us to offer a growing range of value-added and broadband services. With this and other technological upgrades, our infrastructure has developed from a traditional voice facility to a new packet-switched and IP-based network allowing faster transmission of voice, video and data.

IP-based products are bannered by *PLDT DSL (myDSL and BizDSL)*, *PLDT Vibe* and I-Gate. *PLDT DSL* broadband Internet service is targeted for heavy individual Internet users as well as for small and medium enterprises, while *PLDT Vibe*, or PLDT's dial-up/narrowband Internet service, is targeted for light to medium residential individual Internet users. I-Gate, our dedicated leased line Internet access service, on the other hand, is targeted for enterprises and value-added service providers.

In 2006, we continued to broaden our service offerings with the launch of new services and with the expansion or enhancement of some of our existing services.

In June 2006, we introduced *Shops.work Unplugged*, or SWUP, to address the need of retailers and banks for real-time wireless data communication using Smart's GPRS/EDGE network and PLDT's private VPN network. SWUP is a bundled solution that offers wireless VPN connections in response to retailers' cashiering point-of-sale networking requirements, the need for back-up remote connections to bank automated teller machines, or ATMs, and merchants' swipe card terminal access needs. Retailers will now be able to reach out to a bigger market in areas where physical connections are unavailable, expand the banking system with wireless ATMs and release swipe card terminals to more merchants.

In support of the growing data requirements of the small and medium enterprise market, the network footprints of BRAINS, IP-VPN, *Shops.work* and *Shops.work Unplugged*, or SWUP. PLDT's private local networking services, have been expanded with the roll-out of NGN facilities in key business areas across the country.

The continued growth in data services revenues can be attributed to several product offerings. The steady demand for dedicated connectivity or private networking from the corporate market using PLDT's traditional international and domestic data offerings, including, among others, Fibernet, Arcstar, Acacia, I-Gate, Diginet, BRAINS, IP-VPN and *Shops.work*, continues to provide us with a stable revenue source.

Meanwhile, Digital Network, or Diginet, our domestic private leased line service, has been providing Smart's increasing fiber optic and leased line data requirements.

Information and Communications Technology

We conduct our information and communications technology, or ICT, businesses through our wholly-owned subsidiary ePLDT. ePLDT is a broad-based integrated information and communications technology company, focusing on infrastructure and solutions for Internet applications, Internet protocol-, or IP-, based solutions and multimedia content delivery. ePLDT's principal businesses are the operation of (a) call centers through Vocativ, Parlance and *Ventus*, (b) BPO, through SPi, (c) an Internet data center under the brand name *Vitro*, and (d) Internet and online gaming through Infocom, netGames, Digital Paradise, Digital Paradise Thailand, Level Up! and Airborne Access. Our ICT segment registered revenues of Php6,890 million, Php3,305 million and Php2,401 million, accounting for 5%, 3% and 2% of our consolidated operating revenues for the three years ended December 31, 2006, 2005 and 2004, respectively. The increase in the revenue contribution from our information and communication technology segment was primarily due to the consolidation of SPi, CyMed and Level Up! since their acquisition by ePLDT on July 11, 2006, August 11, 2006 and April 30, 2006, respectively, and is expected to increase going forward with the full-year consolidation of SPi.

Call Centers

We are focused on developing our call center business which capitalizes on the availability of English-speaking college graduates in the Philippines with a strong customer service orientation. ePLDT has established one umbrella brand name, *ePLDT Ventus*, for all of its call center businesses, including Vocativ and Parlance. *Ventus* provides offshore, cost-effective contact center outsourcing solutions specializing in inbound customer care. Vocativ provides customer and technical support to its clients in the Philippines, U.S. and U.K., while Parlance provides the exclusive customer support and billing requirements to one of the largest direct-to-home satellite television providers in the U.S. In aggregate, we own and operate approximately 5,600 seats with 5,130 customer service representatives, or CSRs, as at December 31, 2006 compared to approximately 3,350 seats with 3,625 CSRs as at December 31, 2005. In 2006, *ePLDT Ventus* launched two new sites bringing our total call center site count to seven as at December 31, 2006.

Business process outsourcing

ePLDT acquired a 100% equity interest in SPi and its direct and indirect Philippine and offshore subsidiaries for a total cash consideration of US\$135 million on July 11, 2006. SPi is one of the leading pure-play BPO company and the ninth largest independent BPO service provider worldwide. It has operations in 19 locations in North America, Europe and Asia. On August 11, 2006, SPi acquired 100% of CyMed, a leading medical transcription company based in Richmond, Virginia, and on April 16, 2007, SPi acquired 100% of Springfield Service Corporation, one of the ten largest players in the medical billing and revenue cycle management market.

Data Center

ePLDT operates *Vitro*, one of the Philippines' first Internet data centers. The Philippine Board of Investments granted *Vitro* pioneer status, which entitles it to tax and other governmental incentives. *Vitro* is a CISCO-certified co-location service provider. *Vitro* provides co-location, web and server hosting, hardware and software maintenance services, website development and maintenance services, webcasting and webhosting, shared applications, data disaster recovery and business continuity services, intrusion detection and Internet protocol security services, as well as firewall and managed firewall services.

Internet and Online Gaming

ePLDT's Internet and online gaming business is conducted through several subsidiaries. ePLDT owns a 99.6% interest in Infocom, one of the country's leading Internet service providers, or ISPs. Infocom offers consumer prepaid Internet access under the name *WarpSpeed* and *Speed Tipid* and postpaid Internet access; dedicated dial-up and multi-user

dial-up corporate leased lines; broadband Internet access through DSL and cable; and website consulting, development and hosting. ePLDT also owns a 75% interest in Digital Paradise, an Internet café business with over 182 branches which assumed the assets of Netopia Computer Technologies, Inc. and the brand *Netopia*. ePLDT further holds an 80%-interest in netGames, a publisher of Massively Multi-player Online Games in the Philippines, and is the Philippine licensee of *Khan Online*, the country's first full 3D online game; a 51% interest in Airborne Access, the country's leading operator of WiFi hotspots, which provides wireless Internet access in hotspots equipped with Airborne Access WiFi access points and a 60% equity interest in Level Up!, a leading publisher of online games in the Philippines with about an 80% share of the online gaming market.

Infrastructure

Wireless Network Infrastructure

Cellular

Through Smart, we operate a digital GSM network. To meet the growing demand for cellular services, Smart has implemented an extensive deployment program for its GSM network covering substantially all of Metro Manila and most of the other population centers in the Philippines. In 2006, Smart has 42 mobile switching centers, 61 text messaging service centers and 6,099 base stations in operation after having added 117 base stations to its nationwide cellular network in 2006. As at December 31, 2006, Piltel has six active cell sites.

Smart has an operating spectrum of 7.5 MHz in the 900 band supporting both its GSM and previously its ETACS network and 20 MHz in the 1800 band for GSM and 15 MHz in the 3G band for W-CDMA. Its dual-band GSM network allows it to efficiently deploy high capacity 1800 MHz base transceiver stations in dense urban areas while its 900 MHz base transceiver stations can be much more economically deployed in potentially high growth, but less densely populated provincial areas. The 3G network revolutionizes mobile technology by providing more capacity, faster data rates and richer data and video applications. Its initial deployment is seen as feasible in urban areas where there is a demand for mobile broadband applications and where 3G mobile units are more likely to be available. Spectrum constraints will not affect the Smart's expansion plans for GSM in the foreseeable future. Piltel, on the other hand, has an operating spectrum of 11.5 MHz out of the 12.5 MHz allocated in the 800 MHz band.

Due to its access to PLDT's network assets, Smart has been able to achieve significant capital expenditure savings, which are understood to be significantly less, on a per net addition basis, than its current competitors. This translates into an improved ability to price competitively and target the mass market subscriber base in the Philippines, while retaining profitability. Based on existing equipment purchase contracts, Smart expects incremental capital expenditure per net additional subscriber to amount to less than US\$50.

The coming years will see continued increases in coverage (particularly indoor), as well as new types of BTS for outdoor, street level and commercial office coverage. Smart has introduced the Nokia *ConnectSite* GSM solution for wider coverage and increased efficiencies in underserved areas of the Philippines. The new base station equipment called *ConnectSite* can be up to 25% more efficient than traditional outdoor cell sites. Smart is one of the very first operators in the world to adopt this solution.

Smart was awarded a 3G license by the NTC on December 29, 2005. Smart received the largest radio frequency allocation of 15 MHz as well as first choice of frequency spectrum. Smart chose the 1920-1935 MHz and 2110-2125 MHz spectrum, the range that would best enable it to rapidly deploy its 3G network nationwide and at the same time offer the highest quality of 3G service. Smart has commenced its 3G network roll-out and continues to extend the reach of its 3G network in various cities and municipalities nationwide, further improving coverage in major urban centers and selected provincial areas.

Smart and Piltel have been co-locating their cell sites where their base stations are installed. As at December 31, 2006, 36 of Smart's mobile switching centers and 193 of Smart's cell sites were housed in PLDT's fixed line complexes while 242 of Smart's cell sites were co-located with Piltel. These operational synergies have allowed Smart to reduce switch installation time from three months to five weeks.

Wireless Broadband, Satellite, VSAT and Other Services

Smart Broadband operates a nationwide broadband wireless Internet data services. It is operating in the 2.4, 3.5 and 5.7 Ghz spectrum, supporting its WiFi, Canopy and eventually WiMax services, respectively. It offers fixed wireless broadband Internet connectivity to both residential and corporate clients. It also maintains and operates WiFi hotspots installations that serve mobile Internet users. Almost 2,500 of Smart's base stations are now wireless broadband-capable, covering most of the key cities and the other populated centers in the country. These are strategically co-located in the Smart's cellular base stations that allow it to reach as many subscribers as possible, in the fastest possible way. For its backbone, it uses the nationwide PLDT and Smart fiber optic and IP backbone that provide substantial bandwidth capacity to utilize and to grow on demand.

Mabuhay Satellite controls and operates the Agila II satellite, which has 30 C-band transponders and 24 Ku-band transponders covering the Asia-Pacific region, the Indian subcontinent and Hawaii. Of the 54 transponders, six have restricted usage due to satellite interference. Through Agila II, Mabuhay Satellite offers Internet service, video and data broadcasting, and bandwidth-on-demand, facilitating communication links between telecommunications, broadcast and other public utility companies operating in the Asia-Pacific region. In December 2000, Agila II joined the U.S. FCC's "Permitted Space Station" list, which permits U.S.-owned and operated earth stations in Hawaii to access Agila II for transpacific telecommunications, data, video and Internet-over-satellite traffic and vice versa.

Telesat operates a national communications satellite network using VSAT technology to provide voice, facsimile, video and data transmission services to areas in the country that are still underserved or unserved by local telephone

operators. Telesat leases transponder capacity from Agila II to provide VSAT services such as multipoint-to-multipoint and point-to-multipoint data transmission services, private point-to-point service, and connectivity for the cell sites of our cellular network in outlying locations.

ACeS Philippines manages, controls and operates its own satellite gateway and other ground infrastructure, including a 13-meter feeder-link C-band earth station, beam congruency antenna and equipment that serve as the primary interface between the ACeS system and other telecommunications networks. It uses the Garuda I satellite to provide digital voice services to ACeS Philippines mobile and fixed terminal users within the Asian service area.

Fixed Line Network Infrastructure

Domestic

Our domestic telephone network includes installed telephones and other equipment on customers premises, local access lines connecting customers to exchanges, referred to as outside plant, inter-office lines connecting exchanges, and long distance transmission equipment.

The following table gives some basic measures of the development of our domestic telephone network as at December 31, 2006, 2005 and 2004:

| | December 31, | | |
|---|--------------|-----------|-----------|
| | 2006 | 2005 | 2004 |
| Number of central office exchanges | 184 | 183 | 183 |
| Number of fixed line subscribers(1) | 1,776,647 | 1,842,507 | 1,834,306 |
| Employees per 10,000 local exchange subscribers | 49 | 50 | 53 |

(1) Previously set forth as number of fixed lines in service, this was restated in 2006 to reflect the effect of the change in parameters used to align with the PLDT Group's policy on subscriber count with the planned use of an integrated billing system for our subscribers.

We have our own 6,400-kilometer domestic fiber optic network, or DFON, the country's first telecommunications network using fiber optics in delivering voice, video, data, and other broadband and multimedia services nationwide. Our fiber optic network employs synchronous digital hierarchy technology to improve network performance and reduce operating costs. Our network is composed of in-land and submarine cable installations and is configured in

seven self-healing rings allowing route delivery even in the event of single link failure per ring. To date, the PLDT DFON is equipped with N x 10 gigabits per second capacity and is connected directly to four existing international submarine cable systems. We use the *CS VEGA* (formerly *CS PLDT*), a cable ship that we lease from NTT World Engineering Marine Corporation pursuant to a two-year renewal, entered into in January 2006, to a five-year Chartered Arrangement Maintenance Contract that expired in August 2005 to maintain the 2,400 kilometers of submarine cable comprising the submerged portion of our DFON.

We are currently upgrading our fixed line facilities to NGN, a broad term for certain emerging computer network technologies that can encompass voice, data and video where all information is efficiently transmitted via digital packets of data. It is a platform that will allow for more services to be made available to our fixed line subscribers.

International

We provide international network services using our three international gateway switching exchanges. As of December 31, 2006, our international long distance facilities allow direct correspondence with 49 countries/territories (representing 89 correspondents) and can reach 420 foreign destinations (via direct and transited routes including breakouts) worldwide. We also own interests in submarine and satellite systems, through which we route most of our international traffic.

The table below shows the submarine cable systems in which we have interests and the countries or territories they link:

| Cable System | Countries Being Linked |
|------------------------------|---|
| G-P | Guam and the Philippines |
| Asia-Pacific Cable Network | Korea, Japan, Hong Kong, Taiwan, Australia, Philippines, Singapore, Malaysia, Indonesia and Thailand |
| Asia-Pacific Cable Network 2 | Philippines, Hong Kong, Japan, Korea, Malaysia, Singapore, China and Taiwan |
| Transpacific Cable No. 5 | Guam, Japan, Hawaii and the U.S. Mainland |
| SEA-ME-WE-3 | Japan, Korea, China, Taiwan, Hong Kong, Macau, Philippines, Vietnam, Cambodia, Brunei, Malaysia, Singapore, Indonesia, Australia, Thailand, Myanmar, Sri Lanka, India, Pakistan, United Arab Emirates, Oman, Djibouti, Saudi Arabia, Egypt, Cyprus, Turkey, Greece, Italy, Morocco, Portugal, France, UK, Belgium and Germany |
| PacRim East | Hawaii and New Zealand |
| Americas Cable 1 | U.S. Mainland, U.S. Virgin Islands, Brazil, Trinidad and Venezuela |
| China-U.S. Cable | Japan, China, Taiwan, Korea, Guam and U.S. Mainland |
| Columbus II Cable | U.S. Mainland, Italy, U.S. Virgin Islands, Mexico, Portugal and Spain |
| FLAG Cable | Japan, Korea, China, Hong Kong, Malaysia, Thailand, India, United Arab Emirates, Saudi Arabia, Egypt, Italy, Spain and UK |

| | |
|--------------------------------|--|
| RJK Cable | Russia, Japan and Korea |
| Southern Cross Cable | U.S. Mainland, Hawaii, Fiji, Australia and New Zealand |
| TAT 12/13 Cable | U.S. Mainland, UK and France |
| TVH Cable | Thailand, Vietnam and Hong Kong |
| EAC Cable | Japan, Hong Kong, Korea, Taiwan, Singapore and the Philippines |
| PC-1, Japan-U.S. Cable and TGN | Japan and the U.S. |

Additionally, on May 2, 2007, a consortium of seventeen major international telecommunication operators, including PLDT, signed an agreement to build the first high-bandwidth optical fiber submarine cable system linking Southeast Asia and the U.S. The cable project, known as the *Asia-America Gateway*, will span 20,000 kilometers and will use the latest Dense Wavelength Division Multiplexing technology to provide upgradeable, future proof transmission facilities that will support bandwidth requirements for new and revolutionary broadband applications. It is expected that the *Asia-America Gateway* will cost approximately US\$500 million (of which US\$50 million represents PLDT's investment) and will be ready for service by the end of 2008.

Interconnection Agreements

Since the issuance of Executive Order No. 59 in 1993, which requires non-discriminatory interconnection of Philippine carriers' networks, we have entered into bilateral interconnection arrangements with other Philippine fixed line and cellular carriers.

For local calls originating from PLDT and terminating to the cellular networks of Smart and Globe, Smart and Globe charged PLDT a rate of Php4.50 per minute effective January 1, 2002. Effective January 1, 2004, calls terminating to cellular subscribers originating from fixed line subscribers are charged a termination rate of Php4.00 per minute, a decrease from the previous Php4.50 per minute.

Effective January 1, 2003, local access for cellular operators, including Smart, that terminate calls to PLDT's fixed line network increased from Php2.00 per minute to Php2.50 per minute, which further increased to Php3.00 per minute effective January 1, 2004.

Under a separate agreement between PLDT and PAPTELCO, PLDT is the transit facility provider between Smart, Globe, other local exchange carriers, or LEC, operators and PAPTELCO. PAPTELCO is comprised of 48 LEC and operating in 144 major telephone exchanges nationwide. Transit traffic is a service by PLDT to Smart, Globe, other LEC operators and PAPTELCO members where PAPTELCO members have no direct interconnection with either Smart, Globe and other LEC operators.

Effective February 1, 2003, international calls terminating to PLDT's fixed line network were charged a termination rate of US\$0.12 per minute, an increase from the previous rate of US\$0.08 per minute. Also, international calls terminating to Smart's cellular network were charged a termination rate of US\$0.16 per minute, an increase from the previous termination rate of US\$0.12 per minute.

Effective January 1, 2002, Smart charged a termination rate of Php4.00 per minute for calls originating from/terminating to another cellular operator's network. For SMS originating from Smart and terminating on other operators' cellular network and for SMS originating from other operators and terminating on Smart's cellular network, the charge is Php0.35 per message.

Licenses and Regulation

PLDT, Smart and Piltel provide telecommunications services pursuant to legislative franchises that currently expire, in the case of PLDT, on November 28, 2028, in the case of Smart, on March 27, 2017 and, in the case of Piltel, on May 14, 2019. A franchise holder is required to obtain operating authority from the NTC to provide specific telecommunications services. These approvals may take the form of a Certificate of Public Convenience and Necessity, or CPCN, or, while an application for a CPCN is pending, a provisional authority to operate. Provisional authorities are typically granted for a period of 18 months. The Philippine Revised Administrative Code of 1987 provides that if the grantee of a license or permit, such as a CPCN or provisional authority, has made timely and sufficient application for the extension thereof, the existing CPCN or provisional authority will not expire until the application is finally decided upon by the administrative agency concerned.

PLDT operates its business pursuant to a number of provisional authorities and CPCNs, the terms of which will expire at various times between now and 2028. PLDT's CPCNs to provide services to most of the Metropolitan Manila area, Davao and other Philippine cities expired in 2003. Although some of PLDT's CPCNs and provisional authorities have already expired, PLDT filed timely applications for extension of these CPCNs and provisional authorities prior to their respective expiration dates and is therefore entitled to continue to conduct its business under its existing CPCNs and provisional authorities pending the NTC's decision on these extensions. PLDT expects that the NTC will grant these extensions; however, there can be no assurance that this will occur. The period of validity of some of PLDT's CPCNs which expired on November 28, 2003, coterminous with the term of its previous franchise under Republic Act No. 6146, has been extended further by the NTC to November 28, 2028, coterminous with PLDT's current franchise under Republic Act No. 7082. Motions to extend the period of validity of the other CPCNs to November 28, 2028 are now pending with the NTC. See Item 3. Key Information Risks Factors Risks Relating to Us Our business is significantly affected by governmental laws and regulations, including regulations in respect of our franchises, rates and taxes.

Smart operates its cellular, international long distance and national long distance services pursuant to CPCNs, the terms of which will expire upon the expiration of its franchise. On August 26, 2002, Smart was granted a CPCN to install, operate and maintain nationwide global mobile personal communications via satellite which shall also expire upon expiration of its franchise. Smart's provisional authority to establish, install, maintain, lease and operate an international private leased circuit was effective until November 6, 2006. Prior to its expiration, Smart filed for an extension of this provisional authority on the issuance of the CPCN, which remains pending. On July 22, 2002, Smart

was granted separate CPCNs to operate a cellular mobile telephone system and an international gateway facility.

On December 29, 2005, Smart was awarded a 3G license by the NTC after being ranked highest in garnering a perfect score on a 30-point grading system designed to gauge the capability of telecommunication operators to effectively provide extensive 3G services. As a result, Smart received the largest radio frequency allocation of 15 MHz as well as first choice of frequency spectrum. Smart chose the 1920-1935 MHz and 2110-2125 MHz spectrum.

Under the terms of the 3G license, Smart is required to:

- begin installation and rollout of its 3G network no later than 18 months from the date of the award;
- start commercial operations no later than 30 months from the date of the award; and
- cover at least 80% of provincial capitals and 80% of chartered cities within five years.

Smart is also required to pay annual license fees of Php115 million based on the 15 MHz awarded to the Company.

Piltel is authorized to provide virtually every type of telecommunications service, including the transmission of voice, data facsimile, audio and video and information services, in and between provinces, cities and municipalities throughout the Philippines. The franchise, which was last amended on May 14, 1992, will expire on May 14, 2019 and may be extended by a legislative act of the Philippine Congress.

The following table sets forth the spectrum system, licensed frequency and bandwidth used by Smart, Piltel and Smart Broadband:

| Carrier | Spectrum System | Frequency Assignment | Bandwidth |
|----------------|-------------------------|-----------------------------|------------------|
| Smart | ETACS/GSM 900 | 897.5-905/942.5-950 MHz | 7.5 MHz |
| | | 1725-1730/1820-1825 MHz | 5.0 MHz |
| | GSM 1800 | 1730-1732.5/1825-1827.5 MHz | 2.5 MHz |
| | | 1735-1740/1830-1835 MHz | 5.0 MHz |
| | | 1745-1750/1840-1845 MHz | 5.0 MHz |
| | | 1780-1782.5/1875-1877.5 MHz | 2.5 MHz |
| 3G (W-CDMA) | 1920-1935/2110-2125 MHz | 15.0 MHz | |
| Piltel | AMPS/CDMA | 824-835/869-880 MHz | 11.0 MHz |
| | | 845-846.5/890-891.5 MHz | 1.5 MHz |

| | |
|--|---------|
| Smart Broadband Wireless broadband 2400-2483.5 MHz * | 73 MHz |
| 3400-3590 MHz * | 94 MHz |
| 5470-5850 MHz * | 123 MHz |

* *Smart Broadband frequency assignments on these bands are non-contiguous and on a per station and location basis.*

Operators of international gateway facilities and cellular telephone operators, pursuant to Executive Order No. 109, are required to install a minimum number of local exchange lines. Of these new lines, operators are required to install one rural exchange line for every ten urban exchange lines installed. Smart and Piltel were required to install 700,000 and 400,000 lines, respectively, and each has received a certificate of compliance from the NTC.

PLDT, Smart and Piltel are required to pay various permit, regulation and supervision fees to the NTC. PLDT is currently engaged in disputes with the NTC over some of the assessed fees. For more information on the disputes involving PLDT, see Item 8. Financial Information Legal Proceedings NTC supervision and regulatory fees, or SRF.

On May 27, 1998, Smart filed an Urgent Ex Parte Motion and Manifestation regarding the permit fee in the amount of approximately Php113 million assessed by the NTC for the CPCN pertaining to Smart's Integrated Local Exchange Telephone Service, Domestic Toll Service and Private Line Service (NTC Case No. 93-482). Smart contended that the fee should have been calculated on the basis of the actual local exchange carrier project cost, and that therefore the fee should be Php70 million. Although the NTC has not yet resolved this issue, Smart has already paid Php50 million in respect of this assessment as of the date of filing this annual report.

In a letter dated April 12, 2005, the NTC requested that Smart pay the following permit fees in respect of its CPCNs and provisional authorities:

| Case No. | Fee |
|-----------------|---------------|
| 93-482 | Php62,510,950 |
| 94-220 | 878,830 |
| 96-248 | 6,815,500 |
| Total | Php70,205,280 |

In its letter dated May 13, 2005, Smart reiterated its petition that the basis for computation of the permit fees should be amended and cited the pendency of its Urgent Ex Parte Motion and Manifestation in NTC Case No. 93-482.

In order to diversify the ownership base of public utilities, the Public Telecommunications Policy Act (R.A. 7925) requires a telecommunications entity with regulated types of services to make a public offering through the stock exchanges representing at least 30% of its aggregate common shares by the later of the following:

- the fifth anniversary of the date the law became effective; and
- the fifth anniversary of the date of the entity's commencement of commercial operations.

PLDT and Piltel have complied with this requirement. As Smart has not conducted a public offering of its shares by August 2004, the Philippine Congress may revoke the franchise of Smart for failure to comply with the requirement under R.A. 7925 to conduct a public offering of its shares by August 2004. A *quo warranto* case may also be filed against Smart by the Office of the Solicitor General of the Philippines on the ground of violation of R.A. 7925 for the failure of Smart to conduct a public offering of its shares by August 2004. However, Smart believes that it did not violate the terms of its franchise by not conducting an initial public offering by August 2004. Smart believes that the period stated in R.A. 7925 and in the other legislative franchises within which to conduct a public offering and listing of shares of stock of telecommunications companies should be deemed as merely directory and not mandatory. The DOJ has rendered an opinion that the three-year period fixed under the Downstream Oil Industry Deregulation Act of 1998 (R.A. 8479) for the conduct of the initial public offering of shares in entities engaged in the oil refinery business should be regarded as merely directory. Smart believes that this DOJ opinion should also apply to the period for the conduct of initial public offering of telecommunications companies. Moreover, Smart believes that it should be deemed to have complied with the requirement of making a public offering of its shares since PLDT owns 100% of the outstanding shares of Smart. The purpose of R.A. 7925 in requiring telecommunications companies to make a public offering of their shares, which is to broaden public ownership in telecommunications entities, is already realized as PLDT, a publicly listed company, owns 100% of Smart. In September 2004, Senate Bill No. 1675 was filed seeking to amend Section 21 of R.A. 7925. The bill seeks to declare that a telecommunications entity shall be deemed to have complied with the requirement of making a public offering of its shares if two-third of its outstanding voting stock are owned and controlled directly or indirectly, by a listed company. The bill is currently pending in the Philippine Senate. PLDT regularly evaluates various strategic options with respect to its capital structure.

The Philippine Congress is considering two bills that relate to the imposition of franchise tax on telecoms companies. HB No. 1469 proposes to re-impose a 5% franchise tax on gross receipts on telephone and telegraph services in lieu of the VAT. HB No. 1560 proposes a franchise tax at the rate of 3.5% on the first year and 7% thereafter on the gross receipts of telecoms and broadcast companies, in lieu of the VAT. There are also various bills in Congress which propose to tax telecommunications services, among them, the imposition of a tax on mobile phone companies on all text entries to text games; the imposition of a Php0.50 specific tax on each SMS to be borne by the cellular phone companies; and the imposition of a 10% ad valorem tax on all cellular phone calls using 3G.

Competition

The enactment of the Public Telecommunications Policy Act of the Philippines in March 1995 consolidated the government's various policy issuances governing the telecommunications industry and reaffirmed, among other things, the policy of liberalizing the industry and opening up the telecommunications market to new entrants. Including us, there are nine major local exchange carriers, seven international gateway facility providers and five cellular service providers in the country. Many new entrants into the Philippine telecommunications market have entered into strategic alliances with foreign telecommunications companies, which provide them access to technological and funding support as well as service innovations and marketing strategies. Consequently, we are facing increasing competition in major segments of the telecommunications industry, particularly data and other network services segments.

Cellular Service

There are presently six operating service providers, namely Smart, Piltel, Globe, Islacom, Digitel and Express Telecom. Globe acquired Islacom (now known as *Innove*) to form into one operating group, while Smart and Piltel, both being part of the PLDT Group, formed another operating group. These two operating groups have approximately 95% of the Philippine cellular market. The third active operator, Digitel, commenced its cellular service, *Sun Cellular*, on March 29, 2003 and is estimated to have approximately 5% of the cellular market as at December 31, 2006. In December 2005, the NTC awarded 3G licenses to existing cellular operators Smart, Globe, Digitel and to a new entrant, Connectivity Unlimited Resources Enterprises, or CURE. The NTC has yet to award a fifth license to another operator.

Competition in the cellular industry has intensified with the availability of affordably priced handsets offering a range of new functions and the introduction by competitors of new and improved plans for postpaid subscribers, reduced rates per minute and aggressive marketing and promotional strategies. The principal bases of competition are price, including handset cost, quality of service, geographic coverage and attractiveness of packaged services. Smart's network leads the industry in terms of coverage with 6,099 base stations as at December 31, 2006.

As a result of competitive pressures, several service providers, including Smart and Piltel, have recently introduced bucket plans providing unlimited voice and text services, and other promotions. While most of the bucket priced plans currently available in the market are being offered on promotional bases, Smart, Globe and Sun Cellular continue to launch other services that are designed to encourage incremental usage from existing subscribers and also to attract new subscribers.

Cellular operators are also competing actively against each other in launching innovative products and value-added services. The growing range of cellular products and services now include text messaging, multi-media messaging, voice mail, text mail, international roaming, information-on-demand, mobile banking, e-commerce, mobile data, cellular Internet access and Internet messaging.

On February 14, 2006, Smart opened its 3G network in selected key cities nationwide, making video calling, video streaming, high speed Internet browsing and special 3G content downloads on its 3G network available to subscribers with 3G handsets. Likewise, Globe is currently rolling out its 3G network.

Consistent with industry practice and Smart's churn management efforts, Smart "locks" the handsets it sells to its subscribers, rendering them incompatible with SIM cards issued by competitors and thereby hindering them from swapping the existing SIM for a SIM of a competing operator. However, subscribers can have their handsets unlocked by unauthorized parties for a nominal fee and purchase new SIM cards from competing operators. Unlocking does not involve significant cost. Switching to another cellular operator would, however, result in a change of the subscriber's cellular telephone number.

From October 2003 to May 2005, SIM-swapping became a prevalent promotional activity in the cellular industry. In SIM-swapping promotions, prepaid cellular subscribers had the ability to switch from one cellular operator to another by simply exchanging their current prepaid SIM card for another operator's SIM card with a certain amount of preloaded air time credits at no cost. These SIM-swapping activities gave rise to a situation where certain subscribers regularly swapped their SIM card between cellular operators upon full use of the pre-stored air time. As a result, our cellular subscriber base contained a certain number of transient subscribers at any one point in time. In May 2005, we terminated our SIM-swapping promotions; as a result, our churn rates increased in the third and fourth quarters of 2005, but leveled off beginning in the first quarter of 2006.

Local Exchange Service

The concerted nationwide local exchange line build-out by various players, as mandated by the Philippine government, significantly increased the number of fixed line subscribers in the country and resulted in wider access to basic telephone service. The growth of the fixed line market, however, remained weak due to the surge in demand for cellular services and, in the past, the general sluggishness of the national economy. Nevertheless, we have sustained our leading position in the fixed line market on account of PLDT's extensive network in key cities nationwide. In most areas, we face one or two competitors. Our principal competitors in the local exchange market are Digitel, Bayan Telecommunications and Globe.

Over the past couple of years, however, competition among local exchange operators has reduced as certain operators have faced financial difficulties or have shifted strategic focus away from the fixed line business to cellular services. On the other hand, we are facing increasing competition from cellular operators mainly due to substitution of cellular services for fixed line services.

International Long Distance Service

Including us, there are 11 licensed international gateway facility operators in the country. While we have so far been able to maintain a leadership position in this highly competitive segment of the industry, in recent years, our market share has reduced largely as a result of (1) competition from other international gateway facility operators and illegal international simple resale operators; (2) an increase in inbound and outbound international long distance calls terminating to and originating from the growing number of cellular subscribers; and (3) the popularity of alternative and cheaper modes of communication such as text messaging, e-mail, Internet telephony and the establishment of virtual private networks for several corporate entities, further heightening the competition.

With respect to inbound calls into the Philippines, we adopted the U.S. FCC benchmark accounting rate of US\$0.38 per minute for inbound international calls which represented a settlement rate of US\$0.19 per minute, one year ahead of the target date of January 1, 2001. This provided us with increased flexibility to terminate more U.S. traffic into the Philippines, minimize unauthorized traffic termination through international simple resale operations and recover traffic lost due to bypass routings. We have also established, through our wholly-owned subsidiary PLDT Global, presence in key cities overseas to identify and capture Philippine terminating traffic at its source, maximize the use of our international facilities and develop alternative sources of revenue. Effective February 1, 2003, after lengthy negotiations with approximately 100 telecommunications operators around the world, we increased the termination rate with carriers accounting for a substantial portion of our international inbound traffic terminating on its fixed line network to US\$0.12 per minute. Prior to the increase in termination rates, a substantial portion of PLDT's international inbound traffic terminating on its fixed line network was charged an average termination rate of approximately US\$0.08 per minute. See Item 5. Operating and Financial Review and Prospects Results of Operations 2006 Compared to 2005 On Business Segment Basis Fixed Line Operating Revenues Service Revenues International Long Distance Service and Item 3. Key Information Risks Factors Risks Relating to Us Our results of operations have been, and may continue to be, adversely affected by competition in international long distance service for further discussion.

With respect to outbound calls from the Philippines, we compete for market share through our local exchange and cellular businesses, which are the origination points of outbound international calls. We have also introduced a number of marketing initiatives to stimulate growth of outbound call volumes, including tariff reductions and volume discounts for large corporate subscribers. Digitel and Globe have also launched new pricing schemes to grow their outbound call volumes.

National Long Distance Service

Our national long distance service business has been negatively affected by the growing number of cellular subscribers in the Philippines and the widespread availability and growing popularity of alternative economical non-voice methods of communication, particularly text messaging and e-mail. In addition, various ISPs have launched voice services via the net to their subscribers nationwide.

While national long distance call volumes have been declining, we have remained a leading provider of national long distance service in the Philippines due to our significant subscriber base and ownership of the Philippines' most extensive transmission network.

Data and Other Network Services

Another rapidly growing segment of the industry is the market for data and other network services. The growth is spurred by the significant growth in consumer/retail narrowband and broadband Internet access, enterprise resource planning applications, call centers, BPO, on-line gaming and other e-services that drive the need for broadband and Internet-protocol based solutions both here and abroad. Our major competitors in this area are Globe/Innove, Bayan Telecommunications, Eastern Telecoms and Digitel. The principal bases of competition in data services market are coverage, price, customer service and quality of service.

Environmental Matters

We have not been subject to any material fines or legal or regulatory action involving non-compliance with environmental regulations of the Philippines. We are not aware that we are not in compliance in any material respect with relevant environmental protection regulations.

Intellectual Property Rights

We do not own any material intellectual property rights apart from our brand names and logos. We are not dependent on patents, licenses or other intellectual property which are material to our business or results of operations, other than licenses to use the software that accompany most of our equipment purchases.

Properties

We own four office buildings located in Makati City and own and operate 184 exchanges nationwide, of which 61 are located in the Metropolitan Manila area. The remaining 123 exchanges are located in cities and small municipalities outside the Metropolitan Manila area. We also own radio transmitting and receiving equipment used for international and domestic communications. As at December 31, 2006, we had 4,377 cellular cell sites and 6,099 base stations.

As at December 31, 2006, our principal properties, excluding property under construction, consisted of the following, based on book values:

- 67% consisted of cable, wire and cellular facilities, including our domestic fiber optic network, subscriber cable facilities, inter-office trunking and toll cable facilities and cellular facilities;
- 18% consisted of central office equipment, including three international gateway facilities, six pure national toll exchanges and 15 combined local and toll exchanges, and our communications satellite;
- 11% consisted of land and improvements and buildings, which we acquired to house our telecommunications equipment, personnel, inventory and/or fleet;
- 1% consisted of information origination and termination equipment, including pay telephones and radio equipment installed for customers use, and cables and wires installed within customers' premises; and
- 3% consisted of other work equipment.

For more information on these properties, see *Note 7 Property, Plant and Equipment* to the accompanying consolidated financial statements in Item 18.

These properties are located in areas where our subscribers are being served. In our opinion, these properties are in good condition, except for ordinary wear and tear, and are adequately insured.

The majority of our connecting lines are above or under public streets and properties owned by others.

PLDT's and Smart's properties are free from any mortgage, charge, pledge, lien or encumbrance; however, substantial properties of Mabuhay Satellite and Piltel are subject to liens while a portion of ePLDT's property is subject to liens.

PLDT has various long-term lease contracts, the bulk of which have lease terms ranging from two to ten years covering certain offices, warehouses, telecommunications equipment locations and various office equipment.

For more information on the obligations relating to these properties and long-term obligations, see *Note 21 Contractual Obligations and Commercial Commitments* to the accompanying consolidated financial statements in Item 18.

Item 4A. Unresolved Staff Comments

None.

Item 5. Operating and Financial Review and Prospects

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our audited consolidated financial statements (and the related notes) as at December 31, 2006 and 2005 and for the years ended December 31, 2006, 2005 and 2004 included elsewhere in this report. This discussion contains forward-looking statements that reflect our current views with respect to future events and our future financial performance. These statements involve risks and uncertainties, and our actual results may differ materially from those anticipated in these forward-looking statements as a result of particular factors such as those set forth under "Forward-Looking Statements" and Item 3. "Key Information Risk Factors" and elsewhere in this report. Our audited consolidated financial statements, and the financial information discussed below, have been prepared in accordance with U.S. GAAP. For convenience, certain peso financial information in the following discussions has been translated to U.S. dollars at the exchange rate at December 31, 2006 of Php49.045 to US\$1.00, as quoted through the Philippine Dealing System.

Overview

We are the largest and most diversified telecommunications company in the Philippines. We have organized our business into three main segments which serve as the basis for management's decision to allocate resources and evaluate operating performance:

- *Wireless* wireless telecommunications services provided by Smart and Piltel, our cellular service providers; Smart Broadband, our wireless broadband provider; Wolfpac, our wireless content operator; and Mabuhay Satellite, ACeS Philippines and Telesat, our wireless broadband, satellite, VSAT and other services operators;
- *Fixed Line* fixed line telecommunications services are primarily provided through PLDT. We also provide fixed line services through PLDT's subsidiaries ClarkTel, SubicTel, Maratel, Piltel and BCC, which together account for approximately 4% of our consolidated fixed line subscribers, and PLDT Global; and

- *Information and Communications Technology* information and communications infrastructure and services for Internet applications, Internet protocol-based solutions and multimedia content delivery provided by PLDT's subsidiary ePLDT; call center services provided under *ePLDT Ventus*, including Ventus, Parlance and Vocativ; BPO services provided by SPi (consolidated since July 11, 2006); Internet access and gaming services provided by ePLDT's subsidiaries, Infocom, Digital Paradise, Digital Paradise Thailand, netGames, Airborne Access and Level Up!; and e-commerce, and IT-related services provided by other investees of ePLDT, as discussed in *Note 8 Investments* to the accompanying consolidated financial statements in Item 18.

Key performance indicators and drivers that our management uses for the management of our business include, among others, the general economic conditions in the Philippines, our subscriber base, traffic volumes, and interconnection arrangements.

Wireless

We provide cellular and wireless broadband, satellite, VSAT and other services under our wireless business, with cellular contributing about 96% and the remaining wireless services contributing approximately 4% of our wireless service revenues, respectively, in 2006. Rapid growth in the cellular market has resulted in a change in our revenue composition and sources of our revenue growth. Starting in 2003, cellular service has been our major revenue source surpassing fixed line revenues. As of December 31, 2006, Smart and Piltel, which offer services using Smart's network, had the largest and third largest cellular subscriber bases, respectively, in the Philippines. In addition, Smart's and Piltel's subscribers increased by 18% in 2006, resulting in our aggregate system-wide cellular subscribers outnumbering our fixed line in service by more than 14 to 1 at the end of 2006, which was higher than the increases of Smart's and Piltel's subscriber base of 6% in 2005 but lower than the increase of Smart's and Piltel's subscriber base of 48% in 2004. Cellular data services, which include all text messaging and text-related services ranging from ordinary text to value-added services, contributed significantly to our cellular revenue increase. Our wireless operating revenues remained stable and accounted for 63%, 62% and 61% of our consolidated operating revenues for each of the years ended December 31, 2006, 2005 and 2004, respectively.

Fixed Line

Our fixed line business provides local exchange service, international and national long distance services, data and other network services and miscellaneous services. Our fixed line operating revenues accounted for 32%, 36% and 37% of our consolidated operating revenues for the years ended December 31, 2006, 2005 and 2004, respectively. Local exchange revenues have declined owing to shift in subscriber preference from postpaid to prepaid service with lower average revenue per user, or ARPUs. National and international long distance revenues have also been declining largely due to a drop in call volumes as a result of alternative means of communications such as texting, e-mailing and Internet telephony. Mitigating these declines was the steady growth of our data and other network services over the recent years. Recognizing the growth potential of the data and other network services segment, we have put considerable emphasis on the development of new packet-switched, data-capable and IP-based networks.

Information and Communications Technology

We conduct our ICT businesses through ePLDT. ePLDT's principal businesses are the operation of an Internet data center under the brand name *Vitro*™; one umbrella brand name, *ePLDT Ventus*, for all of its call center businesses, including Ventus, Vocativ and Parlance; BPO provided by SPi Technologies, Inc., or SPi; Internet and online gaming through Infocom, Digital Paradise and Digital Paradise Thailand, netGames, Level Up! and Airborne Access. The revenue contribution of our information and communications technology segment accounted for 5% of our consolidated operating revenues for the year ended December 31, 2006, and 2% of our consolidated operating revenues for each of the years ended December 31, 2005 and 2004. The increase in the revenue contribution from our information and communication technology segment was primarily due to the consolidation of SPi since its acquisition by ePLDT on July 11, 2006, and is expected to increase going forward with the full-year consolidation of SPi.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with U.S. GAAP, which requires management to make estimates and assumptions that affect amounts reported in our consolidated financial statements and related notes. In preparing these consolidated financial statements, we have made our best estimates and judgments of certain amounts, giving due consideration to materiality.

We believe the following represent our critical accounting policies under U.S. GAAP. The impact and any associated risks relating to these policies in our business operations are discussed elsewhere in this section.

Revenue Recognition

Our revenue recognition policies require us to make use of estimates and assumptions that may affect the reported amounts of our revenues and receivables.

Our agreements with domestic and foreign carriers for inbound and outbound traffic subject to settlements require traffic reconciliations before actual settlement is done, which may not be the actual volume of traffic as measured by us. Initial recognition of revenues is based on our observed traffic adjusted by our normal experience adjustments, which historically have not been material to our consolidated financial statements. Differences between the amounts initially recognized and actual settlements are taken up in the accounts upon reconciliation. However, there is no assurance that such use of estimates may not result to material adjustments in future periods.

Revenues under a multiple element arrangement specifically applicable to our wireless business are split into separately identifiable components and recognized when the related components are delivered in order to reflect the substance of the transaction. The fair value of components is determined using verifiable objective evidence. Revenue for handset sales is quantified and identified separately using the residual value method from our cellular service revenue.

Estimating Useful Lives of Property, Plant and Equipment

We estimate the useful lives of our property, plant and equipment based on the periods over which our assets are expected to be available for use. Our estimation of the useful lives of our property, plant and equipment is based on our collective assessment of industry practice, internal technical evaluation and experience with similar assets. The estimated useful lives of our property, plant and equipment are reviewed at least annually and are updated if expectations differ from previous estimates due to physical wear and tear, technical and commercial obsolescence and legal and other limitations on the use of our assets. It is possible, however, that future results of operations could be materially affected by changes in our estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of our property, plant and equipment would increase our recorded operating expenses and decrease our noncurrent assets. Total carrying values of property, plant and equipment amounted to Php164,081 million and Php173,007 million as at December 31, 2006 and 2005, respectively.

Asset Impairment

U.S. GAAP requires that an impairment review be performed when certain impairment indicators are present. The impairment review first compares the future undiscounted cash flows expected to be generated from the continued use and ultimate disposition of the assets with the book value of the assets. If these cash flows are not sufficient to recover the book value of the assets, an impairment charge is recognized based on the comparison between the discounted value of these cash flows and the book value of the assets. In addition, our projections for future cash flows are generally less during periods of reduced cash flow. As a result, an impairment charge is more likely to occur during a period when our operating results are already otherwise depressed.

Purchase accounting requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair market values of the assets and liabilities purchased. Our business acquisitions typically result in goodwill, which is also subject to a periodic impairment test. Determining the fair value of property, plant and equipment, investments and intangible assets requires us to make estimates and assumptions, such as the determination of future cash flows expected to be generated from the continued use and ultimate disposition of such assets, that can materially affect our consolidated financial statements. Future events could cause us to conclude that property, plant and equipment, investments and intangible assets associated with an acquired business are impaired. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

The preparation of estimated future cash flows involves significant judgments and estimations. While we believe that our assumptions are appropriate and reasonable, significant changes in our assumptions may materially affect our assessment of recoverable values and may lead to future additional impairment charges under U.S. GAAP.

Total carrying values of goodwill and other intangible assets as at December 31, 2006 and 2005 amounted to Php27,241 million and Php16,875 million, respectively.

Financial Assets and Liabilities

U.S. GAAP requires that we carry certain of our financial assets and liabilities at fair value, which requires extensive use of accounting estimates and judgment. While significant components of fair value measurement were determined using verifiable objective evidence (e.g., foreign exchange rates, interest rates, volatility rates), the fair value would differ if we utilized different valuation methodology. Any changes in fair value of these financial assets and liabilities would directly affect our consolidated statements of income and equity.

Total fair value of financial assets and liabilities as at December 31, 2006 amounted to Php35,952 million and Php104,862 million, respectively, while the total fair value of financial assets and liabilities as at December 31, 2005 amounted to Php43,459 million and Php150,077 million, respectively.

Estimating Allowance for Doubtful Accounts

We estimate the allowance for doubtful accounts related to our trade receivables based on two methods. The amounts calculated using each of these methods are combined to determine the total amount we reserve. First, we evaluate specific accounts where we have information that certain customers are unable to meet their financial obligations. In these cases, we use judgment, based on the best available facts and circumstances, including but not limited to, the length of our relationship with the customer and the customer's current credit status based on third party credit reports and known market factors, to record specific reserves for customers against amounts due to reduce our receivables to amounts that we expect to collect. These specific reserves are re-evaluated and adjusted as additional information received affects the amounts estimated. Second, a provision is established as a certain percentage of operating revenues based on the aging profile of receivables. This percentage is based on a collective assessment of historical collection, write-off experience, current economic trends, changes in our customer payment terms and other factors that may affect our ability to collect payments. Full allowance is provided for receivables from permanently disconnected subscribers and carriers. Such permanent disconnections generally occur within 105 days from the date payment was due. Partial allowance is provided for active subscribers and carriers based on the age status of receivables.

The amounts and timing of recorded expenses for any period would differ if we made different judgments or utilized different estimates. An increase in our allowance for doubtful accounts would increase our recorded expenses and decrease our current assets. Provision for doubtful accounts amounted to Php736 million, Php2,251 million and Php3,955 million for the years ended December 31, 2006, 2005 and 2004, respectively. Trade and other receivables, net of allowance for doubtful accounts, amounted to Php10,158 million and Php7,856 million as at December 31, 2006 and 2005, respectively.

Investments

The various interests that we hold in companies are accounted for under three methods: consolidation, equity method and cost method. The method of accounting applied to investments involves an evaluation of the significant terms of the investments that explicitly grant or suggest evidence of control or significant influence over the operations of the investees. Consolidated investments include our controlled subsidiaries. Investments in businesses which we do not control but have the ability to exercise significant influence over their operating and financial policies are accounted for using the equity method. Investments in businesses which we do not have the ability to exercise significant influence over operating and financial policies are accounted for using the cost method.

Pension Cost and Other Retirement Benefits

The determination of our obligation and cost for pension and other retirement benefits is dependent on our selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in *Note 17 Employee Benefits* to the accompanying consolidated financial statements in Item 18, and include, among other things, discount rates, expected returns on plan assets and rates of compensation increases. In accordance with U.S. GAAP, actual results that differ from our assumptions are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. While we believe that our assumptions are reasonable and appropriate, significant differences in our actual experience or significant changes in our assumptions may materially affect our pension and other retirement obligations. The accrued benefit cost as at December 31, 2006 and 2005 amounted to Php7,627 million and Php2,421 million, respectively. SFAS No. 158 *Employees Accounting for Defined Benefit Pension and Other Post retirement Plans* which was adopted in 2006 requires the recognition of the unfunded status of a benefit plan, and therefore no unrecognized net actuarial loss was recognized as at December 31, 2006. Unrecognized net actuarial gain as at December 31, 2005 amounted to Php116 million.

Deferred Tax Assets

We review the carrying amounts of our deferred tax assets at each balance sheet date and reduce these to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax assets to be utilized. Our assessment on the recognition of deferred tax assets on deductible temporary differences is based on the forecasted taxable income of the subsequent reporting periods. This forecast is based on our past results

and future expectations on revenues and expenses. Management believes that we will not have sufficient future taxable income to utilize the benefits of deductible temporary differences and there is no assurance that we will generate sufficient taxable income to allow all or part of our deferred tax assets to be utilized.

As at December 31, 2006 and 2005, our net deferred tax assets amounted to Php25,366 million and Php23,406 million, respectively, net of valuation allowance amounting to Php299 million and Php5,732 million, respectively.

Legal Contingencies

We are currently involved in various legal proceedings. Our estimate of the probable costs for the resolution of these claims has been developed in consultation with outside counsel handling our defense in these matters and is based upon an analysis of potential results. We currently do not believe these proceedings will have a material adverse effect on our consolidated financial statements. It is possible, however, that future results of operations could be materially affected by changes in our estimates or in the effectiveness of our strategies relating to these proceedings. See Item 8. Financial Information Legal Proceedings Taxation.

Recently Adopted Accounting Pronouncements

Effective January 1, 2006, we adopted SFAS No. 123 (R), *Share-Based Payment*, which revises SFAS No. 123. This statement requires an entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award and to recognize that cost over the period that an employee is required to provide service in exchange for the award. Any awards of liability instruments to employees would be measured at fair value at each reporting date through settlement. We adopted SFAS No. 123 (R) using the modified prospective transition method, and accordingly, the results of prior periods have not been restated. This method requires that the provisions of SFAS No. 123 (R) are applied only to unvested share-based awards as of January 1, 2006. The cumulative effect of adoption of SFAS No. 123 (R) on prior years resulted in a change in our reported net income of Php189 million (net of income taxes of Php93 million and Php1.02 per share) in 2006, which represents the difference between the intrinsic value and the fair value of the liability award on January 1, 2006.

In September 2006, the Financial Accounting Standards Board, or FASB, issued SFAS 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* An amendment of FASB Statements Nos. 87, 88, 106 and 132(R). We adopted SFAS 158 as effective on December 31, 2006. See *Note 17 Employee Benefits*. Additionally, in September 2006, the U.S. Securities and Exchange Commission issued Staff Accounting Bulletin, or SAB, No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB 108 was effective for us upon adoption on December 31, 2006. SAB 108 did not have a material effect on our financial position or results of operations. Effective January 1, 2006, we adopted FASB Interpretation, or FIN, No. 47, *Accounting for Conditional Asset Retirement Obligations*, an interpretation of SFAS 143. The adoption of SFAS 143 did not had material effect on our financial position or results of operations in 2006.

In May 2005, the FASB, as part of an effort to conform to international accounting standards, issued SFAS 154, *Accounting Changes and Error Corrections*, which was effective for us beginning on January 1, 2006. SFAS 154 requires that all voluntary changes in accounting principles be retrospectively applied to prior financial statements as if that principle had always been used, unless it is impracticable to do so. When it is impracticable to calculate the effects on all prior periods, SFAS 154 requires that the new principle be applied to the earliest period practicable. The adoption of SFAS 154 did not have a material effect on our consolidated financial statements in 2006.

New Accounting Pronouncements Effective Subsequent to 2006

In February 2006, FASB issued SFAS 155, *Accounting for Certain Hybrid Financial Instruments*, an amendment to SFAS 133 and FAS 140. SFAS 155 permits an entity to elect fair value remeasurement for any hybrid financial instrument (with changes in fair value recognized in earnings) if the hybrid instrument contains an embedded derivative that would otherwise be required to be bifurcated and accounted for separately under SFAS 133. The election to measure the hybrid instrument at fair value is made on an instrument-by-instrument basis and is irreversible. The statement will be effective for all financial instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of an entity's fiscal years beginning after September 15, 2006, with earlier adoption permitted as of the beginning of fiscal year, provided that financial statements for any interim period of that fiscal year have not been issued. We are currently in the process of evaluating any effect of the adoption of FAS 155 will have on our consolidated financial statements.

In June 2006, the EITF reached a consensus on Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)*. EITF Issue No. 06-3 requires that companies disclose their accounting policy regarding the gross or net presentation of certain taxes. Taxes within the scope of EITF Issue No. 06-3 are any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added and some excise taxes. EITF Issue No. 06-3 is effective for our reporting period beginning January 1, 2007. We are currently in the process of determining the impact of this issue on our consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, or FIN 48, an interpretation of SFAS No. 109, *Accounting for Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for our reporting period beginning January 1, 2007. We are currently in the process of determining the impact of the adoption of this Interpretation on our consolidated financial statements.

In September 2006, FASB issued SFAS 157, Fair Value Measurements. This statement applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. Under this statement, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. This statement clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, the standard establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity's own data. Under this statement, fair value measurements would be separately disclosed by level within the fair value hierarchy. This statement will become effective for financial statements issued for fiscal years beginning after November 15, 2007, and with interim periods within those fiscal years. Early adoption is permitted. We are currently in the process of evaluating the impact of this statement on our consolidated financial statements.

In September 2006, the Emerging Issues Task Force, or EITF, reached a consensus on Issue No. 06-1, Accounting for Consideration Given by a Service Provider to Manufacturers or Resellers of Equipment Necessary for an End-Customer to Receive Service from the Service Provider. EITF Issue No. 06-1 provides guidance regarding whether the consideration given by a service provider to a manufacturer or reseller of specialized equipment should be characterized as a reduction of revenue or an expense. This issue is effective for our reporting period beginning January 1, 2008. Entities are required to recognize the effects of applying this issue as a change in accounting principle through retrospective application to all prior periods unless it is impracticable to do so. We are currently in the process of evaluating the impact of this issue on our consolidated financial statements.

Results of Operations

We have reclassified certain accounts in 2005 and 2004 to conform with our 2006 financial statement presentation.

The following table shows the contribution by each of our business segments to our consolidated operating revenues, expenses and net income for each of the years ended December 31, 2006, 2005 and 2004. Most of our revenues are derived from our operations within the Philippines. Our revenues derived from outside the Philippines consist primarily of revenues from incoming international calls to the Philippines.

| | Wireless | Fixed Line | ICT | Inter-segment Transactions | Total |
|--------------------------------------|---------------|------------|----------|-------------------------------|------------|
| | (in millions) | | | | |
| For the year ended December 31, 2006 | | | | | |
| Operating Revenues | Php80,405 | Php49,282 | Php6,890 | (Php9,041) | Php127,536 |
| Service | 78,383 | 49,203 | 6,337 | (8,919) | 125,004 |
| Non-service | 2,022 | 79 | 553 | (122) | 2,532 |
| Operating Expenses | 42,271 | 39,086 | 7,142 | (9,142) | 79,357 |
| Net Income (Loss) | 32,918 | 923 | (243) | | 33,598 |
| For the year ended December 31, 2005 | | | | | |

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| | | | | | |
|--------------------------------------|--------|--------|-------|---------|---------|
| Operating Revenues | 76,906 | 49,472 | 3,305 | (6,348) | 123,335 |
| Service | 74,195 | 49,431 | 2,953 | (6,231) | 120,348 |
| Non-service | 2,711 | 41 | 352 | (117) | 2,987 |
| Operating Expenses | 39,436 | 38,989 | 3,253 | (6,857) | 74,821 |
| Net Income | 35,830 | 4,660 | 113 | | 40,603 |
| For the year ended December 31, 2004 | | | | | |
| Operating Revenues | 74,764 | 48,546 | 2,401 | (4,538) | 121,173 |
| Service | 68,653 | 48,546 | 2,080 | (4,375) | 114,904 |
| Non-service | 6,111 | | 321 | (163) | 6,269 |
| Operating Expenses | 41,598 | 32,027 | 3,035 | (4,026) | 72,634 |
| Net Income (Loss) | 27,559 | 1,241 | (699) | | 28,101 |

2006 Compared to 2005

On a Consolidated Basis

Consolidated Operating Revenues

Our consolidated operating revenues for 2006 increased by Php4,201 million, or 3%, to Php127,536 million in 2006 from Php123,335 million in 2005. This increase was higher than the increase in our consolidated operating revenues in 2005, primarily due to an increase in our ICT revenues largely due to the consolidation of SPi, CyMed and Level Up!, continued increase in our call center revenues and the continued growth of our wireless business. The revenue contribution of our wireless business accounted for 63% and 62% of our consolidated operating revenues for 2006 and 2005, respectively.

The following table shows the breakdown of our consolidated operating revenues for the years ended December 31, 2006 and 2005 by business segment:

| | Years Ended December 31, | | | | Change | |
|---|--------------------------|-----|------------|-----|----------|-----|
| | 2006 | % | 2005 | % | Amount | % |
| | (in millions) | | | | | |
| Wireless | Php80,405 | 63 | Php76,906 | 62 | Php3,499 | 5 |
| Fixed line | 49,282 | 39 | 49,472 | 40 | (190) | |
| Information and communications technology | 6,890 | 5 | 3,305 | 3 | 3,585 | 108 |
| Inter-segment transactions | (9,041) | (7) | (6,348) | (5) | (2,693) | 42 |
| Total | Php127,536 | 100 | Php123,335 | 100 | Php4,201 | 3 |

Consolidated Operating Expenses

Our consolidated operating expenses in 2006 increased by Php4,536 million, or 6%, to Php79,357 million from Php74,821 million in 2005. The increase was primarily due to higher operating expenses associated with our three business segments primarily due to an increase in compensation and employee benefits, primarily resulting from the effect of collective bargaining agreement-related increases in salaries and benefits, an increase in incentive plan-related accruals, the consolidation of SPi, CyMed and Level Up!, and higher accrued bonuses, pension benefits, long-term incentive plan costs and other employee benefits. We currently expect these expenses to be significantly higher going forward as a result of the full year consolidation of SPi, CyMed and Level Up!. As a percentage of our consolidated operating revenues, consolidated operating expenses increased to 62% in 2006 from 61% in 2005.

The following table shows the breakdown of our consolidated operating expenses for the years ended December 31, 2006 and 2005 by business segment:

| | Years Ended December 31, | | | | Change | |
|---|--------------------------|------|-----------|-----|----------|-----|
| | 2006 | % | 2005 | % | Amount | % |
| | (in millions) | | | | | |
| Wireless | Php42,271 | 53 | Php39,436 | 53 | Php2,835 | 7 |
| Fixed line | 39,086 | 49 | 38,989 | 52 | 97 | |
| Information and communications technology | 7,142 | 9 | 3,253 | 4 | 3,889 | 120 |
| Inter-segment transactions | (9,142) | (11) | (6,857) | (9) | (2,285) | 33 |
| Total | Php79,357 | 100 | Php74,821 | 100 | Php4,536 | 6 |

Consolidated Operating Income

Our consolidated operating income in 2006 was Php48,179 million, a decrease of Php335 million, or 1%, compared to Php48,514 million in 2005 as a result of a 6% increase in our consolidated operating expenses which more than offset the 3% increase in our consolidated operating revenues.

Consolidated Financing Costs

Financing costs on a consolidated basis decreased by Php964 million, or 28%, to Php2,459 million primarily due to lower interest expense and related items owing to lower debt balances in 2006 compared with 2005 and lower accretion on financial liabilities due to lower levels of debt issuance costs, partially offset by lower foreign exchange gains as a result of lower foreign currency debt levels.

Consolidated Interest Income

Interest income on a consolidated basis decreased by Php35 million, or 2%, to Php1,422 million in 2006 from Php1,457 million in 2005 mainly attributable to higher levels of short-term investments which resulted in lower interest income.

Consolidated Loss (Gain) on Derivative Transactions

Loss on derivative transactions on a consolidated basis amounted to Php6,857 million in 2006, an increase of Php5,056 million, or 281%, compared to Php1,801 million in 2005 primarily due to mark-to-market loss from principal only swaps as a result of the peso appreciation in 2006 and lower interest differential between peso and U.S. dollar interest rates.

Consolidated Other Income - Net

Other income on a consolidated basis totaled Php3,595 million in 2006, an increase of Php2,579 million, or 254%, compared to Php1,016 million in 2005. The increase was primarily due to the recognition of a gain of Php1,698 million on early settlement by Piltel of its restructured debt, a gain on disposal of property and equipment of Php355 million, a gain relating to a refund from Manila Electric Company, or Meralco, of Php194 million recorded at fair value in 2006 (payable by Meralco over four years) and a gain on disposal of materials.

Consolidated Income Before Income Tax, Cumulative Effect of Change in Accounting Policy and Minority Interest in Net Loss (Income) of Consolidated Subsidiaries

Our income before income tax, cumulative effect of change in accounting policy and minority interest in net loss (income) of consolidated subsidiaries in 2006 was Php43,828 million, a decrease of Php1,942 million, or 4%, from Php45,770 million in 2005, primarily due to the increase of Php5,056 million in loss on derivative transactions in 2006 and a slightly lower operating income, partially offset by an increase in our other income due to the recognition of a gain of Php1,698 million on early settlement by Piltel of its restructured debt and a significant decline in our financing costs owing to lower interest expense and related items in 2006.

Provision for Income Tax

Provision for income tax increased by Php4,197 million, or 87%, to Php9,046 million in 2006 compared to Php4,849 million in 2005 mainly due to lower non-tax deductible charges, partially offset by the reversal of a valuation allowance of deferred tax assets in relation with the likelihood that Piltel would be able to realize the future tax benefits on these assets. We currently expect that our effective corporate tax rate will be higher going forward than in previous years due to the expiration of Smart's income tax holiday.

Consolidated Net Income

As a result, our consolidated net income in 2006 was Php33,598 million, a decrease of Php7,005 million, or 17%, compared to Php40,603 million in 2005. The following table shows the breakdown of our consolidated net income for the years ended December 31, 2006 and 2005 by business segment:

| | Years Ended December 31, | | | | | |
|---|--------------------------|-----|-----------|-----|------------------|-------|
| | 2006 | % | 2005 | % | Change Amount | % |
| | (in millions) | | | | | |
| Wireless | Php32,918 | 98 | Php35,830 | 88 | (Php2,912) | (8) |
| Fixed line | 923 | 3 | 4,660 | 12 | (3,737) | (80) |
| Information and communications technology | (243) | (1) | 113 | | (356) | (315) |
| Total | Php33,598 | 100 | Php40,603 | 100 | (Php7,005) | (17) |

On Business Segment Basis

Wireless

Operating Revenues

Our wireless business segment offers cellular services as well as wireless broadband, satellite, VSAT and other services.

The following table summarizes our total operating service and non-service revenues from our wireless business for the years ended December 31, 2006 and 2005 by service segment:

| | Years Ended December 31, | | | | Increase (Decrease) | |
|--|--------------------------|-----|-----------|-----|------------------------|------|
| | 2006 | % | 2005 | % | Amount | % |
| (in millions) | | | | | | |
| Wireless services: | | | | | | |
| Service Revenues | | | | | | |
| Cellular | Php75,605 | 94 | Php71,518 | 93 | Php4,087 | 6 |
| Wireless broadband, satellite, VSAT and others | 2,778 | 3 | 2,677 | 3 | 101 | 4 |
| | 78,383 | 97 | 74,195 | 96 | 4,188 | 6 |
| Non-service Revenues | | | | | | |
| Sale of cellular handsets and SIM-packs | 2,022 | 3 | 2,711 | 4 | (689) | (25) |
| Total Wireless Operating Revenues | Php80,405 | 100 | Php76,906 | 100 | Php3,499 | 5 |

Service Revenues

Our wireless service revenues increased by Php4,188 million, or 6%, to Php78,383 million in 2006 compared to Php74,195 million in 2005 mainly as a result of the continued growth of Smart's and Piltel's subscriber base, an increase in international inbound revenues and a reduction in domestic interconnection costs due to a shift from off-network to on-network voice and data usage. As a percentage of our total wireless operating revenues, wireless service revenues increased to 97% in 2006 from 96% in 2005.

Cellular Service

Unless otherwise indicated, the financial data and operating metrics cited in the cellular service section reflect the consolidated results of our cellular subsidiary, Smart and its subsidiary, Piltel.

Our cellular service revenues consist of:

- revenues derived from actual usage of the network by prepaid subscribers and any unused peso value of expired prepaid cards or electronic air time loads, net of discounts given to dealers;
- monthly service fees from postpaid subscribers, including: (1) charges for calls in excess of allocated free local calls; (2) toll charges for national and international long distance calls; (3) charges for text messages of our service customers in excess of allotted free text messages; and (4) charges for value-added services, net of related content

provider costs;

- revenues generated from incoming calls and messages to our subscribers, net of interconnection expenses; fees from reciprocal traffic from international correspondents; and revenues from inbound international roaming calls for the service; and
- other charges, including those for reconnection and migration.

Our cellular service revenues in 2006 amounted to Php75,605 million, an increase of Php4,087 million, or 6%, from Php71,518 million in 2005. Cellular service revenues accounted for 94% and 93% of our total wireless operating revenues in 2006 and 2005, respectively. The increase in cellular service revenues was primarily due to the continued growth of Smart's and Piltel's subscriber base. As at December 31, 2006, Smart and Piltel cellular subscribers totaled 24,175,384, an increase of 3,766,763, or 18%, over their combined cellular subscriber base of 20,408,621 as at December 31, 2005.

The table below shows our cellular subscribers base as at December 31, 2006 and 2005:

| | As at December 31, | | Increase | |
|--------------------------|---------------------------|-------------|-----------------|----------|
| | 2006 | 2005 | Amount | % |
| Cellular subscriber base | 24,175,384 | 20,408,621 | 3,766,763 | 18 |
| Prepaid | 23,856,821 | 20,128,543 | 3,728,278 | 19 |
| Smart | 16,882,442 | 15,144,118 | 1,738,324 | 11 |
| Piltel | 6,974,379 | 4,984,425 | 1,989,954 | 40 |
| Postpaid | 318,563 | 280,078 | 38,485 | 14 |

Of our 24,175,384 subscribers as at December 31, 2006, prepaid subscribers accounted for approximately 99% while postpaid subscribers accounted for the remaining 1%. Our cellular prepaid subscriber base grew by 19% to 23,856,821 as at December 31, 2006 from 20,128,543 as at December 31, 2005, whereas our postpaid subscriber base increased by 14% to 318,563 as at December 31, 2006 from 280,078 as at December 31, 2005. Smart's prepaid and postpaid net subscriber activations totaled 1,738,324 and 38,485, respectively, in 2006, or a quarterly average addition of 434,581 prepaid and 9,621 postpaid subscribers. On the other hand, Piltel's prepaid subscribers increased by 40% to 6,974,379 as at December 31, 2006 from 4,984,425 as at December 31, 2005, or a quarterly average addition of 497,489 subscribers. Postpaid subscribers as at December 31, 2006 were higher than as at December 31, 2005 primarily due to increased net activations in the last two quarters of 2006.

Our quarterly net subscriber activations (reductions) over the eight quarters in 2006 and 2005 are as follows:

| | 2006 | | | | 2005 | | | |
|----------|---------|-----------|---------|-----------|-----------|---------|----------|-----------|
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q |
| Prepaid | 486,009 | 1,553,570 | 450,553 | 1,238,146 | 1,050,638 | 536,840 | (11,230) | (381,443) |
| Smart | 111,987 | 851,326 | 131,486 | 643,525 | 920,885 | 314,607 | (53,953) | (358,709) |
| Piltel | 374,022 | 702,244 | 319,067 | 594,621 | 129,753 | 222,233 | 42,723 | (22,734) |
| Postpaid | 5,001 | 11,955 | 13,722 | 7,807 | (6,357) | 116 | 10,506 | 1,319 |
| Total | 491,010 | 1,565,525 | 464,275 | 1,245,953 | 1,044,281 | 536,956 | (724) | (380,124) |

Wireless Broadband, Satellite, VSAT and Other Services

Our revenues from wireless broadband, satellite, VSAT and other services consist mainly of rentals received for the lease of Mabuhay Satellite's transponders and Telesat's VSAT facilities to other companies and wireless broadband service revenues from Smart Broadband, charges for ACeS Philippines' satellite phone service and service revenues from PLDT Global subsidiary's mobile virtual network operations. Smart Broadband offers a number of wireless broadband services and had 121,867 subscribers as at December 31, 2006.

Gross service revenues from these services for 2006 amounted to Php2,778 million, an increase of Php101 million, or 4%, from Php2,677 million in 2005. The increase was primarily due to the growth in our wireless broadband business.

Non-service Revenues

Our wireless non-service revenues consist of:

- proceeds from sale of cellular handsets; and
- proceeds from sale of cellular SIM-packs.

Our wireless non-service revenues decreased by Php689 million, or 25%, to Php2,022 million in 2006 as compared to Php2,711 million in 2005 mainly attributable to lower handset sales due to the fact that activations in 2006 were primarily driven by more SIM-pack sales.

Operating Expenses

Operating expenses associated with our wireless business in 2006 amounted to Php42,271 million, an increase of Php2,835 million, or 7%, from Php39,436 million in 2005. This increase was mainly due to increases in rent, compensation and benefits, and the recognition of an asset impairment charge, partially offset by decreases in costs of cellular handsets and SIM-packs sold, cost of satellite air time, taxes and licenses, and selling and promotion. As a percentage of our total wireless operating revenues, operating expenses associated with our wireless business decreased to 53% in 2006 from 51% in 2005.

Cellular business expenses accounted for 96% while wireless broadband, satellite, VSAT and other business expenses accounted for 4% of our wireless business expenses in 2006, compared to 94% and 6%, respectively, in 2005.

The following table summarizes our wireless-related expenses for the years ended December 31, 2006 and 2005 and the percentage of each expense item to the total:

| | 2006 | | 2005 | | Increase (Decrease) | |
|---|---------------|----|----------|----|------------------------|------|
| | Amount | % | Amount | % | Amount | % |
| | (in millions) | | | | | |
| Wireless services | | | | | | |
| Depreciation and amortization | 9,743 | 23 | Php9,200 | 23 | Php543 | 6 |
| Rent | 7,887 | 19 | 5,577 | 14 | 2,310 | 41 |
| Compensation and benefits(1) | 5,040 | 12 | 4,245 | 11 | 795 | 19 |
| Costs of cellular handsets and SIM-packs sold | 4,688 | 11 | 5,827 | 15 | (1,139) | (20) |
| Repairs and maintenance | 3,646 | 9 | 3,667 | 9 | (21) | (1) |
| Selling and promotions | 3,012 | 7 | 3,124 | 8 | (112) | (4) |
| Professional and other contracted services | 1,780 | 4 | 1,608 | 4 | 172 | 11 |
| Asset impairment | 1,391 | 3 | | | 1,391 | 100 |
| Taxes and licenses | 1,018 | 2 | 1,538 | 4 | (520) | (34) |
| Communication, training and travel | 891 | 2 | 960 | 2 | (69) | (7) |
| Insurance and security services | 798 | 2 | 947 | 2 | (149) | (16) |
| Cost of satellite air time | 698 | 2 | 1,008 | 3 | (310) | (31) |
| Provision for doubtful accounts | 627 | 1 | 253 | 1 | 374 | 148 |
| Amortization of intangible assets | 272 | 1 | 189 | 1 | 83 | 44 |
| Provision for inventory obsolescence | 202 | 1 | 322 | 1 | (120) | (37) |
| Other operating expenses | 578 | 1 | 971 | 2 | (393) | (40) |

| | | | | | | |
|-------|-----------|-----|-----------|-----|----------|---|
| Total | Php42,271 | 100 | Php39,436 | 100 | Php2,835 | 7 |
|-------|-----------|-----|-----------|-----|----------|---|

(1) Includes salaries and benefits, incentive plan, pension and manpower rightsizing program, or MRP, costs.

Depreciation and amortization charges increased by Php543 million, or 6%, to Php9,743 million in 2006, principally due to an increase in our depreciable asset base mainly in our broadband and 3G network, and customer-deployed equipment. For further details, see *Note 7 Property, Plant and Equipment* to the accompanying consolidated financial statements in Item 18.

Rent expenses increased by Php2,310 million, or 41%, to Php7,887 million on account of an increase in domestic fiber optic network, or DFON, facilities leased by Smart from PLDT, as well as higher satellite transmission and site rental expenses. As at December 31, 2006, we had 4,377 GSM cell sites and 6,099 base stations, compared with 4,305 GSM cell sites and 5,982 base stations as at December 31, 2005.

Compensation and benefits expenses increased by Php795 million, or 19%, to Php5,040 million, primarily due to higher accrued bonuses, pension benefits, long-term incentive plan costs and other employee benefits of Smart. Smart's employee headcount increased by 219, or 4%, to 5,306 in 2006 as compared to 5,087 in 2005. For further discussion on our long-term incentive plan, please see Item 6. *Directors, Senior Management and Employees Long-Term Incentive Plan* and *Note 21 Employee Benefits* to the accompanying consolidated financial statements in Item 18.

Cost of cellular, handsets, and SIM-packs sold decreased by Php1,139 million, or 20%, to Php4,688 million primarily due to a decrease in the volume of phone kits sold and the termination of SIM-swapping activities in May 2005.

Repairs and maintenance expenses decreased by Php21 million, or 1%, to Php3,646 million mainly on account of lower repairs and maintenance costs for network facilities and motor vehicles which more than offset higher expenses for electricity and power generation as well as higher maintenance expense for IT hardware and software.

Selling and promotions expenses decreased by Php112 million, or 4%, to Php3,012 million due to lower commission, and advertising and promotions expenses as well as a decrease in printing costs of prepaid cards.

Professional and other contracted services increased by Php172 million, or 11%, to Php1,780 million, primarily due to increased call center, contracted service, market research, consultancy and technical service fees.

Asset impairment of Php1,391 million in 2006 represents the reduction in value of Mabuhay Satellite's Agila II satellite given the difficulty in generating cash flows with the satellite nearing its end-of-life and other events affecting its business.

Taxes and licenses decreased by Php520 million, or 34%, to Php1,018 million, primarily due to a decrease in Smart's licenses and business-related taxes.

Communication, training and travel expenses decreased by Php69 million, or 7%, to Php891 million due to lower mailing and courier, training, communication and local travel expenses, partially offset by higher freight and hauling charges incurred in 2006.

Insurance and security services decreased by Php149 million, or 16%, to Php798 million, primarily due to the decrease in site security expenses and lower amortization charges on prepaid insurance contracts.

Cost of satellite air time decreased by Php310 million, or 31%, to Php698 million due to a reduction of satellite air time cost as a result of the appreciation of the peso in 2006. See Liquidity and Capital Resources Contractual Obligations and Commercial Commitments Contractual Obligations Unconditional Purchase Obligations Air Time Purchase Agreement with AIL and *Note 16 Related Party Transactions* to the accompanying consolidated financial statements in Item 18.

Provision for doubtful accounts increased by Php374 million, or 148%, to Php627 million primarily due to an increase in the provision for subscriber and carrier receivables coupled with the reversal of the provision for non-trade receivables booked in 2005.

Amortization of intangible assets increased by Php83 million, or 44%, to Php272 million mainly due to an increase in the amount of intangible assets recognized following the purchase of an additional 20% investment in Wolfpac.

Provision for inventory obsolescence decreased by Php120 million, or 37%, to Php202 million primarily due to a lower level of obsolete inventory in 2006.

Other operating expenses decreased by Php393 million, or 40%, to Php578 million primarily due to various lower business and operational-related expenses such as bank charges, representation expenses and a loss on share swap in 2005.

Operating Income

Operating income from our wireless business amounted to Php38,134 million in 2006, an increase of Php664 million, or 2%, from Php37,470 million in 2005, which was primarily due to increased revenues, mainly from our cellular services, partially offset by higher operating expenses.

Financing Costs

Financing gain amounted to Php1,359 million in 2006, an increase of Php552 million, or 68%, from Php807 million in 2005 due to the combined results of lower interest expense owing to lower debt balances and accretion on financial liabilities as well as higher capitalized interest. The breakdown of our financing costs for our wireless business for the years ended December 31, 2006 and 2005 is as follows:

| | Years Ended December 31, | | | |
|--|---------------------------------|-------------|---------------|----------|
| | 2006 | 2005 | Change | |
| | | | Amount | % |
| (in millions) | | | | |
| Interest on loans and related items | Php716 | Php1,037 | (Php321) | (31) |
| Accretion on financial liabilities net | 129 | 248 | (119) | (48) |
| Financing charges | 37 | 52 | (15) | (29) |
| Capitalized interest | (248) | (85) | (163) | 192 |
| Foreign exchange gains net | (1,993) | (2,059) | 66 | (3) |
| | (Php1,359) | (Php807) | (Php552) | 68 |

Interest Income

Interest income generated by our wireless business amounted to Php965 million in 2006, a decrease of Php92 million, or 9%, compared to Php1,057 million in 2005 mainly attributable to Smart's lower average cash balances.

Loss (Gain) on Derivative Transactions

Gain on derivative transactions increased by Php157 million, or 133%, to Php39 million in 2006 as compared to a loss on derivative transactions of Php118 million in 2005 primarily due to mark-to-market gain from Smart's forward foreign exchange contracts as a result of the peso appreciation.

Other Income - Net

Our wireless business segment generated other income - net of Php2,285 million in 2006, an increase of Php993 million, or 77%, from Php1,292 million in 2005. The increase was primarily due to the recognition of a gain of Php1,698 million on early settlement by Piltel of its restructured debt and a reversal of prior years' provision for NTC fees to align with the assessments received in 2005.

Income Before Income Tax, Cumulative Effect of Change in Accounting Policy and Minority Interest in Net Income (Loss) of Consolidated Subsidiaries

Income before income tax, cumulative effect of change in accounting policy and minority interest in net income (loss) of consolidated subsidiaries increased by Php2,274 million, or 6%, to Php42,782 million in 2006 compared to Php40,508 million in 2005, mainly due to a 5% increase in wireless operating revenues, principally from our cellular business resulting from the continued cellular subscriber growth in 2006, and an increase in other income.

Provision for Income Tax

Provision for income tax increased by Php4,444 million, or 104%, to Php8,729 million in 2006 from Php4,285 million in 2005, primarily due to higher non-tax deductible charges and the net movement in deferred tax assets. For 2006, the net movement in deferred tax assets primarily pertains to deferred tax assets recognized in relation to the benefit to be derived from the disposal of certain of Piltel's assets with the lifting of certain mortgage trust indenture restrictions resulting from the full prepayment of Piltel's restructured debt on December 4, 2006. We currently expect that our effective corporate tax rate will be higher going forward than in previous years due to the expiration of Smart's income tax holiday.

Net Income

Our wireless business segment recorded a net income of Php32,918 million in 2006, a decrease of Php2,912 million, or 8%, over Php35,830 million registered in 2005 as the increase in our cellular revenues and our other income was more than offset by an increase in operating expenses and higher provision for income tax.

Fixed Line

Operating Revenues

Our fixed line business provides local exchange service, international and national long distance services, data and other network services, and miscellaneous services. Total fixed line revenues generated from our fixed line business in 2006 totaled Php49,282 million, a decrease of Php190 million from Php49,472 million in 2005. As a percentage of our total operating revenues, fixed line revenues decreased to 36% in 2006 from 38% in 2005, principally due to the continued growth of our wireless business.

The following table summarizes total operating revenues from our fixed line business for the years ended December 31, 2006 and 2005, respectively, by service segment:

| | Years Ended December 31, | | | | Increase (Decrease) | |
|-------------------------------------|--------------------------|-----|-----------|-----|------------------------|------|
| | 2006 | % | 2005 | % | Amount | % |
| | (in millions) | | | | | |
| Fixed line services: | | | | | | |
| Service Revenues | | | | | | |
| Local exchange | Php16,993 | 35 | Php20,229 | 41 | (Php3,236) | (16) |
| International long distance | 9,933 | 20 | 12,245 | 25 | (2,312) | (19) |
| National long distance | 6,920 | 14 | 5,254 | 11 | 1,666 | 32 |
| Data and other network | 13,725 | 28 | 10,394 | 21 | 3,331 | 32 |
| Miscellaneous | 1,632 | 3 | 1,309 | 2 | 323 | 25 |
| | 49,203 | 100 | 49,431 | 100 | (228) | |
| Non-Service Revenues | | | | | | |
| Sale of cellular handsets | 79 | | 41 | | 38 | 93 |
| Total Fixed Line Operating Revenues | Php49,282 | 100 | Php49,472 | 100 | (Php190) | |

*Service Revenues**Local Exchange Service*

Our local exchange service revenues consist of:

- flat monthly fees for our postpaid service;
- installation charges and other one-time fees associated with the establishment of customer service;
- fixed charges paid by other telephone companies, charges retained by PLDT for calls terminating to cellular subscribers within the local area, and local access charges paid by cellular operators for calls by cellular subscribers that terminate to our local exchange network;
- revenues from usage of prepaid cards for calls within the local area and any unused peso value of expired prepaid cards; and
- charges for special features, including bundled value-added services such as call waiting, call forwarding, multi-party conference calling, speed calling and caller ID.

The following table summarizes key measures of our local exchange service business segment as at and for the years ended December 31, 2006 and 2005, respectively:

| | Years Ended December 31, | | | |
|--|--------------------------|-----------|----------------------------------|------|
| | 2006 | 2005 | Increase (Decrease) Amount | % |
| Consolidated local exchange service revenues (in millions) | Php16,993 | Php20,229 | (Php3,236) | (16) |
| Number of fixed line subscribers(1) | 1,776,647 | 1,842,507 | (65,860) | (4) |
| Number of fixed line employees | 8,711 | 9,197 | (486) | (5) |
| Number of fixed line subscribers per employee | 204 | 200 | 4 | 2 |

(1) Previously set forth as number of fixed lines in service. 2006 was restated to reflect the effect of the change in parameters used to align with the PLDT Group's policy on subscriber count with the planned use of an integrated billing system for our subscribers.

Revenues from our local exchange service decreased by Php3,236 million, or 16%, to Php16,993 million in 2006 from Php20,229 million in 2005. The decrease was primarily due to a 4% decline in the number of fixed line subscribers

and the appreciation of the peso which required us to make downward adjustments in our monthly local service rates. The percentage contribution of local exchange revenues to our total fixed line service revenues decreased to 35% in 2006 as compared to 41% in 2005.

As at December 31, 2006, postpaid and prepaid fixed line subscribers totaled 1,450,331 and 326,316, respectively, which accounted for approximately 82 % and 18 %, respectively, of our total fixed line subscribers.

Pursuant to a currency exchange rate adjustment mechanism authorized by the Philippine National Telecommunications Commission, or the NTC, we adjust our postpaid monthly local service rates upward or downward by 1% for every Php0.10 change in the peso-to-dollar exchange rate relative to a base rate of Php11.00 to US\$1.00. In 2006, we implemented eight downward adjustments and three upward adjustments in our monthly local service rates, while there were six downward adjustments and three upward adjustments in 2005. The average Philippine peso to U.S. dollar rate factored in our monthly local service rates in 2006 was Php51.53 to US\$1.00, compared to an average of Php55.21 to US\$1.00 in 2005. This change in the average peso-to-dollar rate translated to a peso appreciation of 7%, which resulted in a net decrease of approximately 6% in our average monthly local service rates in 2006.

International Long Distance Service

Our international long distance service revenues, which we generate through our international gateway facilities, consist of:

- inbound call revenues representing settlements from foreign telecommunications carriers for inbound international calls, virtual transit and hubbing service and reverse charged calls such as received collect and home country direct service;
- access charges paid to us by other Philippine telecommunications carriers for terminating inbound international calls to our local exchange network; and
- outbound call revenues representing amounts billed to our customers (other than our cellular customers) for outbound international calls, net of amounts payable to foreign telecommunications carriers for terminating calls in their territories.

The following table shows information about our international fixed line long distance business for the years ended December 31, 2006 and 2005, respectively:

| | Years Ended December 31, | | | |
|--|--------------------------|-----------|------------------------|------|
| | 2006 | 2005 | Increase (Decrease) | |
| | | | Amount | % |
| Total international long distance service revenues (in millions) | Php9,933 | Php12,245 | (Php2,312) | (19) |
| Inbound | 8,378 | 10,203 | (1,825) | (18) |
| Outbound | 1,555 | 2,042 | (487) | (24) |
| International call volumes (in million minutes, except call ratio) | 2,177 | 2,266 | (89) | (4) |
| Inbound | 1,984 | 2,117 | (133) | (6) |
| Outbound | 193 | 149 | 44 | 30 |
| Inbound-outbound call ratio | 10.3:1 | 14.2:1 | | |

Our total international long distance service revenues decreased by Php2,312 million, or 19%, to Php9,933 million in 2006 from Php12,245 million in 2005, primarily due to the peso appreciation, a decrease in average termination rates for inbound calls and a decline in inbound call volumes largely as a result of alternative means of communications such as e-mailing, texting and Internet telephony. The percentage contribution of international long distance service revenues to our total fixed line service revenues decreased to 20% in 2006 from 25% in 2005.

Our revenues from inbound international long distance service decreased by Php1,825 million, or 18%, to Php8,378 million due to a decrease in inbound traffic volume by 133 million minutes to 1,984 million minutes in 2006 coupled with a decrease in average termination rates. In addition, the appreciation of the Philippine peso to the U.S. dollar with average rates of Php51.165 in 2006 and Php55.006 in 2005 contributed to the decrease in our inbound international long distance revenues in peso terms, since settlement charges for inbound calls are billed in U.S. dollars or in special drawing rights, an established method of settlement among international telecommunications carriers using values based on a basket of foreign currencies that are translated into pesos at the time of billing.

Our revenues from outbound international long distance service decreased by Php487 million, or 24%, to Php1,555 million in 2006 primarily due to a decline in average revenue per minute as a result of a lower average collection rate with the introduction of low-rate services such as *PLDT ID-DSL* and *Budget Card*, and the peso appreciation in 2006, which more than offset the significant increase in outbound international call volumes in 2006.

National Long Distance Service

Our national long distance service revenues consist of:

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- per minute charges for calls made by our fixed line customers outside of the local service areas but within the Philippines, net of interconnection charges payable for calls carried through the backbone network of, and/or terminating to the customer of, another telecommunications carrier;
- access charges received from other telecommunications carriers for calls carried through our backbone network and/or terminating to our customers; and
- fixed charges paid by other telephone companies, charges retained by PLDT for calls terminating to cellular subscribers within the local area, and local access charges paid by cellular operators for calls by cellular subscribers that terminate to our local exchange network.

The following table shows our national long distance service revenues and call volumes for the years ended December 31, 2006 and 2005, respectively:

| | Years Ended December 31, | | | |
|---|--------------------------|----------|----------------------------------|-----|
| | 2006 | 2005 | Increase (Decrease) Amount | % |
| Total national long distance service revenues (in millions) | Php6,920 | Php5,254 | Php1,666 | 32 |
| National long distance call volumes (in million minutes) | 2,251 | 2,348 | (97) | (4) |

Our national long distance service revenues increased by Php1,666 million, or 32%, to Php6,920 million in 2006 from Php5,254 million in 2005, primarily due to higher average revenue per minute in 2006 due to the change in mechanics in our Php10 per call promotion which more than offset the decrease in call volumes. In 2005, the Php10 per call promotion was open to all PLDT Group fixed line subscribers nationwide while in 2006, the Php10 per call service was made available only to registered PLDT subscribers for a monthly service fee. Accordingly, the percentage contribution of national long distance revenues to our fixed line service revenues accounted for 14% and 11% in 2006 and 2005, respectively.

Data and Other Network Services

Our data and other network service revenues include charges for leased lines, IP-based, packet-based and switched-based services. These services are used for domestic and international communications such as private networking, broadband and narrowband Internet-based data communications, and packet-based communication.

The following table shows information about our data and other network service revenues for the years ended December 31, 2006 and 2005:

| | Years Ended December 31, | | | |
|---|--------------------------|-----------|--------------------|----|
| | 2006 | 2005 | Increase Amount | % |
| Data and other network service revenues (in millions) | Php13,725 | Php10,394 | Php3,331 | 32 |
| Number of DSL broadband subscribers | 133,159 | 88,811 | 44,348 | 50 |
| Number of PLDT Vibe narrowband subscribers | 297,250 | 266,703 | 30,547 | 11 |

In 2006, our data and other network services posted revenues of Php13,725 million, an increase of Php3,331 million, or 32%, from Php10,394 million in 2005, primarily due to increases in leased lines, IP-based and switched-based data services, particularly Diginet and DFON rental, *PLDT DSL* and *PLDT Vibe* services. The revenue contribution of this service segment to our fixed line service revenues increased to 28% in 2006 from 21% in 2005.

PLDT DSL contributed revenues of Php3,132 million in 2006, an increase of Php754 million, or 32%, from Php2,378 million in 2005, primarily due to an increase in the number of subscribers. *PLDT DSL* reached 133,159 subscribers as at December 31, 2006 compared with 88,811 subscribers in the same period in 2005. *PLDT DSL* offers a number of packages with maximum speeds ranging from 88 kbps to 5 Mbps depending on the plan.

PLDT Vibe revenues increased by Php106 million, or 38%, to Php387 million in 2006 from Php281 million in 2005, primarily due to an increase in subscribers. As at December 31, 2006, *PLDT Vibe* registered users totaled 297,250, of which 100,362 were exclusive postpaid users, 182,968 were exclusive prepaid users, and 13,920 were both postpaid and prepaid users. As at December 31, 2005, *PLDT Vibe* registered users totaled 266,703, of which 97,016 were exclusive postpaid users, 149,973 were exclusive prepaid users, and 19,714 were both postpaid and prepaid users.

In support of the growing data requirements of the small and medium enterprise market, the network footprints of BRAINS, IP-VPN and *Shops.work*, PLDT's private local networking services, have been expanded with the roll-out of NGN facilities in key business areas across the country.

The continued growth in data services revenues can be attributed to several product offerings. The steady demand for dedicated connectivity or private networking from the corporate market using PLDT's traditional international and domestic data offerings – Fibernet, Arcstar, Acacia, I-Gate, Diginet, BRAINS, IP-VPN and *Shops.work*, among others continues to provide us with a stable revenue source.

Dignet, our domestic private leased line service, has been providing Smart s increasing fiber optic and leased line data requirements. Dignet revenues increased by Php2,335 million, or 53%, to Php6,771 million in 2006 as compared to Php4,436 in 2005 mainly due to Smart s DFON rental of Php4,940 million and Php3,062 million in 2006 and 2005, respectively.

Miscellaneous

Miscellaneous service revenues are derived mostly from directory advertising and facilities rental. In 2006, these revenues increased by Php323 million, or 25%, to Php1,632 million from Php1,309 million in 2005. The improvement was mainly due to an increase in rental income, primarily from co-location charges on account of an increase in the number of co-location sites, coupled with an increase in facility management fees. The percentage contribution of miscellaneous service revenues to our total fixed line service revenues was 3% and 2% in 2006 and 2005, respectively.

Operating Expenses

Expenses related to our fixed line business totaled Php39,086 million in 2006, an increase of Php97 million as compared to Php38,989 million in 2005. The increase was primarily due to an increase in compensation and benefits, repairs and maintenance, selling and promotions and asset impairment expenses, partially offset by lower provision for doubtful accounts, depreciation and amortization and taxes and licenses.

The following table sets forth the breakdown of our total fixed line-related expenses for the years ended December 31, 2006 and 2005, respectively, and the percentage of each expense item to the total:

| | 2006 | | 2005 | | Increase (Decrease) | |
|--|-----------|----|-----------|----|------------------------|------|
| | Amount | % | Amount | % | Amount | % |
| (in millions) | | | | | | |
| Fixed line services: | | | | | | |
| Depreciation and amortization | Php17,676 | 45 | Php18,240 | 47 | (Php564) | (3) |
| Compensation and benefits(1) | 10,207 | 26 | 8,261 | 21 | 1,946 | 24 |
| Repairs and maintenance | 4,232 | 11 | 3,297 | 9 | 935 | 28 |
| Selling and promotions | 1,736 | 5 | 1,535 | 4 | 201 | 13 |
| Rent | 1,579 | 4 | 1,727 | 4 | (148) | (9) |
| Professional and other contracted services | 1,128 | 3 | 1,039 | 3 | 89 | 9 |
| Taxes and licenses | 730 | 2 | 942 | 2 | (212) | (23) |
| Communication, training and travel | 506 | 1 | 447 | 1 | 59 | 13 |
| Insurance and security services | 499 | 1 | 628 | 2 | (129) | (21) |

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| | | | | |
|--------------------------------------|-----------|-------|-----------|--------------|
| Cost of computers | 159 | 53 | 106 | 200 |
| Provision for doubtful accounts | 45 | 1,944 | 5 | (1,899) (98) |
| Provision for inventory obsolescence | 9 | 157 | | (148) (94) |
| Other operating expenses | 580 | 2 | 719 | 2 (139) (19) |
| Total | Php39,086 | 100 | Php38,989 | 100 |
| | | | Php97 | |

(1) Includes salaries and benefits, incentive plan, pension and MRP costs.

Depreciation and amortization charges decreased by Php564 million, or 3%, to Php17,676 million due to the lower depreciation of our regular asset base.

Compensation and benefits expenses increased by Php1,946 million, or 24%, to Php10,207 million, primarily due to the effect of collective bargaining agreement-related increases in salaries and benefits, and an increase in incentive plan-related accruals, partially offset by a reduction in the number of fixed line employees due to PLDT's manpower rightsizing program. For further discussion on our long-term incentive plan, please see Item 6. Directors, Senior Management and Employees Long-Term Incentive Plan and Note 17 Employee Benefits to the accompanying consolidated financial statements in Item 18.

Repairs and maintenance expenses increased by Php935 million, or 28%, to Php4,232 million, primarily due to higher maintenance costs for foreign cable and wire facilities as more operating and maintenance-related restorations were incurred in 2006 as compared to 2005.

Selling and promotions expenses increased by Php201 million, or 13%, to Php1,736 million, primarily as a result of an increase in PLDT's promotional activities in relation to various products and services, coupled with higher public relations expense in 2006.

Rent expenses decreased by Php148 million, or 9%, to Php1,579 million due to lower office and building rentals, and a decrease in transponder lease charges, partially offset by an increase in international and domestic leased circuits charges.

Professional and other contracted services increased by Php89 million, or 9%, to Php1,128 million primarily due to higher contracted services and bill printing fees in 2006.

Taxes and licenses decreased by Php212 million, or 23%, to Php730 million, mainly on account of lower business-related taxes incurred in 2006 as compared to 2005.

Communication, training and travel expenses increased by Php59 million, or 13%, to Php506 million due to an increase in local and foreign travel and training in 2006 as compared to 2005.

Insurance and security services decreased by Php129 million, or 21%, to Php499 million, primarily due to lower premiums on property all-risk, industrial all-risk and industrial fire insurance as well as lower security services due to a decrease in number of contracted security guards.

Cost of computers increased by Php106 million, or 200%, to Php159 million in 2006 due to the computer-bundled sales in relation to our DSL promotion and *WeRoam* subscriptions.

Provision for doubtful accounts decreased by Php1,899 million, or 98%, to Php45 million primarily on account of improvement in collection rates in 2006 as compared to 2005.

Provision for inventory obsolescence decreased by Php148 million, or 94%, to Php9 million primarily due to the consequent reversal of provisions with the change in realizability of certain receivable accounts specifically identified and previously provided for.

Other operating expenses decreased by Php139 million, or 19%, to Php580 million due to lower office supplies consumption and printing costs.

Operating Income

Operating income from our fixed line service amounted to Php10,196 million in 2006, a decrease of Php287 million, or 3%, from Php10,483 million in 2005, which was primarily due to an increase in fixed line-related expenses particularly increased compensation and benefits, coupled with the decrease in fixed line-related revenues.

Financing Costs

Financing costs decreased by Php491 million, or 12%, to Php3,685 million in 2006 largely due to lower interest on loans and related items owing to lower debt balances in 2006 as compared to 2005 partially offset by lower foreign exchange gains recorded in 2006 as a result of lower foreign currency debt levels and higher hedge costs. The

breakdown of financing costs for our fixed line business for the years ended December 31, 2006 and 2005 is as follows:

| | Years Ended December 31, | | | |
|--|--------------------------|----------|------------------|------|
| | 2006 | 2005 | Change Amount | % |
| | (in millions) | | | |
| Interest on loans and related items | Php6,254 | Php9,058 | (Php2,804) | (31) |
| Financing charges | 1,460 | 1,384 | 76 | 5 |
| Accretion on financial liabilities net | 206 | 320 | (114) | (36) |
| Capitalized interest | (301) | (419) | 118 | (28) |
| Foreign exchange gains net | (3,934) | (6,167) | 2,233 | (36) |
| | Php3,685 | Php4,176 | (Php491) | (12) |

Interest Income

Interest income generated by our fixed line business amounted to Php441 million in 2006, an increase of Php56 million, or 15%, compared to Php385 million in 2005 mainly attributable to PLDT's higher average cash balances in 2005.

Loss (Gain) on Derivative Transaction

Loss on derivative transactions amounted to Php6,900 million in 2006, an increase of Php5,217 million, or 310%, from Php1,683 million in 2005 primarily due to PLDT's mark-to-market loss from principal only swaps as a result of the peso appreciation in 2006 and lower interest differential between peso and U.S. dollar interest rates.

Other Income - Net

All other income/gains such as rental income, gain on disposal of property, which do not fall under service revenues are included under this classification. In 2006, our fixed line business segment registered an increase in other income of Php1,118 million to Php1,314 million from Php196 million in 2005 mainly due to a gain on sale of fixed assets, other property and materials in the aggregate amount of Php658 million and a gain relating to a refund from Manila Electric Company, or Meralco, of Php194 million recorded at fair value in 2006 (payable by Meralco over four years.)

Income Before Income Tax, Cumulative Effect of Change in Accounting Policy and Minority Interest in Net Income of Consolidated Subsidiaries

Our fixed line business segment registered an income before income tax, cumulative effect of change in accounting policy and minority interest in net income of consolidated subsidiaries of Php1,366 million in 2006, a decrease of Php3,839 million, or 74%, compared to Php5,205 million in 2005 mainly due to higher loss on derivative transactions partially offset by higher other income.

Provision for Income Tax

Provision for income tax amounted to Php351 million in 2006, a decrease of Php193 million, or 35%, as compared to Php544 million in 2005 primarily due to net movement in deferred tax assets owing to higher foreign exchange differentials realized in 2005.

Net Income

In 2006, our fixed line business segment contributed a net income of Php923 million, a decrease of Php3,737 million, or 80%, as compared to Php4,660 million in 2005 mainly due to higher loss on derivative transactions.

Information and Communications Technology

Operating Revenues

Our information and communications technology business is conducted by ePLDT, a wholly-owned subsidiary of PLDT.

On July 11, 2006, ePLDT acquired a 100% equity interest in SPi and its direct and indirect Philippine and offshore subsidiaries for a cash consideration of US\$135 million. SPi is the second largest pure-play BPO service provider and the ninth largest independent BPO service provider worldwide. It has operations in 19 locations in North America, Europe and Asia. On August 11, 2006, SPi acquired 100% of CyMed, Inc., a leading medical transcription company based in Richmond, Virginia.

On February 16, 2006, ePLDT acquired a 60% equity interest in Level Up!, a leading publisher of online games in the Philippines. The acquisition of Level Up!, together with netGames, ePLDT's online gaming subsidiary, is expected to strengthen ePLDT's online gaming business in the Philippines.

For further discussion, see Item 4. Information on the Company Organization, Item 4. Information on the Company Business Information and Communications Technology and Note 9 Goodwill and Other Intangible Assets to the accompanying consolidated financial statements in Item 18.

In 2006, our information and communications technology business generated revenues of Php6,890 million, an increase of Php3,585 million, or 108%, from Php3,305 million in 2005. This increase was largely due to the consolidation of SPi, CyMed and Level Up! since July 11, 2006, August 11, 2006 and February 16, 2006, respectively, and the continued increase of our call center revenues. Going forward, we expect revenues from our call center and BPO businesses to continue to contribute significantly to our information and communications technology revenues in light of the growing demand for our call center and BPO services and as a result of the full-year consolidation of SPi, CyMed and Level Up!.

The following table summarizes our total operating revenues from our information and communications technology business for the years ended December 31, 2006 and 2005 by service segment:

| | Years Ended December 31, | | | | Increase | |
|------------------------------|--------------------------|-----|----------|-----|----------|-----|
| | 2006 | % | 2005 | % | Amount | % |
| (in millions) | | | | | | |
| Service Revenues | | | | | | |
| Call center | Php2,624 | 38 | Php1,944 | 59 | Php680 | 35 |
| BPO | 2,374 | 34 | | | 2,374 | 100 |
| Internet and online gaming | 796 | 12 | 556 | 17 | 240 | 43 |
| <i>Vitro</i> ™ data center | 428 | 6 | 376 | 11 | 52 | 14 |
| Others | 115 | 2 | 77 | 2 | 38 | 49 |
| | 6,337 | 92 | 2,953 | 89 | 3,384 | 115 |
| Non-service Revenues | | | | | | |
| Point-Product Sales | 553 | 8 | 352 | 11 | 201 | 57 |
| Total Operating ICT Revenues | Php6,890 | 100 | Php3,305 | 100 | Php3,585 | 108 |

Service Revenues

Service revenues generated by our information and communications technology segment amounted to Php6,337 million in 2006, an increase of Php3,384 million, or 115%, as compared to Php2,953 million in 2005 primarily as a result of the consolidation of SPi and Level Up! and the continued growth of our call center business.

Call Center

Call center revenues consist of:

- inbound calls for customer care, product inquiries, sales and technical support based on active minutes;
- outbound calls for sales and collections based on active minutes; and
- service income for e-mail handling, web chat, web co-browsing, data entry and BPO based on transaction volume.

Revenues related to our call center business increased by Php680 million, or 35%, to Php2,624 million in 2006 from Php1,944 million in 2005, primarily due to the combined effects of the following:

- an increase in programs being handled by Vocativ from 2005 brought about by the acquisition of additional clients in 2006, as Ventus entered into an alliance with one of India's leading BPO companies to serve their voice requirements;
- an increase in the number of registered minutes for Parlance's inbound projects and hours for outbound projects;
- an increased call volume handled by Ventus due to the expansion of our domestic call center group, which currently serves internal (Smart) and external (credit card companies) clients;
- the expansion of Vocativ's existing Taguig facility by 530 seats from approximately 1,190 seats in 2005 to approximately 1,720 seats in 2006;

- the expansion of Ventus existing Iloilo facility by 130 seats from approximately 370 seats in 2005 to approximately 500 seats in 2006;
- the expansion of Ventus back-up/overflow Makati facility by 220 seats from approximately 80 seats in 2005 to approximately 300 seats in 2006, which provided capacity for seasonal requirements of Iloilo-based programs;
- the commencement of operations at the 820-seat Ventus Pasig call center in August 2006; and
- the commencement of operations at the 780-seat Parlance Libertad call center in September 2006.

Call center revenues accounted for 41% and 66% of total information and communications technology service revenues in 2006 and 2005, respectively.

Business process outsourcing

BPO revenues consist of:

- editorial and content production services to the scholarly scientific, technical and medical (SSTM) journal publishing industry;
- digital content conversion services to information incentive organizations such as online and traditional publishers, libraries, educational institutions, Global 1,000 corporations and government agencies worldwide;
- pre-press project management services to book publishers;
- litigation support services which involve conventional coding and electronic discovery support services for international law firms, corporate counsels and government agencies; and
- conversion services of medical record/data from handwritten or speech format to electronic format.

We provide our BPO services primarily through SPi and its subsidiaries, which we acquired on July 11, 2006. In 2006, BPO contributed revenues of Php2,374 million, primarily from services of SPi and its subsidiaries, and accounted for 37% of total service revenues of our information and communications technology business in 2006.

Internet and online gaming

Internet and online gaming service revenues consist of:

- revenues derived from actual usage of Internet access network by prepaid subscribers and any unused peso value of expired prepaid cards or electronic Internet time loads, net of discounts given to dealers;
- monthly service fees from postpaid corporate and consumer subscribers, including (1) charges for internet usage in excess of allocated free plan Internet hours; (2) one-time installation and activation fees; and (3) fees for value added services including e-mail and web hosting services;
- one-time fees generated from reselling Internet-related solutions such as security solutions and domain registration;
- franchise and royalty fees for *Netopia* Internet cafés, including a one-time subscription fee and monthly recurring franchise fees based on certain conditions in the franchise agreement;
- revenues from community access of computers and desktop publishing based on actual usage, net of discounts given to users; and
- online gaming revenues from unique subscribers, including one-time sale of gaming cards and electronic pins, and top-up fees upon actual consumption of gaming credits or after expiration of any unused peso value thereof.

Revenues from our Internet and online gaming businesses increased by Php240 million, or 43%, to Php796 million in 2006 from Php556 million in 2005 primarily due to the full year consolidation of Airborne Access and the consolidation of Level Up! in May 2006, which resulted in additional revenues of Php11 million and Php138 million, respectively. Our Internet and online gaming business revenues accounted for 13% and 19% of service revenues of

our information and communications technology business in 2006 and 2005, respectively.

Vitro data center

ePLDT operates an Internet data center under the brand name *Vitro* which provides co-location services, server hosting, hardware and software maintenance services, website development and maintenance services, webcasting and webhosting, shared applications, data disaster recovery and business continuity services, intrusion detection, and security services such as firewalls and managed firewalls.

Vitro revenues consist of:

- monthly service fees derived from co-location services, server hosting, hardware and software maintenance services, website development and maintenance services, web hosting, data recovery security services and other value added services; and
- installation charges and other one-time fees associated with the set-up and professional services of *Vitro*'s certified professionals.

In 2006, *Vitro* contributed revenues of Php428 million, an increase of Php52 million, or 14%, from Php376 million in 2005, primarily due to an increase in co-location revenues and server hosting. *Vitro*'s revenues accounted for 7% and 13% of service revenues of our information and communications technology business in 2006 and 2005, respectively.

Others

Other revenues consist of:

- fees generated for issuance of digital certificates and licenses; and
- revenues derived from IT helpdesk/contact center solutions and terminals for credit, debit and credit card transactions.

Revenues from other businesses related to our information and communications technology segment increased by Php38 million, or 49%, to Php115 million in 2006 from Php77 million in 2005, largely due to IT helpdesk/contact center services rendered coupled with an increase in the number of digital certificates sold.

Please refer to *Note 8 Investments* to the accompanying consolidated financial statements in Item 18 for further discussion on ePLDT's other information and communications technology services.

Non-service Revenues

Non-service revenues consist of sales generated from reselling certain software licenses, server solutions, networking products, storage products and data security products. In 2006, non-service revenues generated by our information and communications technology business increased by Php201 million, or 57%, to Php553 million as compared to Php352 million in 2005, primarily due to higher revenues from sales of networking equipment and software licenses.

Operating Expenses

Expenses associated with our information and communications technology business totaled Php7,142 million in 2006, an increase of Php3,889 million, or 120%, from Php3,253 million in 2005 primarily due to the consolidation of SPi, CyMed and Level Up! resulting primarily in an increase in compensation and benefits, and professional and other contracted services. We currently expect these expenses to be significantly higher going forward as a result of the full year consolidation of SPi, CyMed and Level Up!. As a percentage of our information and communications technology revenues, expenses related to our information and communications technology business were 104% and 98% for 2006 and 2005, respectively.

The following table shows the breakdown of our total information and communications technology-related expenses for the years ended December 31, 2006 and 2005, respectively, and the percentage of each expense item to the total:

| | Years Ended December 31, | | | | Increase | |
|---|--------------------------|----|----------|----|----------|-----|
| | 2006 | % | 2005 | % | Amount | % |
| | (in millions) | | | | | |
| Information and communications technology services: | | | | | | |
| Compensation and benefits(1) | Php3,021 | 42 | Php1,352 | 42 | Php1,669 | 123 |
| Professional and other contracted services | 739 | 10 | 82 | 3 | 657 | 801 |
| Depreciation and amortization | 711 | 10 | 415 | 13 | 296 | 71 |

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| | | | | | | |
|------------------------------------|----------|-----|----------|-----|----------|------|
| Cost of sales point-product | 476 | 7 | 300 | 9 | 176 | 59 |
| Rent | 444 | 6 | 362 | 11 | 82 | 23 |
| Asset impairment | 408 | 6 | 11 | | 397 | 3609 |
| Repairs and maintenance | 368 | 5 | 283 | 9 | 85 | 30 |
| Selling and promotions | 294 | 4 | 121 | 4 | 173 | 143 |
| Communication, training and travel | 276 | 4 | 98 | 3 | 178 | 182 |
| Amortization of intangible assets | 130 | 2 | 15 | | 115 | 767 |
| Taxes and licenses | 67 | 1 | 36 | 1 | 31 | 86 |
| Provision for doubtful accounts | 64 | 1 | 54 | 2 | 10 | 19 |
| Insurance and security services | 33 | | 14 | | 19 | 136 |
| Other operating expenses | 111 | 2 | 110 | 3 | 1 | 1 |
| Total | Php7,142 | 100 | Php3,253 | 100 | Php3,889 | 120 |

(1) Includes salaries and benefits, incentive plan, pension and MRP costs.

Compensation and benefits increased by Php1,669 million, or 123%, to Php3,021 million largely due to the increased number of employees and corresponding salaries and employee benefits resulting from the expansion of our call center businesses and the consolidation of SPi and Level Up! in 2006. ePLDT's employee headcount increased by 9,558, or 208%, to 14,150 in 2006 from 4,592 in 2005. The increase in the number of employees as at December 31, 2006 was primarily due to ePLDT's acquisition of SPi, CyMed and Level Up!.

Professional and other contracted services increased by Php657 million, or 801%, to Php739 million primarily due to services sub-contracted by SPi from third parties related to its BPO services.

Depreciation and amortization charges increased by Php296 million, or 71%, to Php711 million primarily due to an increase in the depreciable asset base in relation to the expansion of our call center businesses and the consolidation of SPi in July 2006.

Cost of sales increased by Php176 million, or 59%, to Php476 million primarily due to an increase in the cost of point products sold in 2006.

Rent expenses increased by Php82 million, or 23%, to Php444 million primarily due to the opening of two additional call center sites in 2006 which led to increased rental of leased circuits.

Asset impairment increased by Php397 million to Php408 million primarily due to the impairment of ePLDT's notes receivable from Technology Support Services, Inc. Please see *Note 8 Investments Investment of ePLDT in Debt Securities of Technology Support Services, Inc., or TSSI (formerly First Advance Multi-Media Entertainment Corp., or FAME)* to the accompanying consolidated financial statements in Item 18 for further discussion.

Repairs and maintenance expenses increased by Php85 million, or 30%, to Php368 million primarily due to higher hosting-related costs incurred in 2006 as compared to 2005 partially offset by Vitro's lower hardware and server maintenance costs.

Selling and promotions expenses increased by Php173 million, or 143%, to Php294 million mainly due to higher advertising and marketing spending of netGames and Level Up!

Communication, training and travel expenses increased by Php178 million, or 182%, to Php276 million, primarily due to the increased cost of phone lines, bandwidth and information system charges, coupled with the increase in foreign and local travel costs incurred by our call center and BPO businesses.

An amortization of intangible assets amounting to Php130 million and Php15 million were recognized in 2006 and 2005, respectively. Amortization of intangibles in 2006 resulted primarily from the acquisition of SPi and Level Up!, while amortization of intangibles in 2005 resulted from the impairment of goodwill of ePLDT's investment in Netopia. See *Note 9 Goodwill and Other Intangible Assets* to the accompanying consolidated financial statements in Item 18 for further discussion.

Taxes and licenses increased by Php31 million, or 86%, to Php67 million due to higher business-related taxes accrued and paid in 2006 as compared to 2005.

Provision for doubtful accounts increased by Php10 million, or 19%, to Php64 million mainly due to anticipated uncollectible accounts specifically identified in 2006.

Insurance and security services increased by Php19 million, or 136%, to Php33 million primarily due to higher premium costs and an increase in the value of assets insured in 2006 as compared to 2005.

Other operating expenses increased by Php1 million, or 1%, to Php111 million mainly due to higher business-related costs.

Financing Costs

Financing costs increased by Php79 million, or 146%, to Php133 million, primarily due to the consolidation of SPi in July 2006.

Provision for Income Tax

Benefit from income tax amounted to Php34 million in 2006 primarily due to the recognition of deferred tax assets pertaining to accrued pension cost, net operating loss carry-over and allowance for doubtful accounts, as compared to a provision for income tax of Php20 million in 2005.

Net Income (Loss)

In 2006, our information and communications technology business segment registered a net loss of Php243 million as against a net income of Php113 million in 2005 mainly as a result of a 120% increase in ICT-related expenses and the recent opening of two call centers, partly offset by the increase in ICT revenues mainly from our call center business and the consolidation of SPi.

2005 Compared to 2004

On a Consolidated Basis

Consolidated Operating Revenues

Largely driven by the growth of our wireless business, our consolidated operating revenues for 2005 increased by Php2,162 million, or 2%, to Php123,335 million in 2005 from Php121,173 million in 2004. This increase was lower than the increase in our consolidated operating revenues in 2004, primarily due to the reduced growth of our cellular subscriber base in 2005 compared to 2004. The revenue contribution of our wireless business accounted for 62% of our consolidated operating revenues for 2005 and 2004.

The following table shows the breakdown of our consolidated operating revenues for the years ended December 31, 2005 and 2004 by business segment:

| | Years Ended December 31, | | | | Change | |
|---|--------------------------|-----|------------|-----|----------|----|
| | 2005 | % | 2004 | % | Amount | % |
| | (in millions) | | | | | |
| Wireless | Php76,906 | 62 | Php74,764 | 62 | Php2,142 | 3 |
| Fixed line | 49,472 | 40 | 48,546 | 40 | 926 | 2 |
| Information and communications technology | 3,305 | 3 | 2,401 | 2 | 904 | 38 |
| Inter-segment revenues | (6,348) | (5) | (4,538) | (4) | (1,810) | 40 |
| Total | Php123,335 | 100 | Php121,173 | 100 | Php2,162 | 2 |

Consolidated Operating Expenses

Our consolidated operating expenses in 2005 increased by Php2,187 million, or 3%, to Php74,821 million from Php72,634 million in 2004. The increase was primarily due to higher operating expenses associated with our fixed line business and our information and communications technology business, partially offset by a decrease in operating expenses associated with our wireless business. As a percentage of our consolidated operating revenues, consolidated operating expenses increased to 61% from 60% in 2004.

The following table shows the breakdown of our consolidated operating expenses for the years ended December 31, 2005 and 2004 by business segment:

| | Years Ended December 31, | | | | Change | |
|---|--------------------------|-----|-----------|-----|------------|-----|
| | 2005 | % | 2004 | % | Amount | % |
| | (in millions) | | | | | |
| Wireless | Php39,436 | 53 | Php41,598 | 57 | (Php2,162) | (5) |
| Fixed line | 38,989 | 52 | 32,027 | 44 | 6,962 | 22 |
| Information and communications technology | 3,253 | 4 | 3,035 | 4 | 218 | 7 |
| Inter-segment revenues | (6,857) | (9) | (4,026) | (5) | (2,831) | 70 |
| Total | Php74,821 | 100 | Php72,634 | 100 | Php2,187 | 3 |

Consolidated Operating Income

Our consolidated operating income in 2005 was Php48,514 million, a decrease of Php25 million compared to Php48,539 million in 2004 as a result of a 3% increase in our consolidated operating expenses which more than offset the 2% increase in our consolidated operating revenues.

Consolidated Financing Costs

Financing costs on a consolidated basis decreased by Php12,810 million, or 79%, to Php3,423 million primarily due to foreign exchange gains pertaining to the foreign exchange revaluation of the carrying values of financial liabilities as against a loss on foreign exchange revaluation in 2004 owing to the peso appreciation in 2005. This decrease was complemented by lower interest expense and related items owing to lower debt balances in 2005 compared with 2004.

Consolidated Interest Income

Interest income on a consolidated basis increased by Php515 million, or 55%, to Php1,457 million in 2005 from Php942 million in 2004 mainly attributable to higher average cash balances.

Consolidated Loss (Gain) on Derivative Transactions

Loss on derivative transactions on a consolidated basis amounted to Php1,801 million in 2005, an increase of Php937 million, or 108%, compared to Php864 million in 2004 primarily due to mark-to-market loss from interest rate swap and bifurcated equity call options partially offset by gains from long-term currency swaps and long-term foreign currency options.

Consolidated Other Income - Net

Other income on a consolidated basis totaled Php1,016 million in 2005, a decrease of Php1,514 million, or 60%, compared to Php2,530 million in 2004. The decrease was mainly due to the recognition of a gain on debt restructuring transaction conducted by Smart in 2004 pertaining to a wireless business with no similar gain in 2005.

Consolidated Income Before Income Tax, Cumulative Effect of Change in Accounting Policy and Minority Interest in Net Loss (Income) of Consolidated Subsidiaries

Our income before income tax, cumulative effect of change in accounting policy and minority interest in net loss (income) of consolidated subsidiaries in 2005 was Php45,770 million, an increase of Php10,930 million, or 31%, from Php34,840 million in 2004, primarily due to the significant decline in our financing costs owing to substantial foreign

exchange gains recognized in 2005.

Provision for Income Tax

Provision for income tax decreased by Php1,977 million, or 29%, to Php4,849 million in 2005 compared to Php6,826 million in 2004 mainly due to lower non-tax deductible charges and the net movement in deferred tax assets as previously unrecognized deferred tax assets were taken-up in 2005 with the increased likelihood that Smart and Piltel would be able to realize the future tax benefits on these assets.

Consolidated Net Income

As a result, our consolidated net income in 2005 was Php40,603 million, an increase of Php12,502 million, or 44%, compared to Php28,101 million in 2004. The following table shows the breakdown of our consolidated net income (loss) for the years ended December 31, 2005 and 2004 by business segment:

| | Years Ended December 31, | | | | | |
|---|--------------------------|-----|-----------|-----|------------------|-----|
| | 2005 | % | 2004 | % | Change Amount | % |
| | (in millions) | | | | | |
| Wireless | Php35,830 | 88 | Php27,559 | 98 | Php8,271 | 30 |
| Fixed line | 4,660 | 12 | 1,241 | 4 | 3,419 | 276 |
| Information and communications technology | 113 | | (699) | (2) | 812 | 116 |
| Total | Php40,603 | 100 | Php28,101 | 100 | Php12,502 | 44 |

On Business Segment Basis

Wireless

Operating Revenues

Our wireless business segment offers cellular services as well as wireless broadband, satellite, VSAT and other services.

The following table summarizes our total operating service and non-service revenues from our wireless business for the years ended December 31, 2005 and 2004 by service segment:

| | Years Ended December 31, | | | | Increase (Decrease) | |
|--|--------------------------|-----|-----------|-----|------------------------|------|
| | 2005 | % | 2004 | % | Amount | % |
| (in millions) | | | | | | |
| Wireless services: | | | | | | |
| Service Revenues | | | | | | |
| Cellular | Php71,518 | 93 | Php66,421 | 89 | Php5,097 | 8 |
| Wireless broadband, satellite, VSAT and others | 2,677 | 3 | 2,232 | 3 | 445 | 20 |
| | 74,195 | 96 | 68,653 | 92 | 5,542 | 8 |
| Non-service Revenues | | | | | | |
| Sale of cellular handsets and SIM-packs | 2,711 | 4 | 6,111 | 8 | (3,400) | (56) |
| Total Wireless Operating Revenues | Php76,906 | 100 | Php74,764 | 100 | Php2,142 | 3 |

Service Revenues

Our wireless service revenues increased by Php5,542 million, or 8%, to Php74,195 million in 2005 compared to Php68,653 million in 2004 mainly as a result of the continued growth of Smart's and Piltel's subscriber base. However, the growth in Smart's and Piltel's subscriber base in 2005 was lower than the increases in Smart's and Piltel's subscriber base of 48% and 51% in 2004 and 2003, respectively. As a percentage of our total wireless operating revenues, wireless service revenues increased to 96% in 2005 from 92% in 2004.

Cellular Service

Unless otherwise indicated, the financial data and operating metrics cited in the cellular service section reflect the consolidated results of our cellular subsidiary, Smart and its subsidiary, Piltel.

Our cellular service revenues in 2005 amounted to Php71,518 million, an increase of Php5,097 million, or 8%, from Php66,421 million in 2004. Cellular service revenues accounted for 93% and 89% of our total wireless operating revenues in 2005 and 2004, respectively. The increase in cellular service revenues was primarily due to the continued growth of Smart's and Piltel's subscriber base. As at December 31, 2005, the combined cellular subscribers of Smart and Piltel reached 20,408,621, an increase of 1,200,389, or 6%, over their combined cellular subscriber base of 19,208,232 as at December 31, 2004. Prepaid and postpaid net subscriber activations totaled 1,194,805 and 5,584, respectively, in 2005. However, the growth in Smart's and Piltel's subscriber base in 2005 was lower than the increases

in Smart's and Piltel's subscriber base of 48% and 51% in 2004 and 2003, respectively.

The table below shows our cellular subscribers base as at December 31, 2005 and 2004:

| | As at December 31, | | Increase | |
|--------------------------|--------------------|------------|-----------|---|
| | 2005 | 2004 | Amount | % |
| Cellular subscriber base | 20,408,621 | 19,208,232 | 1,200,389 | 6 |
| Prepaid | 20,128,543 | 18,933,738 | 1,194,805 | 6 |
| Smart | 15,144,118 | 14,321,288 | 822,830 | 6 |
| Piltel | 4,984,425 | 4,612,450 | 371,975 | 8 |
| Postpaid | 280,078 | 274,494 | 5,584 | 2 |

Of our 20,408,621 subscribers as at December 31, 2005, prepaid subscribers accounted for approximately 99% while postpaid subscribers accounted for the remaining 1%. Our cellular prepaid subscriber base grew by 6% to 20,128,543 as at December 31, 2005 from 18,933,738 as at December 31, 2004, whereas our postpaid subscriber base increased by 2% to 280,078 as at December 31, 2005 from 274,494 as at December 31, 2004. Smart's prepaid and postpaid net subscriber activations totaled 822,830 and 5,584, respectively, in 2005, or a quarterly average addition of 205,707 prepaid and 1,396 postpaid subscribers. On the other hand, Piltel's prepaid subscribers increased by 8% to 4,984,425 as at December 31, 2005 from 4,612,450 as at December 31, 2004, or a quarterly average addition of 92,994 subscribers. Postpaid subscribers as at December 31, 2005 were higher than as at December 31, 2004 primarily due to increased net activations in the last two quarters of 2005.

Our quarterly net subscriber activations (reductions) over the eight quarters in 2005 and 2004 are as follows:

| | Prepaid | | Postpaid | Total |
|----------------|-----------|----------|----------|-----------|
| | Smart | Piltel | Smart | |
| 2005 | | | | |
| First Quarter | 920,885 | 129,753 | (6,357) | 1,044,281 |
| Second Quarter | 314,607 | 222,233 | 116 | 536,956 |
| Third Quarter | (53,953) | 42,723 | 10,506 | (724) |
| Fourth Quarter | (358,709) | (22,734) | 1,319 | (380,124) |
| 2004 | | | | |
| First Quarter | 1,162,301 | 218,038 | 16,866 | 1,397,205 |
| Second Quarter | 1,207,542 | 468,772 | 7,691 | 1,684,005 |
| Third Quarter | 797,686 | 635,978 | 10,445 | 1,444,109 |
| Fourth Quarter | 1,322,624 | 422,577 | (9,485) | 1,735,716 |

Wireless Broadband, Satellite, VSAT and Other Services

Our revenues from wireless broadband, satellite, VSAT and other services consist mainly of rentals received for the lease of Mabuhay Satellite's transponders and Telesat's VSAT facilities to other companies and wireless broadband service revenues from Smart Broadband, charges for ACeS Philippines' satellite phone service and service revenues from PLDT Global subsidiary's mobile virtual network operations. Smart Broadband offers a number of wireless broadband services with 25,428 subscribers as of December 31, 2005, including 21,759 *Smart WiFi* subscribers.

Gross service revenues from these services for 2005 amounted to Php2,677 million, an increase of Php445 million, or 20%, from Php2,232 million in 2004. This increase was primarily due to the growth in our wireless broadband business.

Non-service Revenues

Our wireless non-service revenues decreased by Php3,400 million, or 56%, to Php2,711 million in 2005 as compared to Php6,111 million in 2004 mainly attributable to lower handset sales due to the fact that activations in 2005 were primarily driven by more SIM-pack sales and SIM-swap activities up to May 2005.

Operating Expenses

Operating expenses associated with our wireless business in 2005 amounted to Php39,436 million, a decrease of Php2,162 million, or 5%, from Php41,598 million in 2004. A significant portion of this decrease was mainly attributable to decreases in costs of cellular handsets and SIM-packs sold and selling and promotion, partially offset by higher rent, and professional and other contracted services. As a percentage of our total wireless operating revenues, operating expenses associated with our wireless business decreased to 51% in 2005 from 56% in 2004.

Cellular business expenses accounted for 94% while wireless broadband, satellite, VSAT and other business expenses accounted for 6% of our wireless business expenses in 2005, compared to 93% and 7%, respectively, in 2004.

The following table summarizes our wireless-related expenses for the years ended December 31, 2005 and 2004 and the percentage of each expense item to the total:

Years Ended December 31,

| | 2005 | % | 2004 | % | Increase (Decrease) Amount % | |
|---|---------------|-----|-----------|-----|------------------------------------|-------|
| | (in millions) | | | | | |
| Wireless services | | | | | | |
| Depreciation and amortization | Php9,200 | 23 | Php10,082 | 24 | (Php882) | (9) |
| Costs of cellular handsets and SIM-packs sold | 5,827 | 15 | 10,599 | 25 | (4,772) | (45) |
| Rent | 5,577 | 14 | 4,156 | 10 | 1,421 | 34 |
| Compensation and benefits(1) | 4,245 | 11 | 3,195 | 8 | 1,050 | 33 |
| Repairs and maintenance | 3,667 | 9 | 2,597 | 6 | 1,070 | 41 |
| Selling and promotions | 3,124 | 8 | 4,261 | 10 | (1,137) | (27) |
| Professional and other contracted services | 1,608 | 4 | 472 | 1 | 1,136 | 241 |
| Taxes and licenses | 1,538 | 4 | 1,214 | 3 | 324 | 27 |
| Cost of satellite air time | 1,008 | 3 | 1,299 | 3 | (291) | (22) |
| Communication, training and travel | 960 | 2 | 791 | 2 | 169 | 21 |
| Insurance and security services | 947 | 2 | 937 | 2 | 10 | 1 |
| Provision for inventory obsolescence | 322 | 1 | 213 | 1 | 109 | 51 |
| Provision for doubtful accounts | 253 | 1 | 204 | 1 | 49 | 24 |
| Amortization of intangible assets | 189 | 1 | 93 | | 96 | 103 |
| Asset impairment | | | 430 | 1 | (430) | (100) |
| Other operating expenses | 971 | 2 | 1,055 | 3 | (84) | (8) |
| Total | Php39,436 | 100 | Php41,598 | 100 | (Php2,162) | (5) |

(1) Includes salaries and benefits, incentive plan, pension and manpower rightsizing program, or MRP, costs.

Depreciation and amortization charges decreased by Php882 million, or 9%, to Php9,200 million substantially due to a decrease in the depreciable asset base as certain of our wireless assets were fully depreciated by the end of 2005.

Costs of cellular handsets and SIM-packs sold decreased by Php4,772 million, or 45%, to Php5,827 million as activations in 2005 were primarily driven by more SIM-pack sales and SIM-swap activities compared to handset sales in 2004.

Rent expenses increased by Php1,421 million, or 34%, to Php5,577 million on account of an increase in the number of DFON facilities leased by Smart from PLDT and site rental expense. As at December 31, 2005, we had 4,305 cell sites and 5,982 base stations, compared with 3,951 cell sites and 5,303 base stations as at December 31, 2004.

Compensation and benefits increased by Php1,050 million, or 33%, to Php4,245 million primarily due to salary increases and higher long-term incentive costs of Smart. On the other hand, Smart's employee headcount decreased by 3% to 5,087 as at December 31, 2005 from 5,239 as at December 31, 2004.

Repairs and maintenance expenses increased by Php1,070 million, or 41%, to Php3,667 million mainly on account of higher repairs and maintenance costs, and higher site electricity and power generation expenses due to, and in line with, the continued growth in the number of cell sites and other network facilities.

Selling and promotions expenses decreased by Php1,137 million, or 27%, to Php3,124 million due to efficient media spending and termination of certain media contracts in 2005.

Professional and other contracted services increased by Php1,136 million, or 241%, to Php1,608 million mainly as a result of increased legal, technical service, and call center and payment facilities fees.

Taxes and licenses increased by Php324 million, or 27%, to Php1,538 million mainly due to an increase in Smart's business-related taxes.

Cost of satellite air time decreased by Php291 million, or 22%, to Php1,008 million due to a change in the basis of recognizing air time cost. In 2004, satellite air time cost was accrued at a fixed amount per month based on the payment schedule in a standstill agreement in consideration for unlimited air time access. In 2005, upon the termination of the standstill agreement, air time cost was reverted to the original charging rate on a per minute basis. This was agreed to be the basis of air time cost until a new agreement is finalized.

Communication, training and travel increased by Php169 million, or 21%, to Php960 million due to higher local travel and training costs, as well as an increase in delivery, freight and hauling expenses incurred in 2005.

Insurance and security services increased by Php10 million, or 1%, to Php947 million mainly due to the increase in our number of cell sites and in the amount of network equipment insured as a result of, and in line with, the continued growth and expansion of our network.

Provision for inventory obsolescence increased by Php109 million, or 51%, to Php322 million, primarily due to slow sales of handsets relating to ACeS Philippines in 2005.

Provision for doubtful accounts increased by Php49 million, or 24%, to Php253 million in 2005 mainly due to a net reversal of provisions for carrier accounts in 2004 following subsequent collections from such carrier accounts.

Amortization of intangible assets increased by Php96 million, or 103%, to Php189 million in 2005, primarily due to the full year effect of the amortization of intangibles incurred in acquiring equity interests in Smart Broadband and Wolfpac by Smart in 2004.

No impairment charges were recognized in 2005. Asset impairment charges amounted to Php430 million in 2004 due to impairment losses recognized in respect of Mabuhay Satellite's investment in an investee company.

Other operating expenses decreased by Php84 million, or 8%, to Php971 million due to a decrease in various business and operational-related expenses such as office supplies expense.

Operating Income

Operating income from our wireless business amounted to Php37,470 million in 2005, an increase of Php4,304 million, or 13%, from Php33,166 million in 2004, which was primarily due to increased revenues, mainly from our cellular services, complemented by lower operating expenses.

Financing Costs

Financing gains associated with our wireless business amounted to Php807 million in 2005 compared to financing costs of Php2,292 million in 2004 primarily due to foreign exchange gains as a result of the 6% and 18% level of appreciation of the Philippine peso to the U.S. dollar and Japanese yen, respectively, from December 31, 2004 to December 31, 2005 compared to foreign exchange losses in 2004. Foreign exchange losses recorded in 2004 with the peso depreciation of 1% against the U.S. dollar, aggravated by the peso depreciation with approximately 6% against the Japanese yen from December 31, 2004, amounted to Php423 million. In addition, lower debt balances in 2005 also contributed to decreased interest expense on loans. The breakdown of our financing costs for our wireless business for the years ended December 31, 2005 and 2004 is as follows:

| | Years Ended December 31, | | | |
|-------------------------------------|--------------------------|----------|------------------|-------|
| | 2005 | 2004 | Change Amount | % |
| | (in millions) | | | |
| Interest on loans and related items | Php1,037 | Php1,082 | (Php45) | (4) |
| Accretion on financial liabilities | 248 | 884 | (636) | (72) |
| Financing charges | 52 | 1 | 51 | 5,100 |
| Capitalized interest | (85) | (98) | 13 | (13) |
| Foreign exchange (gains) losses net | (2,059) | 423 | (2,482) | (587) |
| | (Php807) | Php2,292 | (Php3,099) | (135) |

Interest Income

Interest income generated by our wireless business amounted to Php1,057 million in 2005, an increase of Php333 million, or 46%, compared to Php724 million in 2004 mainly attributable to Smart's higher average cash balances.

Loss (Gain) on Derivative Transactions

Loss on derivative transactions amounted to Php118 million in 2005, an increase of Php125 million, from a gain on derivative transactions of Php7 million in 2004 primarily due to mark-to-market loss from Smart's forward foreign exchange contracts as a result of the peso appreciation.

Other Income - Net

Our wireless business segment generated other income - net of Php1,292 million in 2005, a decrease of Php638 million, or 33%, from Php1,930 million in 2004. This decrease was primarily a result of a Php2,820 million gain on a debt restructuring transaction conducted by Smart in 2004 pertaining to our wireless business. See *Note 12 Interest-bearing Financial Liabilities - Term Loans - US\$283 Million Term Loan Facility, or Debt Exchange Facility* to the accompanying consolidated financial statement in Item 18.

Income Before Income Tax, Cumulative Effect of Change in Accounting Policy and Minority Interest in Net Income (Loss) of Consolidated Subsidiaries

Income before income tax, cumulative effect of change in accounting policy and minority interest in net income (loss) of consolidated subsidiaries increased by Php7,045 million, or 21%, to Php40,508 million in 2005 compared to Php33,463 million in 2004, mainly due to a 3% increase in wireless operating revenues, principally from our cellular business, resulting from the continued cellular subscriber growth, as well as a decrease in our wireless business expenses of 5% in 2005.

Provision for Income Tax

Provision for income tax decreased by Php1,682 million, or 28%, to Php4,285 million in 2005 from Php5,967 million in 2004 mainly due to lower non-tax deductible charges and the net movement in deferred tax assets as previously unrecognized deferred tax assets were taken-up in 2005 with the increased likelihood that Smart and Piltel would be able to realize the future tax benefits on these assets. We currently expect that our effective corporate tax rate will be higher going forward than in previous years due to the expiration of Smart's income tax holiday.

Net Income

Our wireless business segment recorded a net income of Php35,830 million in 2005, an increase of Php8,271 million, or 30%, over Php27,559 million registered in 2004 primarily due to the 6% growth in our cellular subscriber base, complemented by a 5% decrease in wireless expenses.

Fixed Line

Operating Revenues

Operating revenues generated from our fixed line business for 2005 totaled Php49,472 million, an increase of Php926 million, or 2%, from Php48,546 million in 2004. This increase was primarily due to higher revenues generated from data and other network services, and miscellaneous revenues, which was partially offset by decreased revenues from national long distance services, international long distance services and local exchange service. As a percentage of our total operating revenues, fixed line revenues decreased to 38% in 2005 from 39% in 2004, principally due to the continued growth of our wireless business.

The following table summarizes total operating revenues from our fixed line business for the years ended December 31, 2005 and 2004, respectively, by service segment:

| | Years Ended December 31, | | | | Increase (Decrease) | |
|-----------------------------|--------------------------|----|-----------|----|------------------------|------|
| | 2005 | % | 2004 | % | Amount | % |
| | (in millions) | | | | | |
| Fixed line services: | | | | | | |
| Service Revenues | | | | | | |
| Local exchange | Php20,229 | 41 | Php20,606 | 42 | (Php377) | (2) |
| International long distance | 12,245 | 25 | 12,804 | 26 | (559) | (4) |
| National long distance | 5,254 | 11 | 6,736 | 14 | (1,482) | (22) |
| Data and other network | 10,394 | 21 | 7,114 | 15 | 3,280 | 46 |

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| | | | | | | |
|-------------------------------------|-----------|-----|-----------|-----|--------|-----|
| Miscellaneous | 1,309 | 2 | 1,286 | 3 | 23 | 2 |
| | 49,431 | 100 | 48,546 | 100 | 885 | 2 |
| Non-Service Revenues | | | | | | |
| Sale of cellular handsets | 41 | | | | 41 | 100 |
| Total Fixed Line Operating Revenues | Php49,472 | 100 | Php48,546 | 100 | Php926 | 2 |

Service Revenues

Local Exchange Service

The following table summarizes key measures of our local exchange service business segment as at and for the years ended December 31, 2005 and 2004, respectively:

| | Years Ended December 31, | | |
|--|--------------------------|-----------|------------------------------------|
| | 2005 | 2004 | Increase (Decrease) Amount % |
| Consolidated local exchange service revenues (in millions) | Php20,229 | Php20,606 | (Php377) (2) |
| Number of fixed line subscribers | 1,842,507 | 1,834,306 | 8,201 |
| Number of fixed line employees | 9,197 | 9,692 | (495) (5) |
| Number of fixed line subscribers per employee | 200 | 189 | 11 6 |

Revenues from our local exchange service in 2005 decreased by Php377 million, or 2%, to Php20,229 million from Php20,606 million in 2004. The decrease was primarily due to a decline in the number of fixed line subscribers and the appreciation of the peso against U.S. dollars which required us to make downward adjustments in our monthly local service rates, which was partially offset by adjustments in our monthly local service rates. The percentage contribution of local exchange revenues to our total fixed line service revenues decreased to 41% in 2005 from 42% in 2004.

As at December 31, 2005, postpaid and prepaid fixed line subscribers totaled 1,453,297 and 389,210, respectively, which accounted for approximately 79% and 21%, respectively, of our total fixed line subscribers.

Pursuant to a currency exchange rate adjustment mechanism authorized by the NTC, we adjust our monthly local service rates upward or downward by 1% for every Php0.10 change in the peso-to-U.S. dollar exchange rate relative to a base rate of Php11.00 to US\$1.00. During 2005, we implemented six downward and three upward adjustments in our monthly local service rates compared to six upward and one downward adjustments in 2004. The average

peso-to-U.S. dollar rate factored in our monthly local service rates in 2005 was Php55.21 to US\$1.00, compared to the average of Php55.89 to US\$1.00 in 2004. This change in the average peso-to-U.S. dollar rate translated to a peso appreciation of 2%, which resulted in an average net decrease of 1% in our monthly local service rates in 2005.

International Long Distance Service

The following table shows information about our international fixed line long distance business for the years ended December 31, 2005 and 2004, respectively:

| | Years Ended December 31, | | | |
|--|---------------------------------|-------------|-----------------|----------|
| | 2005 | 2004 | Decrease | |
| | | | Amount | % |
| Total international long distance service revenues (in millions) | Php12,245 | Php12,804 | (Php559) | (4) |
| Inbound | 10,203 | 10,686 | (483) | (5) |
| Outbound | 2,042 | 2,118 | (76) | (4) |
| International call volumes (in million minutes, except call ratio) | 2,266 | 2,373 | (107) | (5) |
| Inbound | 2,117 | 2,216 | (99) | (4) |
| Outbound | 149 | 157 | (8) | (5) |
| Inbound-outbound call ratio | 14.2:1 | 14.1:1 | | |

Our total international long distance service revenues decreased by Php559 million, or 4%, to Php12,245 million in 2005 from Php12,804 million in 2004 primarily due to the peso appreciation coupled with the decrease in call volumes largely as a result of alternative means of communications such as e-mailing, texting and Internet telephony. The percentage contribution of international long distance service revenues to our fixed line service revenues decreased to 25% in 2005 from 26% in 2004.

Our revenues from inbound international long distance service decreased by Php483 million due to a decrease in inbound traffic volume by 99 million minutes to 2,117 million minutes in 2005. In addition, the 2% appreciation in the average value of peso to U.S. dollar to Php55.006 during 2005 from Php56.149 during 2004 contributed to the decrease in our inbound international long distance revenues in peso terms since settlement charges for inbound calls are billed in U.S. dollars or in special drawing rights, an established method of settlement among international telecommunications carriers using values based on a basket of foreign currencies that are translated into pesos at the time of billing.

Our revenues from outbound international long distance calls in 2005 decreased by Php76 million, or 4%, to Php2,042 million from Php2,118 million in 2004. The decrease resulted from lower conversion rates used as average billing rates were Php55.30 and Php55.98 in 2005 and 2004, respectively.

Our outbound international long distance call volumes declined by 5% to 149 million minutes in 2005 from 157 million minutes in 2004, primarily due to cellular substitution (subscribers opting to use cellular for international outbound calls) and the popularity of alternative means of communications such as e-mailing, international text messaging and Internet telephony.

National Long Distance Service

The following table shows our national long distance service revenues and call volumes for the years ended December 31, 2005 and 2004, respectively:

| | Years Ended December 31, | | | |
|---|---------------------------------|-------------|---|----------|
| | 2005 | 2004 | Increase (Decrease) Amount | % |
| Total national long distance service revenues (in millions) | Php5,254 | Php6,736 | (Php1,482) | (22) |
| National long distance call volumes (in million minutes) | 2,348 | 1,930 | 418 | 22 |

Our national long distance service revenues decreased by Php1,482 million, or 22%, to Php5,254 million in 2005 from Php6,736 million in 2004 as a result of: (1) a decrease in average revenue per minute due to our fixed rate per call promotion starting February 14, 2005; and (2) the integration of local exchanges into a single calling area, which resulted in calls between two exchanges located within the same province no longer being considered as national long distance calls, but rather as local calls. Accordingly, the percentage contribution of national long distance revenues to our fixed line service revenues decreased to 11% in 2005 compared to 14% in 2004.

Our national long distance call volumes increased by approximately 22% to 2,348 million minutes in 2005 from 1,930 million minutes in 2004. This was mainly due to the Php10 per call promotion offered to PLDT fixed line subscribers nationwide.

The integration of some of our local exchanges into a single local calling area, as approved by the NTC, also negatively affected our national long distance call volumes, and consequently, our revenues. Because of this integration, calls between two exchanges located within the same province are no longer considered national long distance calls but are treated as local calls.

Data and Other Network Services

Our data and other network services in 2005 generated revenues of Php10,394 million, an increase of Php3,280 million, or 46%, from Php7,114 million in 2004, which was primarily due to increases in revenues generated in leased lines and IP-based data services, particularly Diginet and DSL. The revenue contribution of this service segment to our fixed line service revenues increased to 21% in 2005 from 15% in 2004.

Data and other network services we currently provide include leased lines, IP-based, packet-based and switch-based services. These services are used for domestic and international communications such as private networking, broadband and narrowband Internet-based data communications, and packet-based communication.

Of our total revenues generated in data and other network services in 2005, leased lines accounted for 55%, IP-based services accounted for 29%, packet-based services accounted for 11% and switched-based services accounted for the remaining 5%, compared to 56%, 25%, 13% and 6%, respectively, in 2004. These percentage increases indicate a continuing demand for broadband services, particularly the high bandwidth clear data requirements of BPOs and call centers. We expect this trend to continue due to growth in the areas of e-commerce, online services and BPOs particularly among call centers, medical transcription, animation and shared services.

The continued growth in data services revenues can be attributed to several product offerings. The steady demand for dedicated connectivity or private networking from the corporate market using PLDT's traditional bandwidth offerings Fibernet, Arcstar, Acacia, I-Gate, Diginet, BRAINS, among others continues to provide us with a stable revenue source. In addition, we provide Smart's increasing fiber optic and leased line data requirements, which are included under our national data services.

Miscellaneous

Miscellaneous service revenues are derived mostly from directory advertising and facilities rental. In 2005, these revenues increased by Php23 million, or 2%, to Php1,309 million from Php1,286 million in 2004. The improvement was mainly due to an increase in co-location charges from more co-location sites coupled with an increase in rent income on duct utilization and cable restoration. The percentage contribution of miscellaneous service revenues to our fixed line service revenues decreased to 2% in 2005 from 3% in 2004.

Operating Expenses

Operating expenses related to our fixed line business in 2005 totaled Php38,989 million, an increase of Php6,962 million, or 22%, compared to Php32,027 million in 2004. The increase was primarily due to higher depreciation and amortization and higher selling and promotions expenses which were partially offset by lower provision for doubtful

accounts expense.

The following table sets forth the breakdown of our total fixed line-related expenses for the years ended December 31, 2005 and 2004, respectively, and the percentage of each expense item to the total:

| | Years Ended December 31, | | | | Increase (Decrease) | |
|--|--------------------------|-----|-----------|-----|------------------------|-------|
| | 2005 | % | 2004 | % | Amount | % |
| | (in millions) | | | | | |
| Fixed line services: | | | | | | |
| Depreciation and amortization | Php18,240 | 47 | Php9,677 | 30 | Php8,563 | 88 |
| Compensation and benefits(1) | 8,261 | 21 | 7,921 | 25 | 340 | 4 |
| Repairs and maintenance | 3,297 | 9 | 3,211 | 10 | 86 | 3 |
| Provision for doubtful accounts | 1,944 | 5 | 3,751 | 12 | (1,807) | (48) |
| Rent | 1,727 | 4 | 1,746 | 5 | (19) | (1) |
| Selling and promotions | 1,535 | 4 | 1,159 | 4 | 376 | 32 |
| Professional and other contracted services | 1,039 | 3 | 1,060 | 3 | (21) | (2) |
| Taxes and licenses | 942 | 2 | 820 | 3 | 122 | 15 |
| Insurance and security services | 628 | 2 | 700 | 2 | (72) | (10) |
| Communication, training and travel | 447 | 1 | 449 | 1 | (2) | |
| Provision for inventory obsolescence | 157 | | 361 | 1 | (204) | (57) |
| Cost of computers sold | 53 | | | | 53 | 100 |
| Asset impairment | | | 365 | 1 | (365) | (100) |
| Other operating expenses | 719 | 2 | 807 | 3 | (88) | (11) |
| Total | Php38,989 | 100 | Php32,027 | 100 | Php6,962 | 22 |

(1) Includes salaries and benefits, incentive plan, pension and MRP costs.

Depreciation and amortization charges increased by Php8,563 million, or 88%, to Php18,240 million mainly due to the effect of our change in estimated useful lives of certain property, plant and equipment in line with our continuous network upgrade and expansion, which resulted in increased depreciation charges for 2005, and higher depreciation of our regular asset base primarily resulting from additional completed projects.

Compensation and benefits expenses increased by Php340 million, or 4%, to Php8,261 million primarily due to the effect of the collective bargaining agreement-related increases in salaries and benefits and an increase in incentive plan-related accruals, partially offset by a reduction in headcount due to PLDT's manpower rightsizing program.

Repairs and maintenance expenses increased by Php86 million, or 3%, to Php3,297 million primarily due to higher maintenance costs for foreign cable and wire facilities as more operating and maintenance-related restorations were incurred in 2005 as compared to 2004.

Provision for doubtful accounts decreased by Php1,807 million, or 48%, to Php1,944 million, primarily on account of a lower provision by PLDT for anticipated uncollectible accounts from various specifically identified domestic telecommunications carriers which were provided for in 2004.

Rent expenses decreased by Php19 million, or 1%, to Php1,727 million due to a decrease in international leased circuits and rental charges occupied by various equipments, partially offset by higher rentals for bundled sales/value added service units.

Selling and promotions expenses increased by Php376 million, or 32%, to Php1,535 million, primarily as a result of an increase in PLDT's promotional activities in relation to various products and services, partially offset by lower commissions paid in 2005.

Professional and other contracted services decreased by Php21 million, or 2%, to Php1,039 million primarily due to lower advisory and legal fees in 2005 for various services, partially offset by an increase in facility management fees and collection agency fees.

Taxes and licenses increased by Php122 million, or 15%, to Php942 million mainly on account of higher NTC supervision and license fees, fringe benefit taxes in respect of our stock option plan and other business-related taxes paid in 2005 as compared to 2004.

Insurance and security services decreased by Php72 million, or 10%, to Php628 million, primarily due to lower premiums on property all-risk, industrial all-risk and industrial fire insurance, partially offset by higher security services due to a rate increase for contracted security guards.

Communication, training and travel expenses decreased by Php2 million to Php447 million due to a decrease in mailing, courier and delivery services, as well as a decrease in local travel and training in 2005 as compared to 2004.

Provision for inventory obsolescence decreased by Php204 million, or 57%, to Php157 million primarily on account of lower inventory obsolescence owing to slow-moving items determined in 2005 as compared to 2004.

Cost of computers sold amounting to Php53 million were recognized in 2005 in relation to our DSL promotion. No similar charges were incurred in 2004.

Asset impairment amounted to Php365 million in 2004 owing to an impairment of a fixed line subsidiary's facilities; no impairment charge was recognized in 2005.

Other operating expenses decreased by Php88 million, or 11%, to Php719 million due to lower office supplies consumption and printing costs resulting from PLDT's continuing cost-containing activities.

Operating Income

Operating income from our fixed line service amounted to Php10,483 million in 2005, a decrease of Php6,036 million, or 37%, from Php16,519 million in 2004, which was primarily due to an increase in fixed line-related expenses particularly increased depreciation, which more than offset the 2% increase in fixed line-related revenues.

Financing Costs

Financing costs decreased by Php9,774 million, or 70%, to Php4,176 million due to the strengthening of the peso relative to the U.S. dollar and Japanese yen resulting in foreign exchange gains in 2005 as compared to foreign exchange losses recorded during 2004, and lower interest payments on loans and related items owing to lower debt balances in 2005 as compared to 2004.

The breakdown of our financing costs for our fixed line business for the years ended December 31, 2005 and 2004 is as follows:

| | Years Ended December 31, | | | |
|--|--------------------------|-----------|----------------------------------|-------|
| | 2005 | 2004 | Increase (Decrease) Amount | % |
| | (in millions) | | | |
| Interest on loans and related items | Php9,058 | Php10,634 | (Php1,576) | (15) |
| Financing charges | 1,384 | 1,156 | 228 | 20 |
| Accretion on financial liabilities net | 320 | 301 | 19 | 6 |
| Capitalized interest | (419) | (497) | 78 | (16) |
| Foreign exchange (gains) losses net | (6,167) | 2,356 | (8,523) | (362) |

Php4,176 Php13,950 (Php9,774) (70)

Interest Income

Interest income generated by our fixed line business amounted to Php385 million in 2005, an increase of Php137 million, or 55%, compared to Php248 million in 2004 mainly attributable to PLDT's higher average cash balances in 2005.

Loss (Gain) on Derivative Transactions

Loss on derivative transactions amounted to Php1,683 million in 2005, an increase of Php812 million, or 93%, from Php871 million in 2004 primarily due to PLDT's mark-to-market loss from interest rate swap and bifurcated equity call options partially offset by gain from long-term currency swaps and long-term foreign currency options.

Other Income - Net

All other income/gains such as rental income, gain on disposal of property, which do not fall under service revenues are included under this classification. In 2005, our fixed line business segment registered an increase in other income of Php122 million, or 165%, to Php196 million from Php74 million in 2004.

Income Before Income Tax, Cumulative Effect of Change in Accounting Policy and Minority Interest in Net Income of Consolidated Subsidiaries

Our fixed line business segment registered an income before income tax, cumulative effect of change in accounting policy and minority interest in net income of consolidated subsidiaries of Php5,205 million in 2005, an increase of Php3,185 million, or 158%, compared to Php2,020 million in 2004, primarily resulting from lower fixed line business-related expenses, particularly financing costs coupled with an increase in fixed line-related revenues, partially offset by higher depreciation and amortization.

Provision for Income Tax

Provision for income tax amounted to Php544 million in 2005 as compared to Php800 million in 2004 due to taxable losses of PLDT owing to higher realized foreign exchange gains in 2005 and the effect of tax rate adjustment.

Net Income

In 2005, our fixed line business segment registered a net income of Php4,660 million, an increase of Php3,419 million, or 276%, compared to Php1,241 million in 2004. The increase was primarily due to a slight increase in fixed line operating revenues and significantly lower financing costs, partially offset by higher fixed line operating expenses particularly increased depreciation and amortization.

Information and Communications Technology

Operating Revenues

In 2005, our information and communications technology business generated operating revenues of Php3,305 million, an increase of Php904 million, or 38%, from Php2,401 million in 2004, primarily due to the growth in our call center business. The revenues of our information and communications technology business accounted for 3% and 2% of our total operating revenues in 2005 and 2004, respectively. ePLDT's call center business contributed revenues of Php1,944 million, Internet and online gaming contributed revenues of Php556 million and *Vitro* contributed revenues of Php376 million, representing 66%, 19% and 13%, respectively, of the total service revenues from our information and communications technology business in 2005, compared to 62%, 27% and 8%, respectively, in 2004. Going forward, we expect revenues from our call center and Internet and online gaming businesses to continue to contribute significantly to our information and communications technology revenues with the growing demand for call center services.

The following table summarizes our total operating revenues from our information and communications technology business for the years ended December 31, 2005 and 2004 by service segment:

| Years Ended December 31, | | | | | |
|---------------------------------|----------|-------------|----------|--------------------------------|-----------|
| | | | | Increase (Decrease) | |
| 2005 | | 2004 | | Amount % | |
| % | | % | | (in millions) | |
| Service Revenues | | | | | |
| Call center | Php1,944 | 59 | Php1,283 | 54 | Php661 52 |
| | 556 | 17 | 569 | 24 | (13) (2) |

| | | | | | | |
|---|----------|-----|----------|-----|--------|-----|
| Internet and online gaming business | | | | | | |
| <i>Vitro</i> data center | 376 | 11 | 173 | 7 | 203 | 117 |
| Others | 77 | 2 | 55 | 2 | 22 | 40 |
| | 2,953 | 89 | 2,080 | 87 | 873 | 42 |
| Non-service Revenues | | | | | | |
| Point-of-product sales | 352 | 11 | 321 | 13 | 31 | 10 |
| Total ICT Operating Revenues | Php3,305 | 100 | Php2,401 | 100 | Php904 | 38 |

Service Revenues

Service revenues generated by our information and communications technology business amounted to Php2,953 million in 2005, an increase of Php873 million, or 42%, from Php2,080 million in 2004. This was primarily a result of the continued growth of our call center business.

Call Center

Revenues related to our call center business in 2005 increased by Php661 million, or 52%, to Php1,944 million from Php1,283 million in 2004, primarily due to the combined effects of the following: (1) Vocativ's upward price adjustment for voice and VoIP, and an increase in programs being handled; (2) an upward price adjustment by Parlance for its inbound and outbound projects, coupled with an increase in the number of registered minutes for inbound projects and hours for outbound projects; and (3) commencement of Ventus operations in Iloilo in March 2005.

Call center revenues accounted for 66% and 62% of our total information and communications technology service revenues in 2005 and 2004, respectively.

Internet and online gaming

Revenues from our Internet and online gaming business in 2005 decreased by Php13 million, or 2%, to Php556 million from Php569 million in 2004, primarily due to a decrease in Infocom's revenues in 2005, which was partially offset by the consolidation of Digital Paradise in June 2004. Our Internet and online gaming business revenues

accounted for 19% and 27% of service revenues from information and communications technology business in 2005 and 2004, respectively.

Vitro data center

ePLDT operates an Internet data center under the brand name *Vitro*. Granted pioneer status as an Internet data center by the BOI, *Vitro* provides co-location services, server hosting, hardware and software maintenance services, website development and maintenance services, webcasting and webhosting, shared applications, data disaster recovery and business continuity services, intrusion detection, and security services such as firewall and managed firewall.

In 2005, *Vitro* contributed revenues of Php376 million, an increase of Php203 million, or 117%, from Php173 million in 2004, primarily due to an increase in co-location revenues, server hosting and other services. *Vitro* revenues accounted for 13% and 8% of service revenues from our information and communications technology business in 2005 and 2004, respectively.

Others

Revenues from other businesses related to our information and communications technology segment in 2005 increased to Php77 million from Php55 million in 2004 largely due to IT helpdesk/contact center services rendered coupled with an increase in the number of digital certificates sold.

Please refer to *Note 8 Investments* to the accompanying consolidated financial statements in Item 18 for further discussion on ePLDT's other information and communications technology services.

Non-service Revenues

Non-service revenues consist of sales generated from reselling certain Microsoft licenses, server solutions, networking products, storage products and data security products. In 2005, non-service revenues generated by our information and communications technology business increased by Php31 million, or 10%, to Php352 million compared to Php321 million in 2004, primarily due to higher revenues from sales of networking equipment and Microsoft licenses.

Operating Expenses

Expenses associated with our information and communications technology business totaled Php3,253 million in 2005, an increase of Php218 million, or 7%, from Php3,035 million in 2004, primarily due to an increase in cash expenses, particularly compensation and benefits, and depreciation and amortization, partly offset by an impairment provision recognized in 2004. As a percentage of our information and communications technology revenues, expenses related to our information and communications technology business were at 98% and 126% for 2005 and 2004, respectively.

The following table shows the breakdown of our total information and communications technology-related expenses for the years ended December 31, 2005 and 2004, respectively, and the percentage of each expense item to the total:

| | Years Ended December 31, | | | | Increase (Decrease) | |
|---|--------------------------|-----|----------|-----|------------------------|-------|
| | 2005 | % | 2004 | % | Amount | % |
| | (in millions) | | | | | |
| Information and communications technology services: | | | | | | |
| Compensation and benefits(1) | Php1,352 | 42 | Php900 | 30 | Php452 | 50 |
| Depreciation and amortization | 415 | 13 | 339 | 11 | 76 | 22 |
| Rent | 362 | 11 | 366 | 12 | (4) | (1) |
| Cost of sales point products | 300 | 9 | 230 | 8 | 70 | 30 |
| Repairs and maintenance | 283 | 9 | 316 | 11 | (33) | (10) |
| Selling and promotions | 121 | 4 | 61 | 2 | 60 | 98 |
| Communication, training and travel | 98 | 3 | 70 | 2 | 28 | 40 |
| Professional and other contracted services | 82 | 3 | 67 | 2 | 15 | 22 |
| Provision for doubtful accounts | 54 | 2 | | | 54 | 100 |
| Taxes and licenses | 36 | 1 | 21 | 1 | 15 | 71 |
| Amortization of intangible assets | 15 | | | | 15 | 100 |
| Insurance and security services | 14 | | 7 | | 7 | 100 |
| Asset impairment | 11 | | 617 | 20 | (606) | (98) |
| Provision for inventory obsolescence | | | 3 | | (3) | (100) |
| Other operating expenses | 110 | 3 | 38 | 1 | 72 | 189 |
| Total | Php3,253 | 100 | Php3,035 | 100 | Php218 | 7 |

(1) Includes salaries and benefits, incentive plan, pension and MRP costs.

Compensation and benefits increased by Php452 million, or 50%, to Php1,352 million, mainly due to the expansion of our call center and Internet and online gaming businesses, which resulted in an increase in headcount coupled with an increase in salaries, bonuses and various incentives of employees.

Depreciation and amortization charges increased by Php76 million, or 22%, to Php415 million, primarily due to an increase in the depreciable asset base in relation to the expansion of our call center and Internet and online gaming businesses.

Rent expenses decreased by Php4 million, or 1%, to Php362 million primarily due to a decline in Vitro's lease of hosting equipment for use in its Bureau of Internal Revenue project and the expansion of our call center and Internet and online gaming businesses.

Cost of sales increased by Php70 million, or 30%, to Php300 million primarily due to an increase in the cost of point products sold.

Repairs and maintenance expenses decreased by Php33 million, or 10%, to Php283 million, primarily due to Vitro's lower hardware maintenance costs related to its IBM and CISCO equipments partially offset by higher hosting-related costs incurred in 2005 as compared to 2004.

Selling and promotions expenses increased by Php60 million, or 98%, to Php121 million mainly as a result of the commercial release of *Khan Online* in February 2005 following the commencement of netGames' commercial operations. Furthermore, Vitro's increase in sales of software products in 2005 as compared to 2004 resulted in higher selling and marketing expenses.

Communication, training and travel expenses increased by Php28 million, or 40%, to Php98 million due to the increased cost of bandwidth and information system charges, coupled by the increase in telecommunications costs incurred by our call center business for its outbound calls. Furthermore, CSR trainings for our call centers during 2005 contributed higher foreign travel and training costs compared to 2004.

Professional and other contracted services increased by Php15 million, or 22%, to Php82 million, primarily due to an increase in consultancy, legal and audit fees in 2005.

Provision for doubtful accounts amounted to Php54 million in 2005 primarily due to specifically identified doubtful accounts pertaining to Infocom as of the end of 2005. No provision was provided for in 2004.

Taxes and licenses increased by Php15 million, or 71%, to Php36 million, mainly on account of documentary stamp taxes paid by ePLDT and Ventus in their issuance of additional capital stock in 2005 as compared to 2004.

Amortization of intangible assets amounted to Php15 million in 2005 due to impairment of goodwill of ePLDT's investment in *Netopia*.

Insurance and security services increased by Php7 million, or 100%, to Php14 million primarily due to higher premium costs and an increase in the assets insured in 2005 as compared to 2004.

Asset impairment amounted to Php11 million in 2005, a decrease of Php606 million, or 98%, primarily due to the recognition of an impairment provision in relation to an investee company in 2004.

Provision for inventory obsolescence amounted to Php3 million in 2004 mainly pertaining to maintenance-related inventory items of Infocom.

Other operating expenses increased by Php72 million, or 189%, to Php110 million mainly due to recognition of royalty fees to *Khan Online* in 2005 and an increase in other business-related costs.

Financing Costs

Financing costs increased by Php15 million, or 38%, to Php54 million, primarily due to higher foreign exchange losses from dollar-denominated receivables in 2005 as compared to 2004.

Provision for Income Tax

Provision for income tax amounted to Php20 million in 2005, a decrease of Php39 million, or 66%, as compared to Php59 million in 2004, primarily due to lower reversal of Infocom's recorded deferred income tax asset in 2005 as compared to 2004.

Net Income (Loss)

In 2005, our information and communications technology business segment registered a net income of Php113 million compared to a net loss of Php699 million posted in 2004 mainly on account of the higher net income contribution of our call center business and impairment provision recognized in 2004, partially offset by Infocom's operating loss in

2005 and Digital Paradise's high operating costs due to its ongoing expansion.

Liquidity and Capital Resources

The following table shows our consolidated cash flows, capitalization and other selected financial data as at and for the years ended December 31, 2006, 2005 and 2004:

| | Years Ended December 31, | | |
|--|--------------------------|-----------|-----------|
| | 2006 | 2005 | 2004 |
| | (in millions) | | |
| Cash Flows | | | |
| Net cash provided by operating activities | Php61,201 | Php66,280 | Php63,107 |
| Net cash used in investing activities | 36,764 | 13,080 | 24,764 |
| Capital expenditures | 20,348 | 15,864 | 19,268 |
| Net cash used in financing activities | 36,916 | 49,470 | 30,325 |
| Effect of foreign exchange rate changes on cash and cash equivalents | (710) | (987) | (69) |
| Net increase (decrease) in cash and cash equivalents | (13,189) | 2,743 | 7,949 |

| | December 31, | |
|---------------------------------------|---------------|------------|
| | 2006 | 2005 |
| | (in millions) | |
| Capitalization | | |
| Cash and cash equivalents | Php16,870 | Php30,059 |
| Short-term debt | | |
| Notes payable | 201 | |
| Current portion of long-term debt | 16,316 | 18,797 |
| Long-term debt net of current portion | 69,542 | 93,516 |
| Total debt | 86,059 | 112,313 |
| Stockholders' equity | 106,173 | 79,595 |
| Total capitalization | Php192,232 | Php191,908 |

As at December 31, 2006, consolidated cash and cash equivalents amounted to Php16,870 million. Our principal sources of consolidated cash in 2006 were cash flows from operating activities amounting to Php61,201 million, drawings from existing long-term credit facilities totaling Php18,883 million, and net equity funds raised through the issuance of capital stock amounting to Php66 million. These funds were used principally for capital expenditures of Php20,348 million (including capitalized interest of Php549 million) and total debt principal repayments of Php38,520 million.

Principal sources of consolidated cash in 2005 and 2004 were cash flows from operating activities amounting to Php66,280 million and Php63,107 million, respectively; drawings from long-term and short-term credit facilities amounting to Php10,797 million and Php329 million, respectively in 2005, and to Php15,187 million and Php457

million, respectively, in 2004; and equity funds raised through the issuance of capital stock amounting to Php334 million in 2005 and Php281 million in 2004. These funds were used principally for capital expenditures of Php15,864 million (including capitalized interest of Php504 million) and payments of long-term and short-term debt totaling to Php48,236 million in 2005; and capital expenditures of Php19,268 million (including capitalized interest of Php595 million) and payments of long-term and short-term debt totaling to Php44,109 million in 2004.

Operating Activities

On a consolidated basis, net cash flows from operating activities in 2006 amounted to Php61,201 million, a decrease of Php5,079 million, or 8%, from Php66,280 million in 2005 and an increase of Php3,173 million, or 5% from Php63,107 million in 2004.

A growing portion of our consolidated cash flow is generated by our wireless and data businesses. The revenue contribution of these businesses has grown significantly over the last three years with wireless business contributing 63%, in 2006, 62% in 2005 and 61% in 2004, and data business contributing an average of 11% in 2006, 8% in 2005 and 6% in 2004 of our total service revenues. Revenues from our local exchange service accounted for approximately 13% of our total service revenues in 2006, down from 16% in 2005 and from 17% in 2004.

Cash flows from operating activities of our wireless business in 2006 accounted for 60% of our consolidated cash flows from operating activities owing to the growth of our cellular subscriber base and service usage. Our fixed line business contributed 38% to our consolidated cash flows from operating activities in 2006 with improved collection efficiency and lower cash expenses in line with our cost-containment efforts.

Until April 2006, Smart was subject to loan covenants that restricted its ability to pay dividends, redeem preferred shares, make distributions to PLDT or otherwise provide funds to PLDT or any associate without the consent of its lenders. Smart was able to obtain waivers from Finnvera and certain of its lenders for each of the dividend payments made by Smart to PLDT in March 2006, 2005, 2004, 2003 and 2002 aggregating Php7,000 million, Php19,717 million, Php16,100 million, Php6,166 million and Php1,540 million, respectively. In 2005, Smart redeemed 380.8 million preferred shares previously issued to PLDT at a redemption price of Php13.875 per share, or a total redemption price aggregating to Php5,283 million.

Payments made by Smart to PLDT after April 2006 did not require prior creditor consent as all loan facilities that contained such restrictions had already been repaid. In June 2006, September 2006 and March 2007, dividend payments received from Smart amounted to Php7,000 million, Php6,600 million and Php8,000 million, respectively. In addition, Smart redeemed 392 million preferred shares at a total redemption price of Php5,441 million in June 2006.

Investing Activities

Our net cash used in investing activities in 2006 amounted to Php36,764 million, an increase of Php23,684 million, or 181%, compared to Php13,080 million in 2005 and a decrease of Php11,684 million, or 47%, from Php24,764 million in 2004. The increase in 2006 primarily resulted from higher business acquisition expenditures by Php10,770 million, higher capital expenditures by Php4,484 million and an increase in short-term investments of Php6,714 million. The decrease in 2005 resulted from a decline in capital expenditures by Php3,404 million, lower business acquisition expenditures by Php1,028 million, higher cash receipts for leased deposits and a decrease in short-term investments of Php3,418 million largely due to the maturity of Smart's investments in 2004.

Our consolidated capital expenditures in 2006 totaled Php20,348 million, an increase of Php4,484 million, or 28%, from Php15,864 million in 2005 primarily due to Smart's and PLDT's higher capital spending. Smart's capital spending of Php10,506 million in 2006 was used to roll-out its 3G network and further expand and upgrade its transmission network facilities to increase capacity and coverage in respect of basic and advanced cellular services. PLDT's capital spending of Php8,573 million in 2006 was principally used to finance the expansion of its fixed line data and IP-based network services. ePLDT and its subsidiaries' capital spending of Php1,134 million in 2006 was used to primarily fund its *Vitro*TM, Digital Paradise and call center business operations. The balances were spent by other subsidiaries mainly PLDT Global, Mabuhay Satellite and Maratel. In addition, in 2006, we made certain strategic investments, including the acquisition of SPi and a 60% equity interest in Level Up! for Php8,847 million and Php347 million, respectively. Our consolidated capital expenditures in 2005 totaled Php15,864 million, a decrease of Php3,404 million, or 18%, from Php19,268 million in 2004 primarily due to Smart's and PLDT's lower capital spending. Smart's capital spending of Php8,785 million in 2005 was used to roll-out its 3G network and further expand and upgrade its transmission network facilities to increase capacity and coverage in respect of basic and advanced cellular services. PLDT's capital spending of Php6,389 million in 2005 was principally used to finance the expansion of its fixed line data and IP-based network services. ePLDT and its subsidiaries' capital spending of Php605 million in 2005 was used to primarily fund its *Vitro*TM, Digital Paradise and call center business operations. The balances were spent by other subsidiaries mainly PLDT Global, Mabuhay Satellite and Maratel. In addition, in 2005, we made certain strategic investments aggregating Php248 million to strengthen our position in the wireless and information and communications technology segments. Of the Php248 million investment, Php238 million represented Smart's partial payment of its investment in a wireless broadband and data service company, and Php10 million pertained to ePLDT's investment in convertible debt securities of a company engaged in a systems integration of Internet and mobile telephone gaming project.

As part of our growth strategy, we may from time to time, continue to make acquisitions and investments in companies or businesses, which may or may not be significant.

For 2007, we anticipate increasing the level of our capital expenditures and equity investments. Our 2007 budget for consolidated capital expenditures is approximately Php21,400 million, of which approximately Php11,100 million is budgeted to be spent by PLDT, approximately Php8,800 million is budgeted to be spent by Smart and the balance represents the budgeted capital spending of our other subsidiaries.

Financing Activities

On a consolidated basis, we used net cash of Php36,916 million for financing activities in 2006, compared to Php49,470 million in 2005 and Php30,325 million in 2004. The net cash used in financing activities in 2006, 2005 and 2004 was mainly attributable to debt repayments and interest payments by PLDT in line with its ongoing debt reduction program and, in 2006 and 2005, dividend payments distributed to common and preferred stockholders.

Debt Financing

Additions to our consolidated long-term debt in 2006 totaled Php18,883 million mainly from Smart's drawings related to the financing of its Phases 8 and 9 GSM facilities. Payments in respect of principal of our total debt amounted to Php38,391 million in 2006, of which Php25,875 million were attributable to PLDT.

Our consolidated indebtedness as at December 31, 2006 was Php86,059 million, lower by Php26,254 million, or 23%, compared to Php112,313 million as at December 31, 2005 mainly due to the reductions of Php25,875 million and Php11,544 million in PLDT's and Smart's indebtedness, respectively. PLDT's non-consolidated indebtedness decreased by 28%, from Php74,028 million as at December 31, 2005 to Php52,936 million as at December 31, 2006, due to debt payments in line with our thrust to reduce PLDT's overall indebtedness. Smart's indebtedness as at December 31, 2006 stood at Php30,783 million, a decrease of 12% from Php35,079 million as at December 31, 2005. On July 2, 2004, Smart acquired from Piltel's creditors US\$289 million, or 69.4%, in the aggregate of Piltel's total outstanding restructured debt at that time, in exchange for US\$283.2 million, or Php13,892 million in July 2, 2004, in new debt of Smart and US\$1.5 million, or Php84 million, in cash. On June 5, 2006 and December 4, 2006, Piltel prepaid its entire restructured debt to Smart and Piltel's other creditors. Please see *Note 12 Interest-bearing Financial Liabilities* to the accompanying consolidated financial statements in Item 18 for further details.

As at December 31, 2006, Smart had several committed dollar-denominated and peso-denominated long-term credit facilities. On July 31, 2006, Smart signed a U.S. Dollar Term Loan Facility for US\$44.2 million with Finnish Export Credit Plc to partly finance the related Phase 9 GSM equipment and services contracts. The facility was drawn on November 10, 2006 for the full amount of US\$44.2 million. On August 14, 2006, Smart signed a Peso Term Loan Facility with Metropolitan Bank and Trust Company to finance the related Phase 9 GSM facility for an amount of Php2,500 million. The facility was drawn on December 10, 2006 for the full amount of Php2,500 million. On October 16, 2006, Smart signed a U.S. Dollar Term Loan Facility with Metropolitan Bank and Trust Company to finance the related Phase 9 GSM Facility for an amount of US\$50 million. On February 15, 2007, Smart issued Php5,000 million unsecured fixed rate corporate notes, comprised of Series A notes amounting to Php3,800 million and Series B notes amounting to Php1,700 million with five- and ten-year terms, respectively.

The scheduled maturities of our outstanding consolidated long-term debt as at December 31, 2006 are as follows:

| Year | US\$ Loans | Peso Loans | Total |
|------------------|---------------|------------|-----------|
| | (in millions) | | |
| 2007 | US\$327 | Php16,027 | Php16,316 |
| 2008 | 147 | 7,203 | 7,759 |
| 2009 | 294 | 14,423 | 14,978 |
| 2010 | 71 | 3,468 | 4,834 |
| 2011 | 15 | 724 | 1,279 |
| 2012 and onwards | 829 | 40,692 | 40,692 |
| | US\$1,681 | Php82,537 | Php85,858 |

Approximately Php45,166 million principal amount of our consolidated outstanding long-term debt as at December 31, 2006 is scheduled to mature over the period from 2007 to 2011. Of this amount, Php25,175 million was attributable to PLDT, Php14,543 million to Smart, and the remainder to Mabuhay Satellite, Maratel, ePLDT and Piltel.

See *Note 12 Interest-bearing Financial Liabilities* to the accompanying consolidated financial statements in Item 18 for an overview of our indebtedness.

Debt Covenants

Our debt instruments contain restrictive covenants, including covenants that could prohibit us from paying dividends on common stock under certain circumstances, and require us to comply with specified financial ratios and other financial tests, calculated in conformity with PFRS, at relevant measurement dates, principally at the end of each quarterly period. We have maintained compliance with all of our maintenance financial ratios as required under our loan covenants and other debt instruments. However, if negative factors adversely affect our financial ratios, we may be unable to maintain compliance with these ratios and covenants or be unable to incur new debt. The terms of some of our debt instruments have no minimum amount for cross-default.

The principal factors that can negatively affect our ability to comply with the financial ratios and other financial tests under our debt instruments are depreciation of the Philippine peso relative to the U.S. dollar, poor operating performance of PLDT and our consolidated subsidiaries, impairment or similar charges in respect of investments or other long-lived assets that may be recognized by PLDT and its consolidated subsidiaries and increases in our interest expenses. Interest expenses may increase as a result of various factors including issuance of new debt, the refinancing of lower cost indebtedness by higher cost indebtedness, depreciation of the Philippine peso, the lowering of PLDT's credit ratings or the credit ratings of the Philippines, increase in reference interest rates, and general market conditions. Since approximately 96% of our total consolidated debts were denominated in foreign currencies, principally in U.S. dollars, many of these financial ratios and other tests are negatively affected by any weakening of the peso. The peso has been subject to significant fluctuations in recent years. From 2002 to 2004, the peso has generally been depreciating from a high of Php49.336 on May 20, 2002 to a low of Php56.443 on October 14, 2004. In 2005, the peso fluctuated significantly from a low of Php56.321 on July 8 to a high of Php53.062 on December 29. As at

December 31, 2006, the peso had appreciated by 8% to Php49.045 to US\$1.00, from Php53.062 to US\$1.00 as at December 31, 2005.

PLDT's ability to maintain compliance with financial covenant requirements measured on a non-consolidated basis is principally affected by the performance of its fixed line business, which is predominantly conducted by PLDT. PLDT cannot be assured of the benefit of net revenues and cash flows generated by Smart and PLDT's other investees in assisting PLDT in complying with non-consolidated covenants or covenants that are calculated without giving effect to the results of PLDT's investees.

PLDT's debt instruments contain a number of other negative covenants that, subject to certain exceptions and qualifications, restrict PLDT's ability to take certain actions without lenders' approval, including: (a) incurring additional indebtedness; (b) prepaying other debt; (c) making investments; (d) extending loans; (e) extending guarantees or assuming the obligations of other persons; (f) paying dividends or other distributions or redeeming, repurchasing or otherwise acquiring shares of PLDT's capital stock; (g) disposing of all or substantially all of its assets or of assets in excess of specified thresholds of its tangible net worth; (h) creating any lien or security interest; (i) permitting set-off against amounts owed to PLDT; (j) merging or consolidating with any other company; (k) entering into transactions with stockholders and affiliates; and (l) entering into sale and leaseback transactions.

Moreover, certain of PLDT's debt instruments restrict PLDT from declaring or distributing dividends to common stockholders. In particular, under certain loan agreements, PLDT may not declare or pay dividends on any of its capital stock without the prior written consent of the lenders (i) if PLDT is in default in the payment of any amounts due and payable under such loan agreement or after the occurrence and during the continuance of any other event of default or potential event of default under such agreements, or (ii) in an amount greater than PLDT's net income after taxes during the fiscal year to which such payment or distribution relates.

In case of a change in control of PLDT, under the terms of the 11.375% Notes due 2012, we are required to offer to purchase outstanding notes due 2012 for cash at a price of 101% of their principal amounts plus accrued interest in the event that (1) the aggregate of NTT Communications' and First Pacific's direct and indirect voting interest in PLDT's outstanding capital stock having voting rights falls below 35% of such capital stock, (2) any person or, in certain instances, group of persons, which is not controlled directly or indirectly by First Pacific or NTT Communications acquires a direct or indirect voting interest in PLDT's outstanding capital stock having voting rights which equals or exceeds 35% of such capital stock and (3) if a rating agency at such time maintains a rating on such notes, the rating agency downgrades its credit rating on the notes within 90 days (or more, in certain circumstances) following notice of the occurrence of the events specified in (1) and (2) above.

PLDT's debt instruments also contain customary and other default provisions that permit the lender to accelerate amounts due or terminate their commitments to extend additional funds under the debt instruments. These default provisions include: (a) cross-defaults and cross-accelerations that permit a lender to declare a default if PLDT is in default under another debt instrument; in some cases, the cross-default provision is triggered upon a payment or other default permitting the acceleration of PLDT's debt, whether or not the defaulted debt is accelerated. In other cases, the cross-default provision requires the defaulted loan to be accelerated. In some debt instruments, the cross-default

provision will be triggered only if the principal amount of the defaulted indebtedness exceeds a threshold amount specified in these debt instruments; (b) failure by PLDT to meet certain financial ratio covenants referred to above; (c) the occurrence of any material adverse change in circumstances that a lender reasonably believes materially impairs PLDT's ability to perform its obligations under its debt instrument with the lender; (d) the revocation, termination or amendment of any of the permits or franchises of PLDT in any manner unacceptable to the lender; (e) the abandonment, termination or amendment of the project financed by a loan in a manner unacceptable to the lender; (f) the nationalization or sustained discontinuance of all or a substantial portion of PLDT's business; and (g) other typical events of default, including the commencement of bankruptcy, insolvency, liquidation or winding up proceedings by PLDT.

Smart's debt instruments contain certain restrictive covenants that require Smart to comply with specified financial ratios and other financial tests at semi-annual measurement dates. The financial tests under Smart's loan agreements include compliance with a debt to equity ratio of not more than 1.50:1 and a debt service coverage ratio of not less than 1.50:1. Smart has maintained compliance with all of its financial covenants. The agreements also contain customary and other default provisions that permit the lender to accelerate amounts due under the loans or terminate their commitments to extend additional funds under the loans. These default provisions include: (a) cross-defaults and cross-accelerations that permit a lender to declare a default if Smart is in default under another loan agreement. These cross-default provisions are triggered upon a payment or other default permitting the acceleration of Smart debt, whether or not the defaulted debt is accelerated; (b) failure by Smart to comply with certain financial ratio covenants; (c) any reduction in PLDT's ownership of Smart's shares below 51%; (d) any reduction in First Pacific's and Metro Pacific Corporation's collective direct and/or indirect ownership of PLDT's common stock below 17.5% of the total common stock outstanding; and (e) the occurrence of any material adverse change in circumstances that the lender reasonably believes materially impairs Smart's ability to perform its obligations under its loan agreements.

As at December 31, 2006, convertible bonds with a principal amount of US\$0.7 million had fallen due for payment and had not been paid. These bonds represent sole unstructured borrowings of Piltel. Piltel's failure to redeem the convertible bonds when they fell due does not cause a default under the debt arrangements of any other member of the PLDT group. Piltel is working to identify the holders of convertible bonds so that it can finalize redemption arrangements.

The Credit and Omnibus Agreements of Mabuhay Satellite imposes several negative covenants. In particular, these covenants, among other things, restrict material changes in Mabuhay Satellite's nature of business and ownership structure, any lien upon or with respect to any of its assets or to any right to receive income, acquisition of capital stock, declaration and payment of dividends, merger, consolidation and sale with another entity and incurring or guaranteeing additional long-term debt beyond prescribed amounts.

ePLDT's loan agreement imposes negative covenants which, among other things, restrict ePLDT in regard to payment of cash dividends or any other income or any capital distribution to PLDT, voluntary suspension of its entire business operations for a period of 60 consecutive days, dissolution of its legal existence, and creation of any encumbrances on the shares pledged. One of ePLDT's loan agreements also requires ePLDT to comply with specified financial ratios and other financial tests at quarterly measurement dates. The agreement also contains customary and other default provisions that permit the lender to accelerate amounts due under the loan or terminate their commitments to extend additional funds under the loan. As at December 31, 2006, ePLDT was in compliance with all of its financial

covenants.

Financing Requirements

We believe that our available cash, including cash flow from operations, will provide sufficient liquidity to fund our projected operating, investment, capital expenditures and debt service requirements for the next 12 months.

Since 2002, we have been utilizing internally generated cash, particularly from our wireless business, to reduce our overall level of indebtedness. In line with this objective, we have managed our capital expenditures, reduced our investments and suspended dividend payments to common shareholders from April 2001 to 2004. As a result of our improving cash flows and reduced debt levels, we have restored the payment of common dividends in May 2005 and currently intend to gradually increase our dividend payout ratio in succeeding years as we expect to improve our leverage ratios.

Credit Ratings

None of our existing indebtedness contains provisions under which credit rating downgrades would trigger a default, changes in applicable interest rates or other similar terms and conditions.

| <u>Rating Agency</u> | <u>Credit Rating</u> | <u>Outlook</u> |
|--------------------------|--|-----------------|
| Standard and Poor's | Foreign Currency Senior Unsecured Debt Rating | BB+ Stable |
| Moody's Investor Service | Foreign Currency Senior Unsecured Debt Rating | Ba2 Stable |
| | Local Currency Corporate Family Rating | Baa3 Positive |
| Fitch | Long-term Foreign Currency Rating | BB Stable |
| | Long-term Local Currency Rating | BB+ Stable |
| | Long-term Foreign Currency Issuer Default Rating | BB+ Stable |
| | Long-term Local Currency Issuer Default Rating | BBB- Positive |
| | National Long-term Rating | AAA(ph1) Stable |

On May 31, 2007, Moody's Investor Service, or Moody's, upgraded PLDT's local currency corporate family rating to Baa2 from Baa3. This concludes the possible upgrade that commenced on April 11, 2007. At the same time, Moody's affirmed PLDT's Ba2 foreign currency bond rating. The outlook on the ratings is stable. The ratings reflect PLDT's continued improvements in its financial profile, a strong operating performance and a dominant market position.

On November 3, 2006, Moody's affirmed PLDT's Ba2 senior unsecured foreign currency rating and changed its outlook to stable from negative. The rating action was prompted by the change in outlook on the Philippines Ba3 country ceiling for foreign currency bonds to stable from negative. On July 18, 2006, Moody's upgraded PLDT's local currency corporate family rating from Ba1 to Baa3 with a positive outlook. The upgrade has been prompted by the following features: (1) continued improvements in PLDT's credit profile; (2) PLDT enjoys a lowly geared balance sheet; (3) PLDT has a 65% share in revenue terms of the market where only one major competitor is present; and (4) PLDT has sufficient flexibility to be able to invest its free cash flows into upgrading its technology base.

On August 18, 2006, Fitch upgraded PLDT's long-term foreign currency IDR to BB+ from BB with a stable outlook, at the same time upgrading PLDT's global bonds and senior notes to BB+ from BB and affirmed PLDT's long-term local currency IDR of BBB- with a positive outlook. Following the licensing of Fitch to provide National ratings in the Philippines, Fitch assigned PLDT a National long-term rating of AAA(ph1) with a stable outlook. The ratings action follows Fitch's announcement that it has upgraded the Country Ceiling on the Republic of the Philippines to BB+ from BB.

On August 30, 2006, Standard & Poor's Ratings Services affirmed its BB+ foreign currency rating on PLDT with stable outlook. At the same time, the rating on PLDT's Series III Preferred Stock has been withdrawn as the preferred stock have been fully converted into common equity. The rating reflects PLDT's leading market position and its improving financial profile.

Off-balance Sheet Arrangements

There are no off-balance sheet arrangements that have or are reasonably likely to have any current or future effect on our financial position, results of operations, cash flows, changes in stockholders' equity, liquidity, capital expenditures or capital resources that are material to investors.

Equity Financing

PLDT raised Php63 million and Php275 million from the exercise by certain officers and executives of stock options in 2006 and 2005, respectively. In addition, through our subscriber investment plan, or SIP, which provides postpaid fixed line subscribers the opportunity to buy shares of our 10% cumulative convertible preferred stock as part of the upfront payments collected from subscribers, PLDT was able to raise Php4 million, Php10 million, Php7 million in 2006, 2005 and 2004, respectively.

Cash dividend payments in 2006 amounted to Php14,999 million, of which Php14,447 million and Php552 million were paid to common and preferred shareholders, respectively, compared to Php11,173 million, of which Php9,587 million and Php1,586 million were paid to common and preferred shareholders, respectively, in 2005.

The following table sets forth dividend payments on shares of PLDT's common stock for 2006 and 2005:

| Class | Declaration | Date Record | Paid | Amount | |
|--------------|-------------------|-------------------|--------------------|-----------|----------|
| | | | | Per Share | Total |
| Common Stock | March 1, 2005 | March 31, 2005 | May 12, 2005 | Php14.00 | Php2,373 |
| | May 5, 2005 | June 3, 2005 | July 14, 2005 | 21.00 | 3,589 |
| | November 8, 2005 | November 28, 2005 | December 28, 2005 | 21.00 | 3,625 |
| | February 27, 2006 | March 20, 2006 | April 20, 2006 | 28.00 | 5,059 |
| | August 8, 2006 | August 21, 2006 | September 21, 2006 | 50.00 | 9,346 |
| | March 6, 2007 | March 20, 2007 | April 20, 2007 | 50.00 | 9,388 |

As at December 31, 2006, there were 188.4 million PLDT common shares outstanding compared to 180.8 million common shares outstanding as at December 31, 2005. See *Note 15 Stockholders' Equity* to the accompanying consolidated financial statements in Item 18 for further discussion.

Contractual Obligations and Commercial Commitments

Contractual Obligations

The following table discloses the PLDT Group's contractual obligations outstanding as at December 31, 2006:

| Year | Long-term lease obligations | | | Unconditional purchase obligations(1) | Other long-term obligations | Total |
|------------------|-----------------------------------|-----------|---------|---------------------------------------|-----------------------------|---------|
| | Long-term debt (in million pesos) | Operating | Capital | | | |
| 2007 | 16,316 | 572 | 1,521 | 4,972 | | 23,381 |
| 2008 | 7,759 | 593 | 38 | 981 | 1,629 | 11,000 |
| 2009 | 14,978 | 564 | 10 | 981 | | 16,533 |
| 2010 | 4,834 | 465 | 1 | 981 | | 6,281 |
| 2011 | 1,279 | 358 | | 981 | | 2,618 |
| 2012 and onwards | 40,692 | 868 | | 1,962 | | 43,522 |
| Total | 85,858 | 3,420 | 1,570 | 10,858 | 1,629 | 103,335 |

(1) Based on the Original Air Time Purchase Agreement with AIL.

Long-term Debt Obligations

For a discussion of our long-term debt obligations, see *Note 12 Interest-bearing Financial Liabilities* to the consolidated financial statements in Item 18.

Long-term Operating Lease Obligations

Digital Passage Service Contracts. PLDT has existing Digital Passage Service Contracts with foreign telecommunication administrations for several dedicated circuits to various destinations for ten to 25 years expiring at various dates. As at December 31, 2006, PLDT's aggregate remaining obligation under these contracts amounted to approximately Php6 million.

License Agreement with Mobius Management Systems (Australia) Pty Ltd., or Mobius. PLDT entered into a license agreement with Mobius pursuant to which Mobius has granted PLDT a non-exclusive, non-assignable and non-transferable license for the use of computer software components. Under this agreement, Mobius is also required to provide maintenance services for a period of one year at no additional maintenance charge. PLDT may purchase maintenance services upon expiration of the first year for a fee of 15% of the current published license fee. As at December 31, 2006, PLDT's aggregate remaining obligation under this agreement was approximately Php10 million.

Other Long-term Operating Lease Obligations. The PLDT Group has various long-term lease contracts for periods ranging from two to ten years covering certain offices, warehouses, cell sites telecommunication equipment locations and various office equipment. In particular, Smart has lease obligations amounting to Php3,053 million as at December 31, 2006 in respect of office and cell site rentals with over 3,000 lessors nationwide, PLDT has lease obligations amounting to Php100 million as at December 31, 2006 in respect of office and lot rentals with over 185 lessors nationwide, ePLDT has lease obligations amounting to Php238 million as at December 31, 2006 in respect of certain office space rentals and PLDT Global has lease obligations amounting to Php13 million as at December 31, 2006 in respect of certain office space rentals.

Long-term Capital Lease Obligations

For a discussion of our long-term capital lease obligations, see *Note 12 Interest-bearing Financial Liabilities* to the consolidated financial statements in Item 18.

Unconditional Purchase Obligations

Air Time Purchase Agreement with AIL. As also discussed in *Note 16 Related Party Transactions* to the consolidated financial statements in Item 18, PLDT is a party to a Founder NSP Air Time Purchase Agreement entered into with AIL in March 1997, which was amended in December 1998 (as amended, the *Original ATPA*), under which PLDT was granted the exclusive right to sell AIL services as national service provider, or NSP, in the Philippines. In exchange, the Original ATPA required PLDT to purchase from AIL a minimum of US\$5 million worth of air time (the *Minimum Air Time Purchase Obligation*) annually over ten years commencing on January 1, 2002 (the *Minimum Purchase Period*), the purported date of commercial operations of the Garuda I Satellite. In the event that AIL's aggregate billed revenue was less than US\$45 million in any given year, the Original ATPA also required PLDT to make supplemental air time purchase payments not to exceed US\$15 million per year during the *Minimum Purchase Period* (the *Supplemental Air Time Purchase Obligation*).

Under the Original ATPA, the *Minimum Air Time Purchase Obligation* and the *Supplemental Air Time Purchase Obligation* terminated upon the earlier of (i) the expiration of the *Minimum Purchase Period* and (ii) the date on which all indebtedness incurred by AIL to finance the AIL System has been repaid. AIL indebtedness consists of: (1) loans with several financial institutions (the *Banks*) under the *Credit Agreement* dated March 12, 1997, as amended from time to time, including the amendment through the rescheduling agreement, dated September 30, 2002, which extended the principal repayment dates to agreed periods with the final maturity date on January 31, 2012 (collectively, the *Amended Credit Agreement*); and (2) amounts owing to MMOC under the *Spacecraft Contract* dated August 28, 1995, as amended on December 30, 1998.

As at December 31, 2006 and 2005, PLDT's outstanding accrued obligations under the Original ATPA was Php3,991 million and Php3,493 million, respectively. Total air time purchases made under this agreement amounted to Php698 million, Php1,008 million and Php1,299 million for the years ended December 31, 2006, 2005 and 2004, respectively.

AIL has incurred recurring significant operating losses, negative operating cash flows, and significant levels of debt. The financial condition of AIL was partly due to the NSPs, inability to generate the amount of revenues originally expected as the growth in subscriber numbers has been significantly lower than budgeted.

On September 1, 2006, AIL, PT Asia Cellular Satellite, a 95% owned subsidiary of AIL, and Inmarsat Global Limited, or Inmarsat, reached an agreement to pool their resources to develop powerful and novel product and service offerings in the Asian region, founded on their respective mobile satellite communications networks, with

- (a) Inmarsat performing the role of satellite and network operator and wholesale product and services developer and
- (b) AIL performing the role of wholesale and retail distributor of products and services.

Inmarsat operates a constellation of geostationary satellites that extend mobile phone, fax and data communications to nearly every part of the world through the services it offers to end users through its established chain of distribution partners and satellite communications service providers.

On September 1, 2006, PLDT entered into a gateway services agreement with Inmarsat, under which PLDT committed to provide gateway infrastructure in Subic Bay up to a maximum amount of US\$5 million. In exchange, PLDT will earn US\$0.015 per minute for interconnection services to be provided to Inmarsat distribution partners for traffic going through the gateway facility in Subic Bay.

On September 1, 2006, AIL and PT Asia Cellular Satellite entered into a term sheet, as amended on October 20, 2006 and further amended on November 20, 2006 (the Bank Term Sheet), with a majority of the banks to be used as the basis for further good faith negotiations between the parties thereto with a view to entering into an agreement further amending the Amended Credit Agreement with AIL's bank creditors. Under the Banks Term Sheet, a majority of the banks agreed, subject to satisfaction of certain conditions, among other things, to amend the Original ATPA as set forth in an attachment to the Banks Terms Sheet and to restructure AIL's indebtedness. Pursuant to the business collaboration arrangements between AIL and Inmarsat, on September 1, 2006, Inmarsat made the first payment of US\$4 million to AIL which was used to pay principal and interest payable to the banks in accordance with the Banks Term Sheet.

On February 1, 2007, the parties to the Original ATPA entered into an amendment to the Original ATPA on substantially the terms attached to the Bank Terms Sheet (the Amended ATPA). Under the Amended ATPA, the Minimum Air Time Purchase Obligation was amended and replaced in its entirety with an obligation of PLDT (the Amended Minimum Air Time Purchase Obligation) to purchase from AIL a minimum of US\$500,000 worth of air time annually over a period ending upon the earlier of (i) the expiration of the Minimum Purchase Period and (ii) the date on which all indebtedness incurred by AIL to finance the AIL System is repaid. Furthermore, the Amended ATPA unconditionally released PLDT from any obligations arising out of or in connection with the Original ATPA prior to the date of the Amended ATPA, except for obligations to pay for billable units used prior to such date. Moreover, pursuant to a letter of confirmation, dated February 1, 2007, the banks released and discharged PLDT and ACeS Philippines and their respective subsidiaries from any and all obligations and liabilities under the Original ATPA and related agreements.

Moreover, in accordance with the above contractual arrangements, ACeS Philippines acquired (i) from LMGT Holdings (ACeS), Inc., or LMGT, 50% of its equity interest in AIL for a consideration of US\$0.75 million pursuant to a sale and purchase agreement entered into on February 1, 2007 and (ii) from Tera Global Investment Ltd., or TGIL, for a nominal consideration 50% of TGIL's interest in a promissory note issued by AIL, which 50% interest represents an aggregate amount of US\$44,743,752, or the Transferred AIL Note, together with related security interests pursuant to sale agreement entered into on February 1, 2007. Immediately thereafter, a portion of the Transferred AIL Note was converted into shares of AIL and the balance was converted into non-interest bearing convertible bonds of AIL. As a result of these transactions, ACeS Philippines owned 36.99% of AIL as at the date of this report.

Other Long-term Obligations

Mandatory Conversion and Purchase of Shares. As discussed in *Note 14 Preferred Stock Subject to Mandatory Redemption* to the consolidated financial statements in Item 18, PLDT had issued a total of 3 million shares of Series V Convertible Preferred Stock, 5 million shares of Series VI Convertible Preferred Stock and 4 million shares of Series VII Convertible Preferred Stock in exchange for a total of 58 million shares of Series K Class I Convertible Preferred Stock of Piltel, pursuant to the debt restructuring plan of Piltel adopted in June 2001. As at December 31, 2006, all Series VII Convertible Preferred Stock had been converted.

Each share of Series V and VI Convertible Preferred Stock is convertible at any time at the option of the holder into one PLDT common share. On the date immediately following the seventh anniversary of the issue date of the Series V and Series VI Convertible Preferred Stocks, the remaining outstanding shares under these series will be mandatorily converted to PLDT common shares. Under a put option exercisable for 30 days, holders of common shares received on mandatory conversion of the Series V and VI Convertible Preferred Stocks will be able to require PLDT to purchase such PLDT common shares for Php1,700 per share and US\$36.132 per share, respectively.

As at December 31, 2006, 2,675,393 shares of Series V Convertible Preferred Stock, 4,419,916 shares of Series VI Convertible Preferred Stock and all of the 3,842,000 shares of Series VII Convertible Preferred Stock had been voluntarily converted to PLDT common shares. As at December 31, 2006, 46,047 shares of Series V and 875,188 shares of Series VI Convertible Preferred Stocks remained outstanding. The aggregate value of the put option based on outstanding shares as at December 31, 2006 was Php1,629 million which is puttable on June 4, 2008, if all of the outstanding shares of Series V and VI Convertible Preferred Stocks were mandatorily converted and all the common shares were put to PLDT at that time. The market value of the underlying shares of common stock was Php2,349 million, based on the market price of PLDT common shares of Php2,550.00 per share as at December 31, 2006.

Commercial Commitments

As at December 31, 2006, our outstanding commercial commitments, in the form of letters of credit, amounted to Php1,546 million. These commitments will expire within one year.

Impact of Inflation and Changing Prices

Inflation can be a significant factor in the Philippine economy, and we are continually seeking ways to minimize its impact. In recent periods, however, we do not believe inflation has had a material impact on our operations. The average inflation rate in the Philippines in 2006 was 6.2%, compared to 7.6% in 2005.

Item 6. Directors, Senior Management and Employees

Directors, Key Officers and Advisors

The following are the names, ages and periods of service, of the directors/independent directors of PLDT, all of whom had been nominated for re-election and were re-elected at the annual meeting of shareholders that was held on June 12, 2007:

| <u>Name</u> | <u>Age</u> | <u>Period during which individual has served as such</u> |
|--------------------------------------|------------|--|
| Manuel V. Pangilinan | 60 | November 24, 1998 to present |
| Napoleon L. Nazareno | 57 | November 24, 1998 to present |
| Helen Y. Dee | 62 | June 18, 1986 to present |
| Ray C. Espinosa | 51 | November 24, 1998 to present |
| Tsuyoshi Kawashima(1) | 48 | July 11, 2006 to present |
| Tatsu Kono | 54 | March 28, 2006 to present |
| Rev. Fr. Bienvenido F. Nebres, S.J.* | 67 | November 24, 1998 to present |
| Corazon S. de la Paz | 66 | September 25, 2001 to present |
| Ma. Lourdes C. Rausa-Chan(2) | 53 | March 6, 2007 to present |
| Oscar S. Reyes* | 61 | April 5, 2005 to present |
| Albert F. del Rosario | 67 | November 24, 1998 to present |
| Pedro E. Roxas* | 51 | March 1, 2001 to present |
| Alfred V. Ty* | 39 | June 13, 2006 to present |

** Independent Director*

(1) Mr. Tsuyoshi Kawashima was elected to fill the vacancy resulting from Mr. Shigeru Yoshida's resignation on July 11, 2006.

(2) Atty. Ma. Lourdes C. Rausa-Chan replaced Mr. Antonio O. Cojuangco who resigned effective January 7, 2007.

The names, ages, positions and periods of service of the key officers and advisors of PLDT as at June 12, 2007 are as follows:

| <u>Name</u> | <u>Age</u> | <u>Position(s)</u> | <u>Period during which individual has served as such</u> |
|-------------|------------|--------------------|--|
|-------------|------------|--------------------|--|

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| | | | |
|---------------------------|----|---|---|
| Manuel V. Pangilinan | 60 | Chairman of the Board | February 19, 2004 to present |
| Napoleon L. Nazareno | 57 | President and Chief Executive Officer | February 19, 2004 to present |
| Ernesto R. Alberto | 45 | Senior Vice President Corporate Business Head | May 15, 2003 to present |
| Rene G. Bañez | 51 | Senior Vice President Chief Governance Officer | January 25, 2005 to present October 5, 2004 to present |
| Anabelle L. Chua | 46 | Treasurer Senior Vice President Corporate Finance and Treasury Head | February 1, 1999 to present February 26, 2002 to present March 1, 1998 to present |
| Jun R. Florencio | 52 | Senior Vice President Audit and Assurance Head | December 1, 2005 to present June 14, 2005 to present September 1, 2000 to February 15, 2006 |
| Menardo G. Jimenez, Jr.. | 44 | Internal Audit and Fraud Risk Management Head Senior Vice President Corporate Communications and Public Affairs Head | February 16, 2006 to present December 9, 2004 to present December 1, 2001 to June 15, 2004 |
| George N. Lim | 55 | Retail Business Head Senior Vice President Network Services Head | June 16, 2004 to present February 26, 1999 to present February 1, 2003 to present |
| Rosalie R. Montenegro | 58 | Senior Vice President Call Center Business Head | July 10, 2000 to present February 1, 2003 to present |
| Alfredo S. Panlilio | 44 | Senior Vice President PLDT Global Corp. President | May 8, 2001 to present June 16, 2004 to present |
| Claro Carmelo P. Ramirez | 47 | Senior Vice President International and Carrier Business Head | July 1, 1999 to present June 16, 2004 to December 4, 2005 |
| Ma. Lourdes C. Rausa-Chan | 53 | Consumer Affairs Head Corporate Secretary | December 5, 2005 to present November 24, 1998 to present |
| Victorico P. Vargas | 56 | Senior Vice President, Corporate Affairs and Legal Services Head Senior Vice President Human Resources Head | January 5, 1999 to present February 15, 2000 to present |
| June Cheryl C. Furigay | 33 | International and Carrier Business Head Vice President Financial Reporting and Controllership Head | March 1, 2007 to present June 14, 2005 to present November 16, 2006 to present |
| Christopher H. Young | 49 | Chief Financial Advisor | November 24, 1998 to present |
| Donald J. Rae | 46 | Chief Operations Advisor of Smart | January 1, 1999 to present |
| Rolando G. Peña | 44 | Network Services Head of Smart | September 1, 1994 to present |
| Ramoncito S. Fernandez | 50 | Administration and Materials Management Head of Smart | June 6, 2000 to present |
| Danilo J. Mojica | 46 | Wireless Consumer Head of Smart | June 1, 2006 to present |

Under the Shareholders Agreement entered into among First Pacific, NTT Communications and NTT-UK on September 28, 1999, as amended by the Cooperation Agreement dated January 31, 2006, NTT Communications is entitled to nominate two directors to the PLDT board of directors and First Pacific and its affiliates are entitled to nominate six directors. The Shareholders Agreement also entitles NTT Communications to nominate two directors to the board of directors of Smart and, subject to specified conditions, one member to the board of directors of all other PLDT subsidiaries. As a result of the Cooperation Agreement, in respect of NTT Communications' right to nominate two directors to each of the board of directors of PLDT and Smart, respectively, NTT Communications and the FP Parties agreed to vote as a PLDT shareholder, lobby the directors of PLDT and otherwise use reasonable efforts to procure a shareholders' vote in favor of replacing on each of the board of directors of PLDT and Smart, respectively, one NTT Communications nominee with one DoCoMo nominee. Under the Shareholders Agreement, NTT Communications is also entitled to appoint members or advisors of certain PLDT management and board committees, including the audit, governance and nomination, executive compensation and technology strategy committees described below under Audit, Governance and Nomination, Executive Compensation and Technology Strategy Committees, and as a result of the Cooperation Agreement, the FP Parties and NTT Communications agreed to use reasonable efforts to procure that DoCoMo be entitled to appoint one individual, who may be replaced at any time, to attend any board committee of PLDT as a member, advisor or observer. Upon NTT Communications, DoCoMo and their subsidiaries owning in the aggregate 20% or more of the shares of PLDT's common stock and for as long as NTT Communications, DoCoMo and their subsidiaries continue to own in the aggregate 17.5% of the shares of PLDT's common stock then outstanding, DoCoMo will be entitled to nominate one additional DoCoMo nominee to the board of directors of each of PLDT and Smart. Under the Shareholders Agreement and the Cooperation Agreement, each party has agreed, under certain circumstances, to vote its shares of common stock in favor of the nominees designated by the other parties. For more information about the Cooperation Agreement, see Item 7. Major Shareholders and Related Party Transactions Related Party Transactions Cooperation Agreement with First Pacific and certain affiliates, or the FP Parties, NTT Communications and DoCoMo.

The business address of Donald J. Rae, Ramoncito S. Fernandez and Rolando G. Peña and Danilo J. Mojica is Smart Tower II, Ayala Avenue, Makati City, Philippines. The business address of each of the other directors, key officers and advisors identified above is the Ramon Cojuangco Building, Makati Avenue, Makati City, Philippines.

The following is a brief description of the business experience during the past five years of each of our directors, key officers and advisors.

Mr. Manuel V. Pangilinan is the chairman of our board and the managing director of First Pacific. He assumed the chairmanship of our board in February 2004 after serving as president and chief executive officer for over five years since November 1998. During his presidency, he led the successful transformation of PLDT from a traditional plain old telephony service (voice) into a convergent voice, data, video (multi-media) service. He is the chairman of the Governance and Nomination and Technology Strategy Committees of PLDT. He is also the chairman of the boards of Smart, Piltel, ePLDT and Metro Pacific Investments Corporation. He also holds directorships in Metro Pacific Corporation and Landco Pacific Corporation. In 2005, he was named Management Man of the Year, a prestigious award that the Management Association of the Philippines bestows on individuals in the business community or government for attaining unquestioned distinction in the practice of management and for contributing to the country's progress. He was chosen for, among his other achievements, engineering the turnaround of PLDT and Piltel through a disciplined convergence strategy consisting of consolidation, diversification and expansion, spearheading PLDT's emergence as one of Asia's most recognized, admired, innovative and best performing telecommunication companies, spurring investor interest in the Philippines by bringing First Pacific and other foreign investors into the Philippines,

being an exemplary Filipino capable of effective and ethical leadership and of competing with the best in the international business community, and for an outstanding career that spans business, academe, charitable, non-government, arts and culture, sports and health organizations. In May 2006, the Office of the President of the Philippines awarded Mr. Pangilinan the Order of Lakandula rank of Komandante in recognition of his contributions to the country.

Mr. Napoleon L. Nazareno is the president and chief executive officer of PLDT effective February 19, 2004 and concurrently the president and chief executive officer of Smart and Piltel, positions he has held since January 2000 and November 2004, respectively. He also serves as a member of the Technology Strategy Committee. He is the chairman of the boards of I-Contacts Corporation, Wolfpac, Smart Broadband and Mabuhay Satellite and the president of ACeS Philippines. He also holds directorships in Rufino Pacific Tower Condominium Corporation and some subsidiaries of PLDT, namely, ePLDT and PLDT Global. His business experience spans over 30 years and cuts across a broad range of industries, namely, packaging, bottling, petrochemicals, real estate and, in the last decade, telecommunications and information technologies. In August 1995, he served as president and chief executive officer of Metro Pacific Corporation until December 1999. In November 2004, Mr. Nazareno was appointed by President Gloria Macapagal-Arroyo as Private Sector Representative of the Public-Private Sector Task Force for the Development of Globally Competitive Philippine Service Industries. He was voted Best Chief Executive Officer of the Year in the Philippines at the 2004, 2005 and 2006 Best-Managed Companies and Corporate Governance Polls conducted by *Asiamoney*, one of Asia's most influential magazines.

Ms. Helen Y. Dee is the chairman and president and/or chief executive officer of Hydee Management & Resources, Inc., House of Investments, Inc., Tameena Resources, Inc., Grepalife Asset Management Corporation and Grepalife Fixed Income Fund Corporation. She is also chairman of Rizal Commercial Banking Corporation, Landev Corporation, Manila Memorial Park, Inc., Mapua Information Technology Center, Inc. and Hi-Eisai Pharmaceuticals, Inc. and the vice-chairman of Pan Malayan Management and Investment Corporation. She is the president of Moira Management, Inc. and YGC Corporate Services, Inc. She sits on the boards of EEI Corporation, Petro Energy Resources Corp., Nippon Life Insurance Co., South Western Cement Corp., Seafront Resources Corp., Malayan Insurance Co. Inc., MICO Equities, Inc., Hermoza Ecozone Development Corporation, La Funeraria Paz, Inc., Honda Cars Philippines, Inc. and Isuzu Philippines, Inc.

Atty. Ray C. Espinosa is the president of ePLDT and the chairman of certain subsidiaries of ePLDT, namely Parlance, Vocativ, ePLDT Ventus, SPi, Infocom, Digital Paradise, Airborne Access and Level Up!. He also serves as a member of the Technology Strategy Committee. He is a member of the boards of Cyber Bay Corporation, Nation Broadcasting Corporation, Lepanto Consolidated Mining Co., Mediaquest Holdings, Inc., Metro Pacific Resources, Inc., Philippine Telecommunications Investment Corporation and several other companies. He is vice-chairman of the PLDT Beneficial Trust Fund. Until June 30, 2000, he was a partner and member of the Executive Committee of the law firm SyCip Salazar Hernandez & Gatmaitan.

Mr. Tsuyoshi Kawashima has been the general manager of the Philippine branch of NTT Communications since April 2005. He joined NTT Communications in October 1999 as senior manager of Global Business Development in the Global Business Division. Prior to that, he occupied various positions in The Long-Term Credit Bank of Japan, Ltd. from 1982 to 1998. Since August 2000, he has been an Executive Advisor of PLDT. He serves as a member of the Executive Compensation Committee and as an advisor to the Audit Committee of the Board of Directors of PLDT.

Mr. Tatsu Kono is the managing director of the Corporate Sales Department, Corporate Division of DoCoMo. He joined DoCoMo in 2000 and served as executive director of the Global Investment Group, Global Business Department. Prior to that, he occupied various positions in Kokusai Denshin Denwa Co., Ltd., or KDD, and became the general manager of the Sales Promotion Department in 1989, the managing director of the Kyoto Sales Office in 1990 and the managing director of the Tokyo Sales Office in 1998. He serves as a member of the Governance and Nomination and Technology Strategy Committees and as an advisor to the Audit Committee of the Board of Directors of PLDT.

Rev. Fr. Bienvenido F. Nebres, S.J. is the president of the Ateneo de Manila University and the vice chairman of the Board of Trustees of Asian Institute of Management. He is also a member of the boards of trustees of several other private educational institutions. He is the chairman of the Audit Committee and a member of the Governance and Nomination Committee of the board of directors of PLDT.

Ms. Corazon S. de la Paz is the vice chairman of the Social Security Commission, the president and chief executive officer of the Social Security System and the chairman of Equitable-PCI Bank. She is an advisor to the Audit Committee of PLDT. She has been elected president of the International Social Security Association, an association based in Geneva, Switzerland, to serve as such for a three-year term commencing in September 2004. Until June 30, 2001, she was the chairman and senior partner of Joaquin Cunanan & Co., a member firm of PricewaterhouseCoopers Worldwide. She is a director of San Miguel Corporation, Ayala Land, Inc., Philippine Health Insurance Corporation, Philex Mining Corporation, Philex Gold, Inc., Republic Glass Holding Corp., PCI Leasing and Finance, Inc., PCI Capital Corporation, EBC Investment, Inc. and Ionics Circuits, Inc. She is also a trustee of several educational and non-profit organizations.

Atty. Ma. Lourdes C. Rausa-Chan is senior vice president for corporate affairs and legal services and the general counsel and corporate secretary of PLDT. She also serves as corporate secretary of several subsidiaries of PLDT. Prior to joining PLDT in November 1998, she was the group vice president for legal affairs of Metro Pacific Corporation for 11 years. She has previously served as a director of PLDT from December 1999 to February 2001 and from June to December 2002 and was elected again on March 6, 2007.

Mr. Oscar S. Reyes is the Chairman of Unicapital Securities, Inc. and Link Edge, Inc. He serves as a member of the Audit, Governance and Nomination, Executive Compensation and Technology Strategy Committees of the Board of Directors of PLDT and also holds directorships in Bank of the Philippine Islands, CEOs, Inc., DMCI Holdings, Inc., Level Up!, Inc., Manila Water Corporation, Universal Robina Corporation, Sunlife of Canada (Philippines) and other private corporations. He was a member of the Advisory Board of PLDT for four years until April 2005. Mr. Reyes was the Country Chairman of the Shell Companies in the Philippines from 1997 to 2001 and concurrently the Managing Director of Shell Philippines Exploration B.V. until 2002. From 2002 to 2004, he served as the Management Adviser of Shell Philippines Exploration B.V. and as CEO Adviser of Pilipinas Shell Petroleum Corporation.

Mr. Albert F. del Rosario is the chairman of the board of Gotuaco del Rosario and Associates, Inc., Philippine Indocoil Corporation and Business World Publishing Corporation, the vice chairman of the board of Asia Traders Insurance Corporation and the president of ADR Holdings, Inc., ARS Reinsurance Brokers, Inc., Management Association of the Philippines and Philippine Telecommunications Investment Corporation. From 2001 to 2006, he served as the Ambassador Plenipotentiary and Extraordinary of the Republic of the Philippines to the United States of America. He is also the chairman of the Board of Trustees of the PLDT Beneficial Trust Fund and the Executive Compensation Committee of the Board of Directors of PLDT. Mr. del Rosario also sits on the boards of Infrontier (Philippines) Inc., Smart Communications Philippine Holdings, Inc., LMG Chemicals Corporation, Pacific Plaza Condominium Corporation, Pacific Plaza Towers Condominium Corporation, Six Harmonies Holdings, Inc., Landco Pacific Corporation and Metro Pacific Investments Corporation.

Mr. Pedro E. Roxas is the chairman and/or chief executive officer of various business organizations in the fields of agri-business, sugar manufacturing and real estate development including Roxas Holdings, Inc., CADP Group Corp., Roxaco Land Corporation and Roxas & Company, Inc., and is a director of BDO Private Bank. He serves as a member of the Audit Committee and Executive Compensation Committee of the Board of Directors of PLDT.

Mr. Alfred V. Ty is the chairman of Asia Pacific Top Management International Resources Corporation, vice chairman of Toyota Motor Philippines Corporation, the president of Federalland, Inc. and the corporate secretary of Metropolitan Bank and Trust Corporation. He serves as a member of the Governance and Nomination and Executive Compensation Committees of PLDT.

Mr. Ernesto R. Alberto is senior vice president for the corporate business group of PLDT. He has over 20 years of work experience in the areas of corporate banking, relationship management and business development. Prior to joining PLDT in May 2003, he was a vice president and the group head of the national corporate group of Citibank N.A., Manila from 1996 to 2003, and previously served as vice president and group head of the relationship management group of Citytrust Banking Corporation. Mr. Alberto is a director of several subsidiaries of PLDT.

Mr. Rene G. Bañez is our chief governance officer and is a non-voting member of the Governance and Nomination Committee of PLDT. He served as Commissioner of the Philippine Bureau of Internal Revenue from February 2001 to August 2002. Prior to that, he was the head of support services and tax management group of PLDT from January 1999 to January 2001. He served as group vice president for Tax Affairs of Metro Pacific Corporation for three years until December 1998. He is a non-voting member of the Governance and Nomination Committee of the Board of Directors of PLDT.

Ms. Anabelle L. Chua is the treasurer of PLDT and senior vice president for PLDT's corporate finance and treasury sector. She concurrently serves as the Chief Financial Officer of Smart. She was a vice president at Citibank, N.A. where she worked for ten years prior to joining PLDT in March 1998. She has over 15 years of work experience in the areas of corporate finance, treasury, financial control and credit risk management. Ms. Chua is currently a director of the Philippine Stock Exchange, Inc. and several subsidiaries and affiliates of PLDT. She is also a member of the board of trustees of the PLDT Beneficial Trust Fund.

Mr. Jun R. Florencio is the senior vice president for PLDT's internal audit and fraud risk management group. He has over 20 years of work experience in the areas of external and internal audit, credit management, information technology, financial management and controllership. He joined PLDT in April 1999 and served as the financial reporting and control sector head until March 2000. He then served as audit and assurance head until he assumed his present position in February 2006. He held various positions in the finance organization of Eastern Telecommunications and was the financial controller of Smart for four years until March 1999.

Mr. Menardo G. Jimenez, Jr. is senior vice president for the retail business group of PLDT and has previously served as the Officer-in-Charge of the Mobile Consumer Division of Smart. He managed various broadcasting and production companies in radio, television and stage-theater prior to his appointment as corporate communications and public affairs head of PLDT in December 2001. His business experience spans more than 20 years in film and cinema, theater, television advertising, publishing, broadcasting, education and, recently, in the telecommunications sector. As a film producer, he came up with internationally recognized and top-grossing movies and, under Trumpets Theater Company, a company he founded, he produced top musical plays. He had a stint at GMA Network, Inc., where he served as head of creative services and network promotions, during which he produced a number of international award-winning campaigns for its radio and television programs. In 1998, Mr. Jimenez was given the Ten Outstanding Young Men (TOYM) Award in Manila for Multi-Media Achievement. In 1999, he received his Ten Outstanding Young Persons (TOYP) of the World Award for Cultural Achievement in Cannes, France. He won the first CEO (Communications Excellence in Organizations) Awards given by the International Association of Business Communicators. In 2006, his further achievements in handling the retail business of PLDT and his stint in Smart as Officer-in-Charge for marketing were recognized by the Agora Awards, which chose him as its Marketing Man of the Year. Mr. Jimenez is the President of the TOYM Foundation, a regular speaker for the Business Matters Foundation and a contributing writer at two major daily newspapers. He is a founder of the Philippine Forum, which convenes the young movers of the Philippine business, government, media, art and other sectors in a yearly major forum.

Mr. George N. Lim is senior vice president for the network services group of PLDT. He has over 25 years of work experience in telecommunications management. Prior to his appointment as head of network services in February 2003, he served as head of network development and provisioning from February 1999 and as head of marketing from December 1993. He is a director of some subsidiaries of PLDT and Philippine Home Cable Holdings, Inc.

Ms. Rosalie R. Montenegro concurrently serves as president of Vocativ, Parlance and Ventus, all of which are wholly-owned subsidiaries of ePLDT engaged in the call center business. Prior to her appointment as a senior vice president in July 2000, she served as consumer banking head of ABN-AMRO Savings Bank and as vice president for remote banking of ABN-AMRO Consumer Bank, Singapore Regional Office from 1997 to 1999. She was vice president for global consumer banking (CitiPhone banking) and service quality director of Citibank N.A. from 1985 to 1996, servicing both banking and the credit cards businesses. Ms. Montenegro holds directorships in several subsidiaries of PLDT and ePLDT.

Mr. Alfredo S. Panlilio is a senior vice president of PLDT and currently serves as the president of PLDT Global Corp. He joined PLDT in July 1999 and served as corporate business head until February 2003 and as international carrier business until May 2004. He has over 15 years of work experience in the field of business development and

information technology. He held management positions at IBM Philippines, Inc. and was the vice president for business development of the Lopez Communications Group (ABS-CBN Broadcasting, Bayan Telecommunications and SKYCable) prior to joining PLDT in July 1999. Mr. Panlilio is also a director of several subsidiaries of PLDT and PLDT Global.

Mr. Claro Carmelo P. Ramirez is senior vice president for the consumer affairs group. He was the retail business head from February 2003 to June 2004 and then served as the international and carrier business head until December 2005. He is also a director of several subsidiaries of PLDT. He has over 20 years of work experience in the field of marketing. He has worked as associate director for Colgate Palmolive Company, Global Business Development in New York, and as marketing director for Colgate Palmolive Argentina, S.A.I.C. Prior to his appointment as senior vice president in July 1999, he was the marketing director of Colgate Palmolive Philippines, Inc.

Mr. Victorico P. Vargas is senior vice president for human resources management and effective March 1, 2007, concurrently heads the international and carrier business group of PLDT. He has over 20 years of work experience in the area of human resource management with respect to various industries including insurance, consumer goods, real estate, banking and finance, and telecommunications/IT. Prior to joining PLDT in February 2000, he was the country human resources director of Citibank N.A., Manila, and spent two years outside the Philippines as country human resources director of Citibank, N.A., Bangkok. He is also a director of several subsidiaries of PLDT and is a non-voting member of the Governance and Nomination and Executive Compensation Committees of the Board of Directors of PLDT.

Ms. June Cheryl C. Furigay joined PLDT in June 2000 as an executive trainee in the finance group and then served as an executive assistant to the corporate finance and treasury sector head from December 2000 to April 2002. Prior to being appointed to her present position as vice president and financial reporting and controllership head in June 2005 and November 2006, respectively, she was the Head of Financial Reporting and Planning Center. From 1993 to 1997, she was a Senior Associate in the business audit and advisory group of SGV & Co. She also serves as director and is the treasurer of several subsidiaries of PLDT.

Mr. Christopher H. Young is our chief financial advisor. He worked in PricewaterhouseCoopers in London and Hong Kong from 1979 until 1987, at which time he joined First Pacific in Hong Kong as group financial controller. He joined Metro Pacific Corporation in 1995 as finance director, a position he held until he joined us in November 1998.

Mr. Donald J. Rae is the chief operations advisor to Smart. He served as the chief operating officer for Time Telecommunications Sdn. Bhd. in Malaysia prior to joining Smart in January 1999. He also spent over ten years with Deloitte & Touche Consulting specializing in the Asian telecommunications sector.

Mr. Rolando G. Peña is head of the Network Services Division of Smart. He was first vice president for technical operations group at Digitel, where he worked for five years prior to his appointment as a director for Smart's local

exchange carrier services in September 1994. He held various positions in Eastern Telecommunications Philippines, Inc. from 1982 until 1989. He has over 22 years of experience in telecommunications operations, regional business and technical and operations support. He sits in the boards of Smart, Piltel, Wolfpac, Netopia, Smart Broadband and Mabuhay Satellite.

Mr. Ramoncito S. Fernandez is head of the Administration and Materials Management Division of Smart. He is also a member of the board of directors of Smart, Piltel, I-Contact and Wolfpac. Until June 2000, he was the executive vice president in charge of marketing, sales and logistics of Starpack Philippines Corporation. He has over 15 years of experience in materials management, industrial marketing and sales.

Mr. Danilo J. Mojica is head of the Wireless Consumer Division of Smart. Prior to joining Smart in June 2006, he was the general manager and chief operating officer of Cebu Pacific Air, a wholly-owned subsidiary of JG Summit Group, from 2003 to 2006 and was president of Rickett Benckiser Indonesia from 1997 to 2003.

Terms of Office

The directors of PLDT are elected each year to serve until the next annual meeting of stockholders and until their successors are elected and qualified. The term of office of all officers is coterminous with that of the board of directors that elected or appointed them.

Family Relationships

None of the directors, key officers and advisors of PLDT has any family relationships up to the fourth civil degree either by consanguinity or affinity.

Compensation of Key Management Personnel of the PLDT Group

The aggregate compensation paid to our key officers and directors named above, as a group, for 2006 amounted to approximately Php368 million.

Each of the directors, including the members of the advisory board of PLDT, is entitled to a director's fee in the amount of Php125,000 for each meeting of the board attended. Each of the members or advisors of the audit, executive compensation, governance and nomination and technology strategy committees is entitled to a fee in the

amount of Php50,000 for each committee meeting attended.

There are no agreements between PLDT Group and any of its key management personnel providing for benefits upon termination of employment, except for such benefits to which they may be entitled under PLDT Group's retirement and incentive plans.

Long-Term Incentive Plan

On August 3, 2004, PLDT's Board of Directors approved the establishment of a Long Term Incentive Plan, or Original LTIP, for eligible key executive officers and advisors of PLDT and its subsidiaries, which is administered by the Executive Compensation Committee. The Original LTIP is a four-year cash-settled share based plan covering the period from January 1, 2004 to December 31, 2007, or the Performance Cycle. The payment of awards was intended to be made at the end of the Performance Cycle (without interim payments) and contingent upon the achievement of an approved target increase in PLDT's common share price by the end of the performance cycle and a cumulative consolidated net income target for the Performance Cycle.

On August 28, 2006, PLDT's Board of Directors approved, in principle, the broad outline of the PLDT Group's strategic plans for 2007 to 2009 focusing on the development of new revenue streams to drive future growth while protecting the existing core communications business. To ensure the proper execution of the three-year plan, particularly with respect to the manpower resources being committed to such plans, a new LTIP, or New LTIP, upon endorsement of the Executive Compensation Committee, was approved by the Board of Directors to cover the period from January 1, 2007 to December 31, 2009, or New Performance Cycle.

As a result of the establishment of the New LTIP, the Board also approved the early vesting of the Original LTIP by the end of 2006 for those of its participants who were invited to join the New LTIP and chose to join. Participants in the Original LTIP who were not invited to join the New LTIP, or who were invited but chose not to join, remained subject to the Original LTIP and its original vesting schedule.

The Original LTIP cost, including cost for advisors (presented under professional and other service fees in the statements of income), and cumulative effect of the adoption of SFAS 123 (R), recognized as an expense as at December 31, 2006 and 2005 amounted to Php3,432 million and Php1,224 million, respectively. As at December 31, 2006 and 2005, total Original LTIP liability amounted to Php5,030 million and Php1,880 million, respectively.

The New LTIP, like the Original LTIP, is a cash plan that is intended to provide meaningful, contingent, financial incentive compensation for eligible executives, officers and advisors of the PLDT Group, who are consistent performers and contributors to the achievement of the long-term strategic plans and objectives, as well as the functional strategy and goals of the PLDT Group.

The New LTIP, like the Original LTIP, is administered by the Executive Compensation Committee which has the authority to determine (a) eligibility and identity of participants; (b) the award attributable to each participant based on the participant's annual base compensation and taking into account such participant's seniority, responsibility level, performance potential, tenure with the PLDT Group, job difficulty and such other measures as the Committee deems appropriate; (c) the level of achievement of the performance objectives; and (d) the actual award payable to each participant based on the level of achievement of the performance objectives.

Executive Stock Option Plan

On April 27, 1999 and December 10, 1999, the board of directors and stockholders, respectively, of PLDT approved the executive stock option plan covering a total of 1,289,745 shares of common stock and the amendment of the seventh article of the Articles of Incorporation of PLDT denying the pre-emptive right of holders of shares of common stock to subscribe for any issue of the 1,289,745 shares of common stock pursuant to the executive stock option plan.

Stock options that were granted pursuant to the executive stock option plan to management executives and advisors/consultants of PLDT became fully vested in December 2004. An option holder may exercise his option to purchase that number of vested shares of common stock underlying his option, in whole or in part, at the price at Php814 per share, subject to adjustment upon the occurrence of specific events described in the executive stock option plan. The option exercise period is until December 9, 2009. The option holder is required to give written notice of exercise to the executive compensation committee, indicating the number of vested shares to be purchased, accompanied by payment in cash of the full amount of the purchase price for those shares.

As at May 31, 2007, the total number of shares of common stock allocated for options granted to the chief executive officer, directors and key officers of PLDT named below, as a group, under the executive stock option plan was 261,290.

Share Ownership

The following table sets forth information regarding ownership of our common stock, preferred stock and executive stock options, as at May 31, 2007, by our continuing directors, key officers and advisors. Each individual below owns less than 1% of our outstanding common and preferred shares.

| Name of Owner | Shares of | Shares of | Shares of Common Stock Underlying Executive |
|----------------------|---------------------|------------------------|--|
| | Common Stock | Preferred Stock | |

Stock Options(1)

| | | | |
|------------------------------------|---------------|-------|--------|
| Manuel V. Pangilinan | 217,350 | 360 | |
| Napoleon L. Nazareno | 6,427 | 495 | |
| Helen Y. Dee | 22,055(2) | 180 | |
| Ray C. Espinosa | 3,201(3) | | 13,042 |
| Tsuyoshi Kawashima | 10 | | |
| Tatsu Kono | 100 | | |
| Rev. Fr. Bienvenido F. Nebres, S.J | 3,078(4) | | |
| Corazon S. de la Paz | 11,146,310(5) | | |
| Ma. Lourdes C. Rausa-Chan | 699(3) | 350 | |
| Oscar S. Reyes | 1 | 360 | |
| Albert F. del Rosario | 119,995(3) | 1,560 | |
| Pedro E. Roxas | 1 | 540 | |
| Alfred V. Ty | 1 | | |
| Ernesto R. Alberto | | | |
| Rene G. Bañez | 1 | 540 | |
| Anabelle L. Chua | 12,778(3) | | |
| Jun R. Florencio | 15 | 530 | |
| Menardo G. Jimenez, Jr. | 22 | | |
| George N. Lim | 5,756(3) | 360 | |
| Rosalie R. Montenegro | | | |
| Alfredo S. Panlilio | 1 | | |
| Claro Carmelo P. Ramirez | 11,500 | | |
| Victorico P. Vargas | | 180 | 2,878 |
| June Cheryl C. Furigay | | | |
| Christopher H. Young | 47,813(3) | | |
| Donald J. Rae | | | |
| Rolando G. Peña | | | |
| Ramoncito S. Fernandez | 156 | | |
| Danilo J. Mojica | | | |

(1) As at May 31, 2007, under PLDT's ESOP, options to purchase 19,938 shares of common stock for the key officers listed in the table above remain unexercised. No options have been granted to non-executive directors. All outstanding options are exercisable at an exercise price of Php814 per share and have an expiration date of December 10, 2009. All outstanding options were fully vested as at December 10, 2004.

(2) Includes 21,957 PLDT common shares registered in the name of Hydee Management and Resources, Inc. As chairperson and president of Hydee Management & Resources, Inc., Ms. Dee may exercise voting rights in respect and may be considered to have beneficial ownership of these shares.

(3) Includes PLDT common shares that have been lodged with the Philippine Central Depository, Inc.

(4) Includes 386 shares of PLDT's common stock registered in the name of Ateneo de Manila University and 2,690 shares of PLDT's common stock held of record by PCD Nominee Corporation. As President of the Ateneo de Manila University, Rev. Fr. Nebres may exercise voting rights in respect of these shares and may be considered to have beneficial ownership of these shares.

(5) *Includes 5,024,789 PLDT common shares registered in the name of Social Security System and 6,121,520 PLDT common shares held of record by PCD Nominee Corporation. Ms. De la Paz, as president and chief executive officer of the Social Security System, may exercise voting rights in respect of these shares and may be considered to have beneficial ownership of these shares.*

The aggregate number of common and preferred shares directly and indirectly owned by directors, key officers and advisors listed above, as at May 31, 2007, was 11,597,270 and 5,455 respectively, or 6.148182% and 0.000772% of PLDT's outstanding common and preferred shares, respectively.

Board of Directors Independent Directors

At least four of our directors, namely, Rev. Fr. Bienvenido F. Nebres, S.J., Oscar S. Reyes, Pedro E. Roxas and Alfred V. Ty, are independent directors who are not officers or employees of PLDT or any of its subsidiaries, and who are free from any business or other relationship with PLDT or any of its subsidiaries which could, or could reasonably be perceived to, materially interfere with the exercise of independent judgment in carrying out their responsibilities as directors. The independence standards/criteria are provided in our By-Laws and Manual on Corporate Governance pursuant to which, in general, a director may not be deemed independent if such director is, or in the past five years had been, employed in an executive capacity by us or any company controlling, controlled by or under common control with us or he is, or within the past five years had been, retained as a professional adviser by us or any of our related companies, or he is not free from any business or other relationships with us which could, or could reasonably be perceived, to materially interfere with his exercise of independent judgment in carrying out his responsibilities as a director.

Audit, Governance and Nomination, Executive Compensation and Technology Strategy Committees

Our board of directors is authorized under the by-laws to create committees, as it may deem necessary. We currently have four board committees, namely, the audit, governance and nomination, executive compensation and technology strategy committees, the purpose of which is to assist our board of directors. Each of these committees has a board-approved written charter that provides for such committee's composition, membership qualifications, functions and responsibilities, conduct of meetings, and reporting procedure to the board of directors.

Audit Committee

Our audit committee is composed of three members, all of whom are independent directors, namely, Fr. Bienvenido F. Nebres, S.J., who chairs the committee, Mr. Pedro E. Roxas and Mr. Oscar S. Reyes. Mr. Tatsu Kono and Mr. Tsuyoshi Kawashima, who are non-independent members of our board of directors, Ms. Corazon S. de la Paz and Mr. Roberto R. Romulo serve as advisors to the audit committee. All of the members of our audit committee are

financially literate and Ms. Corazon S. de la Paz, an advisor to the audit committee, is an accounting and financial management expert.

As provided for in the audit committee charter, the purposes of the audit committee are to assist our board of directors:

- in its oversight of PLDT's accounting and financial reporting principles and policies and internal audit controls and procedures;
- in its oversight of the integrity of PLDT's financial statements and the independent audit thereof;
- in its oversight of PLDT's compliance with legal and regulatory requirements;
- in its oversight of the external auditor's qualifications and independence; and
- in its oversight of the performance of the internal auditing organization and the external auditors.

To carry its direct responsibility for the appointment, setting of compensation, retention and removal of the external auditors, the audit committee has the following duties and powers:

- to review and evaluate the qualifications, performance and independence of the external auditors and the lead partner of the external auditors;
- to select and appoint the external auditors and to remove or replace the external auditors;
- to review and approve in consultation with the head of the internal auditing organization and the chief financial advisor the fees charged by the external auditors for audit and non-audit services;
- to pre-approve all audit and non-audit services to be provided by and all fees to be paid to the external auditors;

- to ensure that the external auditors prepare and deliver annually the statement as to independence and auditors statement, to discuss with the external auditors any relationships or services disclosed in such statements that may impact the objectivity, independence or quality of services of our external auditors and to take appropriate action in response to such statements to satisfy itself of the external auditor's independence;
- to ensure that the external auditors or the lead partner of the external auditors is rotated at least once every five (5) years;
- to have separate sessions periodically, with management, with the internal audit organization and with the external auditors, where deemed appropriate, to surface issues warranting the attention of the audit committee; and
- to resolve disagreements between management and the external auditors regarding financial reporting.

The audit committee also has the authority to retain or obtain advice from special counsel or other experts or consultants in the discharge of their responsibilities without the need for board approval.

Governance and Nomination Committee

Our governance and nomination committee is composed of five voting and two non-voting members. Three of the voting members are independent directors namely, Fr. Bienvenido F. Nebres, S.J., Mr. Alfred V. Ty and Mr. Oscar S. Reyes. Mr. Manuel V. Pangilinan, who serves as chairman, and Mr. Tatsu Kono are the other voting members, and Mr. Victorico P. Vargas and Mr. Rene G. Bañez are the non-voting members.

The principal functions and responsibilities of our governance and nomination committee are:

1. To develop and recommend to the board for approval and oversee the implementation of corporate governance principles and policies;
2. To review and evaluate the qualifications of the persons nominated for election as directors (including independent directors) or other positions requiring board appointment;

3. To identify the qualified nominees and recommend that the board select and recommend such qualified nominees for election as directors/independent directors at the annual meeting of shareholders; and
4. To provide an assessment on our board's effectiveness in the process of replacing or appointing new directors or members of the board committees.

Executive Compensation Committee

Our executive compensation committee is composed of six members: five voting members and one non-voting member. Three of these voting members are independent directors, namely Mr. Pedro E. Roxas, Mr. Oscar S. Reyes and Mr. Alfred V. Ty, two are non-independent directors, namely Mr. Tsuyoshi Kawashima and Mr. Albert F. del Rosario, who serves as chairman, and one is a non-voting member, namely Mr. Victorico P. Vargas.

The principal functions and responsibilities of our executive compensation committee are:

1. To provide guidance to and assist our board of directors in developing a compensation philosophy or policy consistent with our culture, strategy and control environment;
2. To oversee the development and administration of our compensation programs; and
3. To review and approve corporate goals and objectives relevant to the compensation of our chief executive officer, evaluate the performance of our chief executive officer in light of those goals and objectives, and set the compensation level of our chief executive officer based on such evaluation.

Technology Strategy Committee

Effective June 12, 2007, our board of directors created a new committee, the technology strategy committee. Our technology strategy committee is composed of five members, all of whom are voting members. One of the members is an independent director, namely Mr. Oscar S. Reyes, and four are non-independent directors, namely Mr. Manuel V. Pangilinan, who serves as chairman, Mr. Napoleon L. Nazareno, Mr. Ray C. Espinosa and Mr. Tatsu Kono.

The principal functions and responsibilities of our technology strategy committee are:

1. To review and approve our technology strategy and roadmap, and to review and advise our board on major technology trends and strategies;
2. To evaluate and advise our board on actual and proposed technology investments and transactions;
3. To review and submit to the board recommendations regarding management's formulation and execution, and to oversee the execution of, our technology strategy; and
4. To recommend to the board approaches to acquiring and maintaining technology positions and maximizing our access to relevant technologies, and to ensure optimized contribution of technology to our business strategy and growth targets.

Finance Committee Dissolved

Effective June 12, 2007, our board of directors dissolved our finance committee as its functions had regularly been carried out by the full board of directors for a prolonged period of time, supplanting the need to continue to maintain a finance committee.

Directors and Officers Involvement in Certain Legal Proceedings

The following is a description of the cases in which our Chairman, Manuel V. Pangilinan, our President and Chief Executive Officer, Mr. Napoleon L. Nazareno and our directors, Mr. Albert F. del Rosario and Ms. Ma. Lourdes C. Rausa-Chan are respondents:

1. Mr. Manuel V. Pangilinan, in his capacity as Chairman of the Board of Metro Pacific Corporation, a stockholder of Metro Tagaytay Land Company, Inc. (MTLCI), and four other individuals are respondents in I.S. 04-A-1057 for alleged violation of Article 315 (1)(b) (estafa) of the Revised Penal Code filed by Mr. Vicente A. Tuason in behalf of Universal Leisure Club, Inc. (ULCI) and Mr. Jose L. Merin in behalf of Universal Rightfield Property Holdings, Inc. (URPHI). In the complaint-affidavit, Messrs. Tuason and Merin alleged that, in violation of the trust reposed by ULCI

and certain contractual commitments and representations, MTLCI, with the participation and/or conformity of the respondents, misappropriated and converted P139 million that ULCI entrusted for the purpose of incorporating Golf Land Co., Inc. (GLCI), a corporation to be wholly owned by MTLCI and to which a property of MTLCI was to be transferred in exchange for shares in GLCI. The said shares were then supposed to be transferred to ULCI. Based on his counsel's advice, Mr. Pangilinan cannot be held liable for violating Article 315 (1)(b) of the Revised Penal Code because no document or other evidence has been presented to prove that Mr. Pangilinan actually participated in the negotiation, preparation, approval, execution and/or implementation of the agreement/contract upon which the claims of the complainants are purportedly based, much less that Mr. Pangilinan, with abuse of trust and confidence, misappropriated any amounts paid by ULCI to MTLCI. On March 25, 2004, Mr. Pangilinan submitted his counter-affidavit in I.S. No. 04-A-1057. In a Joint Resolution dated June 7, 2004, the City Prosecution Office of Makati dismissed all charges in the estafa case against Mr. Pangilinan. On November 16, 2004, ULCI, through Messrs. Tuason and Merin, filed with the Philippine Department of Justice, or DOJ, a Petition for Review assailing the Resolution of the City Prosecution Office of Makati. Subsequently, the complainants and respondents, including Mr. Pangilinan, filed a Joint Motion to Dismiss (with prejudice) the charges and counter-charges subject of the investigation, which motion is pending resolution by the DOJ.

2. Mr. Napoleon L. Nazareno is a respondent in Criminal Case No. 133235-R pending before the 6th Municipal Trial Court in Cities, Branch 6 of Cebu City, and I. S. No. 2005-57-B pending before the Municipal Trial Court of Borongan, Samar, all for alleged violation of Section 301 in relation to Section 213 of Presidential Decree 1096 (otherwise know as the National Building Code of the Philippines). The complaints alleged that Smart built its cellsites without securing building permits and Smart's officers are criminally liable therefor. The proceedings in Criminal Case No. 133235-R and I. S. No. 2005-57-B have been suspended pending the submission by Smart of a building permit. To date, the building permits for the sites have been secured and Smart is set to file the appropriate pleadings for the dismissal of the cases.

3. Messrs. Nazareno and Albert F. del Rosario and other directors and officers of the former PDCP Bank, are respondents in a complaint docketed as I.S. No. 2004-631, which was filed by Chung Hing Wong/Unisteel/Unisco Metals, Inc. with the DOJ, for alleged syndicated estafa, estafa through falsification of documents, other deceits, misconduct and robbery. As stated in their respective counter affidavits, the charges against the PDCP directors are entirely without merit. The case is currently pending with the Philippine DOJ.

4. Mr. del Rosario and other former directors/officers and corporate secretaries/assistant corporate secretaries, including Ma. Lourdes C. Rausa-Chan, of Steniel Cavite Packaging Corporation, Metro Paper and Packaging Products, Inc., AR Packaging Corporation and Starpack Philippines Corporation, are respondents in a case docketed as OMB C-C-04-0363-H (CPL No. C-04-1248), in the Office of the Ombudsman. The complaint is for alleged: (a) violation of Republic Act No. 3019 (otherwise known as the Anti-Graft and Corrupt Practices Act); (b) estafa through falsification of public documents; (c) falsification of public documents under Article 171, in relation to Article 172, of the Revised Penal Code, or RPC; (d) infidelity in the custody of public documents under Article 226 of the RPC; and (e) grave misconduct. The complaint related to various tax credit certificates (allegedly fraudulent, with spurious and fake supporting documents) issued to Victory Textile Mills, Inc. (allegedly a non-existent corporation with fictitious incorporators and directors) and transferred to several companies including the aforesaid companies. The complaint against Mr. del Rosario and Ms. Rausa-Chan involves the first two offenses only and in their capacity as director and corporate secretary, respectively, of Metro Paper and Packaging Products, Inc. In the opinion of the legal counsels for Mr. del Rosario and Ms. Rausa-Chan, there are no legal and factual bases for their inclusion as respondents in this complaint. Mr. del Rosario and Ms. Rausa-Chan had no participation or involvement

in the alleged anomalous acquisition and transfer of the subject tax credit certificates. The case is currently pending with the Office of the Ombudsman.

Employees and Labor Relations

As at December 31, 2006, we had 28,219 employees within the PLDT Group. PLDT had 8,526 employees at the end of 2006, of which 44% were rank-and-file employees, 51% were management/supervisory staff and 5% were executives. This number represents a decrease of 493 employees, or approximately 6%, from the staff level as of the end of 2005, mainly as a result of the ongoing manpower rightsizing program. From a peak of 20,312 at the end of 1994, PLDT's number of employees has declined by 11,786, or 58%, by the end of 2006. As at December 31, 2005, we had 18,926 and 9,013 employees under the PLDT Group and PLDT, respectively. The increase in the number of employees as at December 31, 2006 was primarily due to the acquisition of SPi, CyMed and Level Up!

PLDT has three employee unions, the members of which in the aggregate represent 23% of the employees of the PLDT Group. We consider our relationship with our rank-and-file employees' union, our supervisors' union and our sales supervisors' union to be good.

On November 16, 2006, PLDT and the *Manggagawa ng Komunikasyon sa Pilipinas*, or MKP, our rank-and-file employees' union, concluded and signed a new three-year Collective Bargaining Agreement, or CBA, covering the period from November 9, 2006 to November 8, 2008. This CBA provides each member a signing bonus equivalent to one month's salary (computed at the salary rate prevailing prior to November 9, 2007) plus Php15,000; monthly salary increases of Php2,150, Php2,200 and Php2,550 for the first, second and third year, respectively; an increase in the yearly Christmas gift certificate from Php7,000 to Php8,000; an increase in the amount of coverage under the group life insurance plan from Php500,000 to Php650,000; an additional contribution of Php1 million to the Educational Loan Fund; and Php35,000 funeral assistance for death of a dependent. Other highlights of this CBA include increases in the rice subsidy and professional fee for dependent's hospitalization.

On March 8, 2005, PLDT and PLDT Sales Supervisors' Union, or PSSU, concluded and signed a new three-year CBA covering the period from January 1, 2005 to December 31, 2007. This CBA provides each member monthly salary increases of 8% of basic pay or Php2,000, whichever is higher, for the first year; 10% of basic pay or Php2,700, whichever is higher, for the second year; and another 10% of basic pay or Php2,400, whichever is higher, for the third year. Other highlights of this CBA are improvements of existing benefits and a one-time signing bonus of Php33,000, including a Php3,000 goodwill bonus, for each member of PSSU. Furthermore, a Php4,000 one-time clothing accessory allowance was also provided.

On January 20, 2005, PLDT and *Gabay ng Unyon sa Telekomunikasyon ng mga Superbisor*, or GUTS, our supervisors' union, concluded and signed a new three-year CBA covering the period from January 1, 2005 to December 31, 2007. This CBA provides each member monthly salary increases of 8% of basic pay or Php2,000, whichever is higher, for 2005; 10% of basic pay or Php2,700, whichever is higher, for 2006; and another 10% of basic

pay or Php2,400, whichever is higher, for 2007. Other highlights of this CBA are improvements of existing benefits and a one-time signing bonus of Php33,000, including a Php3,000 goodwill bonus, for each member of GUTS.

Pension and Retirement Benefits

Defined Benefit Plans

We have defined benefit pension plans, covering substantially all of our employees, except the employees of Smart. The plans require contributions to be made to a separate administrative fund.

PLDT has a trustee, non-contributory defined benefit plan covering all permanent and regular employees. The benefit plan provides benefits upon normal retirement beginning at age 65, early retirement beginning at age 50 or completion of at least 30 years of credited service, voluntary resignation with completion of at least 15 years of credited service, total and physical disability, death and involuntary separation. Benefits are based on the employee's final monthly basic salary and length of service.

The normal retirement benefit is equal to a percentage of the final monthly basic salary per year of credited service. The percentage is 100% for those with less than 15 years of service at retirement and 125% for those with 15 years of service at retirement. Thereafter, the percentage increases by 5% for every additional year of credited service up to a maximum of 200%. Early retirement benefit is equal to the accrued normal retirement benefit based on salary and service at the date of early retirement.

In the event the benefit plan's assets were insufficient to pay the required retirement benefits, PLDT would be obligated to fund the amount of the shortfall. In addition, claims of PLDT's employees for retirement benefits that have accrued would rank above the claims of all other creditors of PLDT, in the event of PLDT's bankruptcy or liquidation.

For more information about the benefit plan, see *Note 17 Employee Benefits* to the accompanying consolidated financial statements in Item 18.

Item 7. Major Shareholders and Related Party Transactions

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The following table sets forth information regarding ownership of shares of PLDT's common stock as at May 31, 2007 of all shareholders known to us to beneficially own 5% or more of PLDT shares of common stock. All shares of PLDT's common stock have one vote per share.

| Title of Class | Name and Address of Record Owner and Relationship with Issuer | Place of Incorporation | Name of Beneficial Owner and Relationship with Record Owner | Number of Shares Held | Percentage of Class |
|----------------|---|------------------------|--|-----------------------|---------------------|
| Common | Philippine Telecommunications Investment Corporation(1) 12th Floor Ramon Cojuangco Bldg., Makati Avenue, Makati City | Philippine Corporation | Metro Pacific Assets Holdings, Inc. c/o Corporate Secretary 18th Floor Liberty Center, 104 H.V. Dela Costa St., Salcedo Village, Makati City (See Footnote 1 below) | 13,338,415 | 7.07 |
| Common | Metro Pacific Resources, Inc. (2) c/o Corporate Secretary 18th Floor Liberty Center, 104 H.V. dela Costa St. Salcedo Village, Makati City | Philippine Corporation | Metro Pacific Holdings, Inc. c/o Corporate Secretary 18th Floor Liberty Center, 104 H.V. Dela Costa St., Salcedo Village, Makati City (See Footnotes 1 and 2 below) | 17,112,534 | 9.07 |
| Common | NTT Communications Corporation(3) 1-1-6 Uchisaiwai-cho 1-Chome, Chiyoda-ku Tokyo 100-8019, Japan | Japanese Corporation | Nippon Telegraph and Telephone Corporation 2-3-1 Otemachi Chiyoda-ku, TKY 100-8116 | 12,633,487 | 6.70 |
| Common | NTT DoCoMo, Inc.(4) 41st flr Sanno Park Tower 2-11-1 Nagata-cho, Chiyoda-ku Tokyo 100-6150, Japan | Japanese Corporation | Nippon Telegraph and Telephone Corporation 2-3-1 Otemachi Chiyoda-ku, TKY 100-8116 | 15,987,736 | 8.48 |
| Common | Social Security System(5) SSS Building East Avenue, Quezon City | Philippine Corporation | Same as Record Owner | 11,146,309 | 5.91 |
| Common | PCD Nominee Corporation(6) 37/F Enterprise Building, Tower 1 | Philippine Corporation | See Footnote 6 below | 87,123,483 | 46.19 |

| | | | | | |
|--------|--|----------------------|----------------------|------------|-------|
| | Paseo de Roxas cor. Ayala Avenue, Makati City | | | | |
| Common | J.P. Morgan Asset Holdings (HK) Limited(7) (various accounts) 20/F Chater House, 8 Connaught Road Central, Hongkong | Hongkong Corporation | See Footnote 7 below | 34,902,407 | 18.50 |
| Common | Capital Research and Management Company(8) | U.S. Company | See Footnote 8 below | 14,575,690 | 7.73 |

(1) Pursuant to a resolution adopted by the Board of Directors of Philippine Telecommunications Investment Corporation, or PTIC, a copy of which had been furnished to PLDT, the President of PTIC, Mr. Manuel V. Pangilinan, has the continuing authority to represent PTIC at any and all meetings of the stockholders of a corporation in which PTIC owns of record or beneficially any shares of stock or other voting security, and to sign and deliver, in favor of any person he may deem fit, a proxy or other power of attorney, with full power of delegation and substitution, authorizing his designated proxy or attorney-in-fact to vote any and all shares of stock and other voting securities owned of record or beneficially by PTIC at any and all meetings of the stockholders of the corporation issuing such shares of stock or voting securities.

First Pacific Group beneficially owned 28% of our common shares as at May 31, 2007 by virtue of the PLDT common shareholdings by intermediate holding companies, including PTIC, MPRI, Metro Pacific Assets Holdings, Inc., and Metro Pacific Holdings, Inc.

PTIC's shareholding of 13,338,415 shares excludes the 12,695,848 PLDT shares that have been delivered and lodged with Philippine Depositary and Trust Co. The actual percentage of PLDT's shares held by PTIC, if the shares delivered and lodged with PCD are included, is 13.8%.

(2) Based on the resolution of the Board of Directors of Metro Pacific Resources, Inc., or MPRI, a copy of which had been furnished to PLDT, Mr. Manuel V. Pangilinan has been appointed as proxy or duly authorized representative of MPRI to represent and vote the PLDT shares of common stock of MPRI in the annual meeting of stockholders of PLDT.

(3) Based on publicly available information, NTT Communications is a wholly-owned subsidiary of Nippon Telegraph and Telephone Corporation. Pursuant to the amendment No. 4 to Schedule 13D filed with the Securities and Exchange Commission on April 18, 2007 by NTT and NTT Communications, NTT, NTT Communications and DoCoMo as a group beneficially owned 28,621,223 shares of PLDT common stock. As certified by our stock transfer agent, NTT Communications was the record owner of 12,633,487 shares of PLDT common stock as at May 31, 2007. Based on a certification signed by a duly authorized officer of NTT Communications, a copy of which had been furnished to PLDT, Mr. Jun Sawada is authorized to execute for and on behalf of NTT Communications,

endorsements, transfers and other matters relating to the PLDT shares of common stock held by NTT Communications.

(4) DoCoMo completed the acquisition of 12,633,486 shares of PLDT common stock from NTT Communications on March 14, 2006. Moreover, as disclosed in its amendment No. 1 to Schedule 13D filed with the Securities and Exchange Commission on April 18, 2007 (the DoCoMo Schedule 13D), from March 20, 2007 through April 16, 2007, DoCoMo acquired through open market purchases an additional 1,966,062 shares of PLDT common stock. DoCoMo informed PLDT that DoCoMo made further open market purchases of shares of PLDT common stock thereby increasing the number of shares of PLDT common stock held by DoCoMo to 15,987,736 as at May 31, 2007. Based on publicly available information, DoCoMo is a majority-owned and publicly traded subsidiary of NTT. Based on a certification signed by a duly authorized officer of DoCoMo, a copy of which had been furnished to PLDT, Mr. Toshinari Kunieda or Mr. Matsuo Yamamoto, is authorized to execute for and on behalf of NTT DoCoMo, endorsements, transfers and other matters relating to the PLDT shares of common stock held by DoCoMo.

(5) Social Security System, or SSS, is the record owner of 5,024,789 shares and is the beneficial owner of 6,121,520 shares held of record by PCD Nominee Corporation as at May 31, 2007. Please refer to footnote 6. Pursuant to a resolution of the Board of Directors of the SSS, a copy of which had been furnished to PLDT, Ms. Corazon S. de la Paz, as President and Chief Executive Officer of the SSS, has been authorized to represent and vote the PLDT shares of common stock of SSS in the Annual Meeting.

(6) Registered owner of shares held by participants in the Philippine Depository and Trust Co., or PDTC, a private company organized to implement an automated book entry system of handling securities transactions in the Philippines. Under the PDTC procedures, when an issuer of a PDTC-eligible issue will hold a stockholders meeting, the PDTC will execute a pro-forma proxy in favor of its participants for the total number of shares in their respective principal securities account as well as for the total number of shares in their client securities account. For the shares held in the principal securities account, the participant concerned is appointed as proxy with full voting rights and powers as registered owner of such shares. For the shares held in the client securities account, the participant concerned is appointed as proxy, with the obligation to constitute a sub-proxy in favor of its clients with full voting and other rights for the number of shares beneficially owned by such clients. Based on available information, none of the owners of the PLDT common shares registered under the name of PCD Nominee Corporation, or PCD, owned more than 5% of PLDT's outstanding common stock as at May 31, 2007, except The Hongkong and Shanghai Banking Corp. Ltd. Clients, Capital Research and Management Company, Standard Chartered Bank and Citibank N.A., which own approximately 21.47%, 7.73%, 5.77% and 5.55%, respectively, of PLDT's outstanding common stock as at such date. The Company has no knowledge if any beneficial owner of the shares under The Hongkong and Shanghai Banking Corp. Ltd. Clients and Standard Chartered Bank accounts own more than 5% of PLDT's outstanding common stock as at such date.

The PCD account also includes 6,121,520 shares beneficially owned by the Social Security System and 11,938,750 shares beneficially owned by Capital Research and Management Company. Please refer to footnotes 5 and 8.

(7) Holds shares as nominee of JPMorgan Chase Bank, successor depositary under the Common Stock Deposit Agreement, dated October 14, 1994, as amended on February 10, 2003, between JPMorgan Chase Bank and the holders of American Depositary Receipts, or ADRs, evidencing American Depositary Shares, or ADSs, representing shares of common stock of the Company (the Deposit Agreement). Under the Deposit Agreement, if the depositary does not receive voting instructions from a holder of ADRs, such holder will be deemed to have instructed the depositary to provide a discretionary proxy to a person designated by PLDT for the purpose of exercising the voting rights pertaining to the shares of common stock represented by such holder of ADRs, except that no discretionary proxy will be given with respect to any matter as to which substantial opposition exists or which materially and adversely affects the rights of the holders of such ADRs.

This account also includes 2,636,940 shares of common stock underlying ADSs owned by Capital Research and Management Company. Please refer to footnote 8.

(8) According to the Schedule 13G of Capital Research and Management Company, filed with the Securities and Exchange Commission on February 6, 2007, Capital Research and Management Company, as an investment adviser, beneficially owned 14,575,690 shares of PLDT common stock, including 2,636,940 shares of PLDT common stock represented by ADSs as at December 29, 2006. Please refer to footnotes 6 and 7 for further discussion.

As at May 31, 2007, approximately 86.03% of the outstanding capital stock of PLDT was registered in the names of Philippine persons.

Related Party Transactions

Cooperation Agreement with First Pacific and certain affiliates, or the FP Parties, NTT Communications and DoCoMo

In connection with the transfer by NTT Communications Corporation, or NTT Communications, of approximately 12.6 million shares of PLDT's common stock to NTT DoCoMo, Inc, or DoCoMo, pursuant to a Stock Sale and Purchase Agreement dated January 31, 2006 between NTT Communications and DoCoMo, the FP Parties, NTT Communications and DoCoMo entered into a Cooperation Agreement, dated January 31, 2006. Under the Cooperation Agreement, the relevant parties extended certain rights of NTT Communications under the Stock Purchase and Strategic Investment Agreement dated September 28, 1999, as amended, and the Shareholders Agreement dated March 24, 2000, to DoCoMo, including:

- certain contractual veto rights over a number of major decisions or transactions, as set forth above under Item 3. Key Information Risk Factors Risks Relating to Us A significant number of PLDT's shares are held by three separate shareholders, which may not act in the interests of other shareholders or stakeholders in PLDT; and

- rights relating to the representation on the board of directors of PLDT and Smart, respectively, and any committees thereof, as described above under Item 6. Directors, Senior Management and Employees Directors, Key Officers and Advisors .

Moreover, key provisions of the Cooperation Agreement pertain to, among other things:

- *Restriction on Ownership of Shares of PLDT by NTT Communications and DoCoMo.* Each of NTT Communications and DoCoMo has agreed not to beneficially own, directly or indirectly, in the aggregate with their respective subsidiaries and affiliates, more than 21% of then issued and outstanding shares of PLDT's common stock. If such event does occur, the FP Parties, as long as they own in the aggregate not less than 21% of then issued and outstanding shares of PLDT's common stock, have the right to terminate their respective rights and obligations under the Cooperation Agreement, the Shareholders Agreement and the Stock Purchase and Strategic Investment Agreement.
- *Limitation on Competition.* NTT Communications, DoCoMo and their respective subsidiaries are prohibited from investing in excess of certain thresholds in businesses competing with PLDT in respect of customers principally located in the Philippines and from using their assets in the Philippines in such businesses. Moreover, if PLDT, Smart or any of Smart's subsidiaries intends to enter into any contractual arrangement relating to certain competing businesses, PLDT is required to provide, or to use reasonable efforts to procure that Smart or any of Smart's subsidiaries provide, NTT Communications and DoCoMo with the same opportunity to enter into such agreement with PLDT or Smart or Smart's subsidiaries, as the case may be.
- *Business Cooperation.* PLDT and DoCoMo agreed in principle to collaborate with each other on the business development, roll-out and use of a W-CDMA mobile communication network. In addition, PLDT agreed, to the extent of the power conferred by its direct or indirect shareholding in Smart, to procure that Smart will (i) become a member of a strategic alliance group for international roaming and corporate sales and services and (ii) enter into a business relationship concerning preferred roaming and inter-operator tariff discounts with DoCoMo.
- *Additional Rights of DoCoMo.* Upon NTT Communications, DoCoMo and their subsidiaries owning in the aggregate 20% or more of the shares of PLDT's common stock and for as long as NTT Communications, DoCoMo and their subsidiaries continue to own in the aggregate 17.5% of the shares of PLDT's common stock then outstanding, DoCoMo will be entitled to certain additional rights under the Cooperation Agreement.
- *Change in Control.* Each of NTT Communications, DoCoMo and the FP Parties agreed that to the extent permissible under applicable laws and regulations of the Philippines and other jurisdictions, subject to certain conditions, to cast its vote as a shareholder in support of any resolution proposed by the board of directors of PLDT for the purpose of safeguarding PLDT from any Hostile Transferee. A Hostile Transferee is defined under the

Cooperation Agreement to mean any person (other than NTT Communications, DoCoMo, First Pacific or any of their respective affiliates) determined to be so by the PLDT board of directors and includes, without limitation, a person who announces an intention to acquire, seeking to acquire or acquires 30% or more of PLDT common shares then issued and outstanding from time-to-time or having (by itself or together with itself) acquired 30% or more of the PLDT common shares announces an intention to acquire, seeking to acquire or acquires a further 2% of such PLDT common shares (a) at a price per share which is less than the fair market value as determined by the board of directors of PLDT as advised by a professional financial advisor, (b) which is subject to conditions which are subjective or which could not reasonably be satisfied, (c) without making an offer for all PLDT common shares not held by it and/or its affiliates and/or persons who, pursuant to an agreement or understanding (whether formal or informal), actively cooperate to obtain or consolidate control over PLDT, (d) whose offer for the PLDT common shares is unlikely to succeed or (e) whose intention is otherwise not bona fide; provided that, no person will be deemed a Hostile Transferee unless prior to making such determination, the board of directors of PLDT has used reasonable efforts to discuss with NTT Communications and DoCoMo in good faith whether such person should be considered a Hostile Transferee. For information as to certain provisions of PLDT's Amended By-Laws that may have the effect of preventing a change in control of PLDT, see Item 10. Additional Information Articles of Incorporations and By-Laws Change in Control .

- *Termination.* If NTT Communications, DoCoMo or their respective subsidiaries cease to own, in the aggregate, full legal and beneficial title to at least 10% of the shares of PLDT's common stock then issued and outstanding, their respective rights and obligations under the Cooperation Agreement and the Shareholders Agreement will terminate and the Strategic Arrangements (as defined in the Stock Purchase and Strategic Investment Agreement) will terminate. If the FP Parties and their respective subsidiaries cease to have, directly or indirectly, effective voting power in respect of shares of PLDT's common stock representing at least 18.5% of the shares of PLDT's common stock then issued and outstanding, their respective rights and obligations under the Cooperation Agreement, the Stock Purchase and Strategic Investment Agreement, and the Shareholders Agreement will terminate.

Integrated i-mode Services Package Agreement between DoCoMo and Smart

An Integrated i-mode Services Package Agreement was entered into by Smart and DoCoMo on February 15, 2006, under which DoCoMo agreed to grant Smart, on an exclusive basis within the territory of the Philippines for a period of five years, an integrated i-mode services package including a non-transferable license to use the licensed materials and the i-mode brand, as well as implementation support and assistance and post-commercial launch support from DoCoMo. Pursuant to this agreement, Smart is required to pay an initial license fee and running royalty fees based on the revenue arising from i-mode subscription fees and data traffic. The initial license fee paid as at December 31, 2006 amounted to Php53 million.

Advisory Services Agreement between DoCoMo and PLDT

An Advisory Services Agreement was entered into by DoCoMo and PLDT on June 5, 2006, in accordance with the Cooperation Agreement. Pursuant to the Agreement, DoCoMo will provide the services of certain key personnel in connection with certain aspects of the business of PLDT and Smart. Also, the agreement governs the terms and

conditions of the appointments and the corresponding fees related thereto. The initial license fee paid as at December 31, 2006 amounted to Php12 million. Outstanding liability under this agreement amounted to Php32 million as at December 31, 2006.

Other Agreements with NTT Communications and/or its Affiliates

PLDT is a party to the following agreements with NTT Communications and/or its affiliates:

- *Advisory Services Agreement.* On March 24, 2000, PLDT entered into an agreement with NTT Communications, as amended on March 31, 2003, March 31, 2005 and June 16, 2006, under which NTT Communications provides PLDT with technical, marketing and other consulting services for various business areas of PLDT starting April 1, 2000;
- *Arcstar Licensing Agreement and Arcstar Service Provider Agreement.* On March 24, 2000, PLDT entered into an agreement with NTT Worldwide Telecommunications Corporation under which PLDT markets managed data and other services under NTT Communications Arcstar brand to its corporate customers in the Philippines. PLDT also entered into a Trade Name and Trademark Agreement with NTT Communications under which PLDT has been given the right to use the tradename Arcstar and its related trademark, logo and symbols, solely for the purpose of PLDT's marketing, promotional and sales activities for the Arcstar services within the Philippines; and
- *Conventional International Telecommunications Services Agreement.* On March 24, 2000, PLDT entered into an agreement with NTT Communications under which PLDT and NTT Communications agreed to cooperative arrangements for conventional international telecommunications services to enhance their respective international businesses.

Total fees under these agreements amounted to Php184 million, Php256 million and Php336 million for the years ended December 31, 2006, 2005 and 2004, respectively. As at December 31, 2006 and 2005, outstanding obligations of PLDT amounted to Php18 million and Php23 million, respectively.

Air Time Purchase Agreement between PLDT and AIL and Related Agreements

See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Contractual Obligations and Commercial Commitments Contractual Obligations Unconditional Purchase Obligations Air Time Purchase Agreement with AIL above and Note 16 Related Party Transactions to the consolidated financial statements in Item 18 for a discussion of the ATPA and PLDT's obligations thereunder.

Agreement between Smart and Asia Link B.V., or ALBV

Smart has an existing Technical Assistance Agreement with ALBV, a subsidiary of the First Pacific Group, for ALBV to provide technical support services and assistance in the operations and maintenance of cellular business for a period of five years, subject to renewal upon mutual agreement between the parties. The agreement provides for quarterly payments of technical service fees equivalent to 2% of the net revenues of Smart. In January 2004, the agreement was amended, reducing the technical service fees to be paid by Smart to ALBV to 1% of net revenues effective January 1, 2004. On February 18, 2004, Smart and ALBV entered into a renewal of the Technical Assistance Agreement extending the effectivity of the terms thereof to February 23, 2008. Furthermore, in view of the acquisition by Smart of Piltel Series K Class I Convertible Preferred Stock held by PLDT, the parties agreed to make the consolidated net revenues of Smart the basis for the computation of the 1% technical service fees payable by Smart to ALBV, effective January 1, 2005.

Smart also has an existing Services Agreement with ALBV for a period of 25 years starting January 1, 1999, which shall automatically expire unless renewed by mutual agreement of both parties. Under the agreement, ALBV provides advice and assistance to Smart in sourcing capital equipment and negotiating with international suppliers, arranging international financing and other services therein consistent with and for the furtherance of the objectives of the services. Service agreement fees were paid for the whole 25-year period.

Total fees under these agreements amounted to Php591 million, Php567 and Php507 million for the years ended December 31, 2006, 2005 and 2004, respectively. Outstanding obligations of Smart under these agreements amounted to Php128 million and Php194 million as at December 31, 2006 and 2005, respectively. Outstanding prepaid management fees as at December 31, 2006 and 2005 amounted to Php869 million and Php920 million, respectively.

Agreements relating to insurance companies

Gotuaco del Rosario and Associates, or Gotuaco, acts as the broker for certain insurance companies to cover certain insurable properties of the PLDT Group. Insurance premiums are remitted to Gotuaco and the broker's fees are settled between Gotuaco and the insurance companies. In addition, PLDT has an insurance policy with Malayan Insurance Co., Inc., or Malayan, wherein premiums are paid directly to Malayan. Total insurance expenses paid under these agreements amounted to Php360 million, Php468 million and Php534 million for the years ended December 31, 2006, 2005 and 2004, respectively. Two directors of PLDT have a direct/indirect interest in or serve as a director/officer of Gotuaco and Malayan.

There have been no loans between PLDT and any related party during the period beginning January 1, 2004 through the date of filing of this annual report.

Except for the transactions described above, there were no other material transactions during the last two years, nor are there any material transactions currently proposed, to which PLDT was or is to be a party, in which a director or

key officer or owner of more than 10% of the common shares of PLDT, or any member of the immediate family of a director or key officer or owner of more than 10% of the common shares of PLDT had or is to have a direct or indirect material interest. In the ordinary course of business, PLDT has transactions with other companies in which some of such persons may have an interest.

No director or officer of PLDT or associate of any such director or officer was indebted to PLDT at any time during the period from January 1, 2004 through the date of filing of this annual report.

Item 8. Financial Information

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Consolidated Statements and Other Financial Information

Consolidated financial statements are set forth under Item 18. Financial Statements.

Legal Proceedings

Except as disclosed in the following paragraphs, neither PLDT nor any of its subsidiaries is a party to, and none of their respective properties is subject to, any pending legal proceedings that PLDT considers to be potentially material to its and its subsidiaries' business.

Quo Warranto Action

On June 4, 1990, the Solicitor General of the Philippines instituted legal proceedings in the Regional Trial Court of Makati City seeking to oust Philippine Long Distance Telephone Company (PLDT) from exercising its franchise and/or to revoke, cancel and/or pre-terminate its franchise (Act No. 3436, as amended) and/or to break up an alleged unlawful monopoly and give equal and fair opportunity to other service corporations. The Solicitor General cited constitutional and statutory grounds for his action, including alleged foreign investors' participation in the control and management of PLDT on a basis disproportionate to their holdings of PLDT's capital stock, violation of the requirement that 60% of the capital of a public utility be owned by Philippine citizens, inadequate and costly equipment and service, and blocking of the right of other parties to provide telephone service in the Philippines.

We believe that these allegations are without merit and plan to defend ourselves vigorously. The Philippine Congress granted PLDT's amended franchise under Republic Act No. 7082 notwithstanding the existence of these proceedings

and the opposition of the Solicitor General. The case has been archived by virtue of a court order dated January 20, 1999. No further action has been taken and the case remains inactive.

Taxation

National Internal Revenue Taxes

PLDT has filed various cases against the Commissioner of the Bureau of Internal Revenue, or BIR, for refunds and/or tax credit of:

- erroneously paid VAT, compensating taxes, advance sales taxes and other internal revenue taxes on PLDT's importation of various equipment, machinery and spare parts; and
- erroneously paid withholding tax on separation pay of employees who availed of the benefits under the Manpower Reduction Program.

In the case of the claim for refund of erroneously paid VAT, compensating taxes, advance sales taxes and other internal revenue taxes on PLDT's importation of various equipment, machinery and spare parts, the Supreme Court, on December 15, 2005, rendered a decision partially granting the claim for refund or tax credit certificates and ordering the Commissioner of the BIR to issue a Tax Credit Certificate or to refund to PLDT approximately Php95 million representing erroneously collected advance sales tax and compensating tax. PLDT filed a motion for execution that was opposed by the BIR and is currently still pending with the Court of Tax Appeals. The Court of Tax Appeals has issued a Resolution on May 18, 2007, ordering the issuance of the corresponding Writ of Execution.

The case of the claim for refund of erroneously paid withholding tax on separation pay is still pending with the Supreme Court.

NTC supervision and regulation fees, or SRF

Since 1994, following the NTC's rejection of PLDT's formal protest against the assessments by the NTC of permit, supervision and regulation fees, PLDT and the NTC have been involved in legal proceedings before the Court of Appeals and the Supreme Court. The basis of these legal proceedings is the NTC's inclusion of stock dividends and capital in excess of the par value of stock in computing these fees, and the NTC's assessment of administrative fees for

the increase in PLDT's authorized capital stock even in the absence of NTC's performance of regulatory services. As at December 31, 2006, since 1994, PLDT has paid a total amount of Php2,219 million in supervision and regulation fees, of which Php1,956 million were paid under protest.

Local business and franchise tax assessments

PLDT is presently a party to several cases involving the issue of exemption of PLDT from local franchise and business taxes. PLDT believes, based on the opinion of its legal counsel, that it is exempt from payment of local franchise and business taxes.

The Local Government Code of 1991, or Republic Act (R.A.) 7160, which took effect on January 1, 1992, extended to local government units, or LGUs, the power to tax businesses within their territorial jurisdiction granted under Batas Pambansa 337, and withdrew tax exemptions previously granted to franchise grantees under Section 12 of R.A. 7082.

PLDT believes, based on the opinion of its legal counsel, that R.A. 7925, which took effect on March 16, 1995, and the grant of local franchise and business taxes exemption privileges to other franchise holders subsequent to the effectivity of R.A. 7160, implicitly restored its local franchise and business taxes exemption privilege under Section 12 of R.A. 7082, or the PLDT Franchise pursuant to Section 23 thereof or the equality of treatment clause.

To confirm this position, PLDT sought and obtained on June 2, 1998 a ruling from the Bureau of Local Government Finance, or BLGF, of the Philippine Department of Finance, which ruled that PLDT is exempt from the payment of local franchise and business taxes imposable by LGUs under R.A. 7160.

By virtue of the BLGF Ruling, PLDT stopped paying local franchise and business taxes starting with the fourth quarter of 1998 and has filed with certain LGUs claims for tax refund covering the period from the second quarter of 1995 to the third quarter of 1998. PLDT has received assessments for local franchise and business taxes from several cities and provinces following PLDT's decision to stop payment of local franchise and business taxes.

Following a decision of the Supreme Court on March 25, 2003, a judgment in the amount of Php4 million against PLDT involving the City of Davao became final and executory on April 9, 2003, pursuant to which PLDT was declared not exempt from the local franchise tax. Pursuant to said decision, PLDT has voluntarily paid the total amount of Php15 million for the period from the fourth quarter of 1998 until December 31, 2003, which includes the Php4 million subject of the case.

PLDT had no longer contested assessments of LGUs for franchise taxes as at December 31, 2006. However, PLDT continues to contest the validity of the assessment of penalties and surcharges of Php1.3 million and Php2.3 million, by the City of Ozamiz and the Province of Bulacan, respectively, for the years 1998 to 2002 when PLDT refrained from payment of local franchise taxes upon its reliance in good faith on the BLGF Ruling that it is exempt from local franchise tax. PLDT is also contesting the validity of the assessment of local franchise tax of Php2.8 million by the Province of Cagayan on the gross receipts received or collected by PLDT in Tuguegarao City wherein franchise tax was already paid to the latter.

PLDT likewise continues to contest the imposition of local business taxes in addition to local franchise tax by the Cities of Tuguegarao, Balanga and Caloocan in the amounts of Php1.9 million, Php0.2 million and Php6.3 million, respectively, for the years 1998 to 2003 for the City of Tuguegarao, and for the years 2005 to 2007 for the Cities of Balanga and Caloocan. PLDT is likewise contesting the imposition of a business tax on the transmission of messages by the Municipality of San Pedro in the amount of Php0.3 million for the years 2005 to 2007.

PLDT currently expects that going forward it will pay local franchise and business taxes on an annual basis and based on the gross receipts received or collected for services rendered within the jurisdiction of the respective taxing authority.

Smart has paid local business and franchise taxes to certain cities and provinces in the aggregate amount of Php313 million under protest. Smart's legal position is that it is not liable to pay the local franchise tax by virtue of its Smart's exemption under legislative franchise under R.A. 7294, which took effect after the effective date of the Local Government Code of 1991, or R.A. 7160.

The Regional Trial Court, or RTC, of Makati has declared Smart exempt from payment of local franchise tax to the City of Makati in a decision rendered in the case entitled *Smart Communications, Inc. vs. City of Makati* (Civil Cases No. 02-249 & 02-725, August 3, 2004). The City of Makati has filed a Motion for Extension to file a Petition for Review with the Court of Appeals. However, on June 9, 2005, the Court of Appeals dismissed the appeal filed by the City of Makati.

The RTC of Iloilo has likewise ruled in a decision dated January 19, 2005 that Smart is exempt from payment of local franchise tax to the City of Iloilo. The City of Iloilo has filed an appeal directly with the Supreme Court, which remains pending.

Piltel's Bureau of Internal Revenue Assessment

Piltel has received the following assessment notices from the BIR:

| Year Tax Assessment Type | Basic Interest Total | | |
|-------------------------------------|-----------------------------|------|-------|
| | (in million pesos) | | |
| 1998 VAT | 85.8 | 68.7 | 154.5 |
| Overseas Communications Tax, or OCT | 31.8 | 25.5 | 57.3 |
| Income Tax | 12.4 | 9.4 | 21.8 |
| Administrative Penalties | 0.1 | | 0.1 |
| 1999 VAT | 94.5 | 67.8 | 162.3 |
| Income Tax | 22.7 | 13.8 | 36.5 |
| 2001 VAT | 56.2 | 35.1 | 91.3 |
| Income Tax | 13.4 | 8.9 | 22.3 |

On December 12, 2005, Piltel filed a collective application for a compromise settlement with the BIR for the deficiency tax assessments arising from taxable years 1998, 1999 and 2001, citing reasonable doubt as to the validity of the tax assessments as a basis. The prescribed minimum percentage of the compromise settlement for such basis is 40% of the basic assessed tax.

On January 27, 2006, Piltel received the favorable recommendation and approval from the BIR on the said application for a compromise settlement. On January 31, 2006, Piltel settled the total amount of Php114 million, which is equivalent to 40% of the basic taxes per final assessment notices received, to effect the immediate cancellation of the tax assessments. On February 24, 2006, the BIR accepted Piltel's application for a compromise settlement of income taxes and VAT for the years 1998, 1999 and 2001, and issued the Certificate of Availment on the said date.

Dividend Distribution Policy

In 2006 and 2005, PLDT declared cash dividends of Php588 million and Php1,627 million, respectively, solely for its preferred shareholders. In addition, on March 1, 2005, PLDT declared a cash dividend at Php14 per common share to holders of record as at March 31, 2005, which was paid on May 12, 2005, constituting the first cash dividend declaration to common shareholders since March 2001. This was followed by cash dividend declarations made by PLDT on its common stock on May 5, 2005, at Php21 per common share to holders of record as at June 3, 2005, which was paid on July 14, 2005; on November 8, 2005, at Php21 per common share to holders of record as at November 28, 2005, which was paid on December 28, 2005; on February 27, 2006, at Php28 per common share to holders of record as at March 20, 2006, which was paid on April 20, 2006; and on August 8, 2006, at Php50 per common share to holders of record as at August 21, 2006, which was paid on September 21, 2006. .

Our current policy is to declare and pay dividends taking into consideration the interests of our shareholders as well as our working capital, capital expenditures and debt servicing requirements. Also taken into consideration are our ability to meet loan covenant requirements and the required prior written consents of certain creditors and preferred

stockholders (for stock dividends), under certain conditions, in the declaration and payment of dividends as discussed in *Note 12 Interest-bearing Financial Liabilities* and *Note 15 Stockholders Equity* to the accompanying consolidated financial statements in Item 18. The retention of earnings is necessary to meet the funding requirements of our business expansion and development programs. Unappropriated retained earnings of PLDT include undistributed earnings representing accumulated equity in the net earnings of our subsidiaries, which are not available for distribution as dividends until received in the form of dividends from such subsidiaries (see *Note 15 Stockholders Equity* to the accompanying consolidated financial statements in Item 18). Dividends are generally paid in Philippine pesos. In the case of shareholders residing outside the Philippines, PLDT's transfer agent in Manila, which acts as the dividend-disbursing agent, converts the peso dividends into U.S. dollars at the prevailing exchange rates and remits the dollar proceeds abroad, net of withholding tax.

Item 9. The Offer and Listing

Common Capital Stock and American Depositary Shares (ADSs)

The common shares of PLDT are listed and traded on the PSE. On October 19, 1994, an ADR facility was established, pursuant to which Citibank, N.A., as the depository, issued ADRs evidencing ADSs, with each ADS representing one PLDT common share with a par value of Php5 per share. Effective February 10, 2003, PLDT appointed JP Morgan Chase Bank as successor depository of PLDT's ADR facility. The facility was established in accordance with a Common Stock Deposit Agreement dated October 19, 1994, as amended on February 10, 2003 between the Depository and the holders of the ADRs. The ADSs have been listed and are traded on the New York Stock Exchange, or NYSE, in the United States under the symbol PHI .

Until recently, the ADSs were also listed on the NYSE Arca. However, on December 18, 2006, PLDT issued a notice of its intent to voluntarily delist its ADSs from NYSE Arca, after determining that doing so is in the best interest of PLDT and its stockholders as it would eliminate the duplicative administrative burdens and costs inherent in dual listing on both the NYSE and NYSE Arca. The actual delisting from the NYSE Arca became effective on February 12, 2007.

In 2006, a total of 39.6 million shares of PLDT's common capital stock were traded on the PSE. During the same year, the volume of trading was 69.7 million ADSs on the NYSE.

As at May 31, 2007, approximately 11,105 stockholders were Philippine persons and held approximately 35% of the shares of PLDT's common stock and approximately 86.03% of the outstanding capital stock of PLDT. In addition, as at May 31, 2007, there was a total of over 40 million ADSs outstanding, substantially all of which PLDT believes were held in the United States by 379 holders.

High and low sales prices for PLDT's common shares on the PSE and ADSs on the NYSE for each of the five most recent fiscal years, each full quarterly period during the two most recent fiscal years, and each month in the most recent six months were as follows:

| | PSE | | NYSE | |
|--|-------------|-------------|-----------|-----------|
| | High | Low | High | Low |
| 2007 | | | | |
| Second Quarter (through June 26, 2007) | Php2,730.00 | Php2,390.00 | US\$58.88 | US\$50.05 |
| April | 2,585.00 | 2,390.00 | 54.89 | 50.05 |
| May | 2,585.00 | 2,470.00 | 56.66 | 53.00 |
| June (through June 26, 2007) | 2,730.00 | 2,525.00 | 58.88 | 54.88 |
| First Quarter | 2,820.00 | 2,250.00 | 56.62 | 45.25 |
| January | 2,820.00 | 2,385.00 | 56.62 | 48.20 |
| February | 2,675.00 | 2,285.00 | 54.10 | 45.25 |
| March | 2,555.00 | 2,250.00 | 53.40 | 46.30 |
| 2006 | 2,610.00 | 1,675.00 | 51.90 | 32.15 |
| First Quarter | 1,930.00 | 1,675.00 | 38.09 | 32.20 |
| Second Quarter | 2,295.00 | 1,700.00 | 43.99 | 32.15 |
| Third Quarter | 2,300.00 | 1,790.00 | 45.00 | 34.57 |
| Fourth Quarter | 2,610.00 | 2,150.00 | 51.90 | 42.56 |
| December | 2,570.00 | 2,325.00 | 51.50 | 47.08 |
| 2005 | 1,860.00 | 1,310.00 | 34.35 | 23.50 |
| First Quarter | 1,495.00 | 1,310.00 | 27.75 | 23.50 |
| Second Quarter | 1,645.00 | 1,330.00 | 30.07 | 24.10 |
| Third Quarter | 1,715.00 | 1,520.00 | 30.59 | 27.28 |
| Fourth Quarter | 1,860.00 | 1,630.00 | 34.35 | 28.88 |
| 2004 | 1,505.00 | 810.00 | 27.03 | 14.38 |
| 2003 | 990.00 | 265.00 | 17.79 | 4.85 |
| 2002 | 565.00 | 209.00 | 11.30 | 3.85 |

Item 10. Additional Information

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Articles of Incorporation and By-Laws

The following summarizes certain provisions of PLDT's Articles of Incorporation and By-Laws and applicable Philippine law. This summary is qualified in its entirety by reference to the Corporation Code of the Philippines (the Corporation Code) and PLDT's Articles of Incorporation and By-Laws. Information on where investors can obtain copies of the Articles of Association and By-Laws is described under the heading Documents Available.

Purpose of PLDT

PLDT's Articles of Incorporation have been filed with the Philippine SEC and PLDT has been issued Philippine SEC Reg. No. 55. The Second Article of PLDT's Articles of Incorporation provides that the purposes for which PLDT was formed are to install, maintain, and operate any and all kinds of equipment for communications; to install, maintain, operate or lease telephone lines and systems, and to purchase, sell and deal in all kinds of products which may be combined with the building, installing and operation of those systems and lines and in general, to engage in any and all acts and business which may be necessary or convenient, in the furtherance of such lines of communication and business.

Directors

PLDT's Amended By-Laws provide that the Board of Directors shall consist of thirteen members, each of whom must hold at least one share of stock of PLDT in his own name and possess the minimum qualifications and have none of the disqualifications provided in the By-Laws. There are no provisions in PLDT's Amended Articles of Incorporation or Amended By-Laws with respect to (a) a director's power to vote on a proposal, arrangement or contract in which the director is materially interested, (b) the directors' power, in the absence of an independent quorum, to vote compensation to themselves or any members of their body, (c) borrowing powers exercisable by the directors and how such borrowing powers can be varied, or (d) retirement or non-retirement of directors under an age limit requirement.

Description of PLDT Capital Stock

Authorized Capital Stock

The authorized capital stock of PLDT is Php9,395 million divided into two classes consisting of 234 million shares of Common Capital Stock with a par value of Php5 per share (the Common Stock) and 822.5 million shares of serial Preferred Stock with a par value of Php10 per share (the Preferred Stock).

Common Stock

Set out below is a statement of the dividend, voting, pre-emption and other rights of the holders of Common Stock as set out in the Articles of Incorporation and/or By-Laws of PLDT:

(a) After the requirements with respect to preferential dividends on the serial Preferred Stock shall have been met and after PLDT shall have complied with all the requirements, if any, with respect to the setting aside of sums as

purchase, retirement or sinking funds, the holders of the Common Stock shall be entitled to receive such dividends as may be declared from time to time by the Board of Directors out of funds legally available therefor.

(b) After distribution in full of the preferential amounts to be distributed to the holders of serial Preferred Stock in the event of the voluntary or involuntary liquidation, dissolution, distribution of assets or winding up of PLDT, the holders of Common Stock shall be entitled to receive all the remaining assets of PLDT of whatever kind available for distribution to stockholders ratably in proportion to the number of Common Stock held by them, respectively.

(c) Except as may be otherwise required by law, or by the Articles of Incorporation of PLDT, each holder of Common Stock shall have one vote in respect of each share of such stock held by him on all matters to be voted upon by the stockholders, and the holders of Common Stock shall have the exclusive right to vote for the election of directors and for all other purposes. At every election of directors, a holder of Common Stock is entitled to vote such shares of Common Stock held by him for as many persons as there are directors to be elected, or to cumulate said shares and give one candidate as many votes as the number of directors to be elected multiplied by the number of his shares shall equal, or to distribute such votes on the same principle among as many candidates as he shall think fit.

In addition to the foregoing rights, the Corporation Code provides for other stockholders' rights generally, which include:

(a) Appraisal right or the right of a dissenting stockholder to demand payment of the fair value of his shares of stock in the following instances: (a) in case any amendment to the articles of incorporation has the effect of changing or restricting the rights of any stockholders or class of shares, or of authorizing preferences in any respect superior to those of outstanding shares of any class, or of extending or shortening the term of corporate existence; (b) in case of sale, lease, exchange, transfer, mortgage, pledge or other disposition of all or substantially all of the corporate property and assets of the corporation; (c) in case of merger or consolidation; and (d) in case of investment of funds of the corporation in any other corporation or business or for any purpose other than the primary purpose for which it was organized, except where the investment by the corporation is reasonably necessary to accomplish its primary purpose as stated in its articles of incorporation.

(b) The right to approve certain corporate acts, such as (a) election of directors; (b) removal of directors; (c) extension or shortening of the corporate term; (d) increase or decrease of capital stock, and incurring, creating or increasing bonded indebtedness; (e) sale or other disposition of all or substantially all of the corporate assets; (f) investment of corporate funds in any other corporation or business or for any purpose other than the primary purpose for which it was organized except where the investment is reasonably necessary to accomplish its primary purpose as stated in the corporation's articles of incorporation; (g) declaration of stock dividend; (h) entering into a management contract with another corporation; (i) plan of merger or consolidation; and (j) voluntary dissolution of the corporation by shortening the corporate term.

(c) The right to inspect at reasonable hours on business days the records of all business transactions of the corporation and the minutes of any meeting; however, the stockholders' right to inspect corporate records and books is not an absolute right so that the corporation may deny said right on the basis of impropriety of the purpose or motive of the stockholder.

(d) The right to be furnished the most recent financial statements of the corporation, within ten (10) days from receipt by the corporation of a written request from a stockholder. The same right exists at the annual meeting of stockholders at which the Board of Directors must present to the stockholders a financial report of the operations of the corporation for the preceding year which shall include financial statements duly signed and certified by an independent certified public accountant.

Restrictions on Foreign Ownership

The Constitution of the Republic of the Philippines (Section 11, Article XII) states that no franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines at least 60% of whose capital is owned by such citizens.

While the Articles of Incorporation and By-Laws of PLDT do not contain any specific restriction on the sale, assignment or transfer of shares that would violate the aforesaid ownership requirement, the Articles of Incorporation of PLDT provide that the Board of Directors shall have full power and authority to authorize (whether by adoption of amendments to the By-Laws of PLDT or of resolutions, the promulgation of rules or regulations or otherwise) the taking by said corporation of all such actions as the Board of Directors may deem necessary or appropriate to ensure compliance by said corporation with any applicable provision of the Constitution of the Republic of the Philippines or any other applicable law, treaty, rule or regulation relating to the ownership of securities of said corporation by citizens of the Philippines, aliens or other persons or group of persons.

Meetings

The Corporation Code requires corporations to hold an annual meeting of stockholders and to send notice thereof to stockholders. Under PLDT's By-Laws, the annual meeting of stockholders shall be held at the principal office of the corporation, or at such other place designated by the Board of Directors in the city or municipality where the principal office of the corporation is located, on the second Tuesday in June of each year. In the annual meeting, the Board of Directors shall be elected and such other business may be transacted as shall come before the meeting. At least fifteen (15) business days written or printed notice of the date, time and place of holding every annual stockholders' meeting shall be given by the Secretary or by an Assistant Secretary by personal delivery or by mail to each stockholder at his or her last known place of residence or business. Special meetings of stockholders may be called at any time by the President or three (3) of the Directors or by a number of stockholders representing two-thirds (2/3) of the subscribed capital stock. Notice in writing of such meeting stating the date, time or place thereof, shall be given to each

stockholder by the Secretary or Assistant Secretary or, in case of his absence, inability, refusal or neglect to act, then by the President, Directors or stockholders calling said meeting, by personal delivery or by mail to each stockholder at his or her last known place of residence, at least fifteen (15) business days before the date fixed for the meeting.

The By-Laws of PLDT provide that each share of common stock which has voting rights on any matter under consideration may be represented at any meeting of stockholders by the holder thereof or by his attorney duly authorized by proxy in writing on forms prescribed by the Board of Directors which shall be furnished to a stockholder upon his request. Unless otherwise provided in the proxy, it shall be valid only for the meeting in respect of which such proxy was issued. Proxies must be filed with the Secretary, Assistant Secretary or transfer agent of PLDT at least two (2) days before the day of the meeting. Any proxy filed with the Secretary, Assistant Secretary or transfer agent of the corporation may be revoked by the stockholder concerned either in an instrument in writing duly presented to the Secretary, Assistant Secretary or transfer agent of the corporation at least two (2) days before the day of the meeting or by his personal presence at the meeting. The decision of the Secretary on the validity of proxies shall be final and binding until and unless set aside by a court of competent jurisdiction. As provided in the Corporation Code, unless otherwise provided in the proxy, it shall be valid only for the meeting for which it is intended and no proxy shall be valid and effective for a period longer than five (5) years at any one time.

The By-Laws of PLDT also provide that at any meeting of the stockholders, persons representing, in person or by proxy, a majority of the shares issued and outstanding and entitled to vote at said meeting shall constitute a quorum for the transaction of any business, except as otherwise provided by law, and except that a lesser number may adjourn the meeting.

Issues of Shares

The Board of Directors of PLDT has the power to authorize the issue and sale of authorized but unissued shares of Common Stock of said corporation for such consideration as it shall determine, provided that such consideration shall not be less than the par value of such shares and, provided further, that such issue and sale is not otherwise prohibited under applicable laws.

Under the Securities Regulation Code of the Philippines (R.A. No. 8799), or SRC, no securities except of a class exempt under the provisions thereof or unless sold in any transaction exempt under any of the provisions thereof, shall be sold or offered for sale or distribution to the public unless such securities shall have been registered and permitted to be sold pursuant to the SRC.

Transfer of Shares

The shares of Common Stock may be transferred by delivery of certificate(s) endorsed by the shareholder named in the certificate or his duly authorized attorney or representative. No transfer, however, shall be valid, except as between the parties, until the transfer is recorded in the stock and transfer books of PLDT maintained by Hongkong and Shanghai Banking Corporation, the stock transfer agent of PLDT for its Common Stock.

Philippine law does not require transfers of Common Stock to be effected on the PSE, but any off-exchange transfers will subject the transferor to a capital gains tax that may be significantly greater than the stock transfer tax applicable to transfers effected on the PSE. All transfers of shares of Common Stock on the PSE must be effected through a licensed broker in the Philippines.

Share Certificates

Certificates representing fully paid shares of Common Stock are issued in such denominations as stockholders may request, except that certificates will not be issued for any fractional part of a share or any undivided interest in any share.

Dividends

Under the Corporation Code, the Board of Directors may declare dividends on the Common Stock out of the unrestricted retained earnings which may be payable in cash, in property or in stock to all stockholders on the basis of outstanding shares held by them. The declaration of stock dividends requires the approval of the stockholders of PLDT representing not less than two-thirds of the outstanding capital stock of PLDT. If a stock dividend would require an increase in the authorized capital stock, Philippine SEC approval would be required. Common Stock issued as stock dividends should be registered with and licensed by the Philippine SEC and listed on the PSE.

The Corporation Code requires a Philippine corporation with retained earnings in excess of 100% of its paid-in capital to declare and distribute as dividends the amount of such surplus. Notwithstanding this general requirement, a Philippine corporation may retain all or any portion of such surplus in the following cases: (i) when justified by definite corporate expansion projects or programs approved by the board of directors; (ii) when the corporation is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without its/his consent, and such consent has not yet been secured; or (iii) when it can be clearly shown that such retention is necessary under special circumstances relevant to the corporation, such as when there is a need for special reserve for probable contingencies.

PLDT has entered into certain loan and credit agreements, which restrict the declaration and payment of dividends by PLDT. In particular, under certain loan agreements, PLDT may not declare or pay dividends on any of its capital stock without the prior written consent of the lenders (i) if PLDT is in default in the payment of any amounts due and

payable under such loan agreement or after the occurrence and during the continuance of any other event of default or potential event of default under such agreements, (ii) if after giving effect to such action the current ratio would be less than 0.90:1 or (iii) in an amount greater than PLDT's net income after taxes during the fiscal year to which such payment or distribution relates. On March 1, 2005, PLDT declared a cash dividend at Php14 per common share to holders of record as at March 31, 2005, which was paid on May 12, 2005, constituting the first cash dividend declaration to common shareholders since March 2001. This was followed by cash dividend declarations made by PLDT on its common stock on May 5, 2005, at Php21 per common share to holders of record as at June 3, 2005, which was paid on July 14, 2005; on November 8, 2005, at Php21 per common share to holders of record as at November 28, 2005, which was paid on December 28, 2005; on February 27, 2006, at Php28 per common share to holders of record as at March 20, 2006, which was paid on April 20, 2006; and on August 8, 2006, at Php50 per common share to holders of record as at August 21, 2006, which was paid on September 21, 2006.

Preferred Stock

Preferred Stock may be issued from time to time in one or more series as the Board of Directors may determine. The Board of Directors is authorized to establish and designate the title and number of shares of each series and to fix the terms thereof, including dividend rate, redemption and sinking fund provisions, conversion rights and the amount to be received upon liquidation, provided that the amounts payable upon redemption or liquidation may not be more than 110%, nor less than 100%, of par value, plus in each such case accrued and unpaid dividends. Except as otherwise provided by law, the holders of Preferred Stock are not entitled to vote for the election of directors or for any other purpose; provided, however, that PLDT may not change the rights of the holders of any series of Preferred Stock in any manner prejudicial to the holders thereof without the affirmative vote of the holders of a majority of the shares of such series. No such approval is needed to increase the number of shares of Preferred Stock (up to the number from time to time authorized by the Articles) or to authorize classes of shares ranking on a parity with the Preferred Stock.

Issued and Outstanding Preferred Stock

The series of Preferred Stock and the number of shares issued and outstanding under each series as at May 31, 2007 are as follows:

| <u>Series</u> | <u>No. of Shares</u> |
|---|-----------------------------|
| Series A to EE 10% Cumulative Convertible | 406,100,137 |
| Series IV Cumulative Non-Convertible Redeemable | 36,000,000 |
| Series V Cumulative Convertible Redeemable | 43,675 |
| Series VI Cumulative Convertible Redeemable | 743,218 |

The Series A to EE 10% Cumulative Convertible Preferred Stock are entitled to receive cumulative dividends at the rate of 10% per annum; redeemable at the option of PLDT, at par value plus accrued dividends, five years after the year of issuance; convertible to shares of Common Stock a year after the year of share issuance, at a price equivalent

to 10% below the average market price of the Common Stock at the PSE over a period of 30 consecutive trading days before the conversion date; and entitled to be paid an amount equal to the par value of the shares plus accrued and unpaid dividends thereon to the date fixed for such payment in the event of a voluntary or involuntary liquidation, dissolution, distribution of assets or winding up of the affairs of the corporation.

The Series IV Cumulative Non-Convertible Redeemable Preferred Stock are entitled to receive cumulative dividends at the rate of 13.5% per annum based on the paid-up subscription price. It is redeemable at the option of PLDT one year at any time after subscription at an amount equal to the par value of such shares so redeemed or if such shares are not yet fully paid, the actual amount paid, plus accrued and unpaid dividends thereon; and in the event of a voluntary or involuntary liquidation, dissolution or winding up of affairs of PLDT, shall be entitled to be paid an amount equal to the par value of such shares or if such shares are not yet fully paid, the actual amount paid, plus an amount equal to the dividends accrued thereon to the date fixed for payment. The outstanding shares of Series IV Cumulative Non-Convertible Redeemable Preferred Stock have not been fully paid.

Shares of Series V and VI Convertible Preferred Stock are entitled to receive annual dividends of Php18.70 per share and US\$0.397 per share, respectively. Each share of Series V and VI PLDT Convertible Preferred Stock is convertible at any time at the option of the holder into one share of PLDT Common Stock. In the event of any voluntary or involuntary liquidation, dissolution or winding up of PLDT, the holders of the Series V and VI Convertible Preferred Stock are entitled to receive out of the assets of PLDT available for distribution to the shareholders of PLDT, before any distribution of assets is made to holders of shares of Common Stock or any other shares of stock of PLDT ranking as to such distribution junior to the Series V and VI Convertible Preferred Stock, liquidating distributions in the amount of Php11 per share plus accrued and unpaid dividends. On the date immediately following the seventh anniversary of the issue date of the Series V and VI Convertible Preferred Stock, the remaining outstanding shares under these series will be mandatorily converted into shares of PLDT Common Stock at a conversion rate of one share of Common Stock for each share of Series V or VI Convertible Preferred Stock subject to adjustments in certain events. Under a put option exercisable for 30 days, holders of shares of Common Stock received on mandatory conversion will be able to require PLDT to purchase such shares of Common Stock for Php1,700 per share and US\$36.132 per share, for Series V and VI Convertible Preferred Stock, respectively.

As at December 31, 2006, 2,675,393 shares of Series V Convertible Preferred Stock, 4,419,916 shares of Series VI Convertible Preferred Stock and all 3,842,000 shares of the then outstanding Series VII Convertible Preferred Stock had been voluntarily converted to PLDT common shares. As at December 31, 2006, 46,047 shares of Series V and 875,188 shares of Series VI Convertible Preferred Stocks remained outstanding. The aggregate value of the put option based on outstanding shares as at December 31, 2006 was Php1,629 million which is puttable on June 4, 2008, if all of the outstanding shares of Series V and VI Convertible Preferred Stocks were mandatorily converted and all the common shares were put to PLDT at that time. The market value of the underlying shares of common stock was Php2,349 million, based on the market price of PLDT common shares of Php2,550 per share as at December 31, 2006.

Change in Control

Article V, Section 1 of PLDT's Amended By-Laws may have the effect of preventing a change in control of PLDT. This section provides that any person who is engaged in any business that competes with or is antagonistic to that of PLDT or its subsidiaries is ineligible for nomination or election to the Board of Directors.

Under the Cooperation Agreement, each of NTT Communications, DoCoMo and the FP Parties agreed that to the extent permissible under applicable laws and regulations of the Philippines and other jurisdictions, subject to certain conditions, it shall cast its vote as a PLDT shareholder in support of any resolution proposed by the PLDT board of directors for the purpose of safeguarding PLDT from any Hostile Transferee. See Item 7. Major Shareholders and Related Party Transactions Related Party Transactions Cooperation Agreement with the First Pacific and certain affiliates, or the FP Parties, NTT Communications and DoCoMo .

Material Contracts

We have entered into the following contract within the two years preceding the date of this annual report which is or may be material:

The Cooperation Agreement, dated January 31, 2006, entered into by and among PLDT, First Pacific, Metro Pacific Corporation, Metro Asia Link Holdings, Inc., Metro Pacific Resources, Inc., Larouge B.V., Metro Pacific Assets Holdings, Inc., NTT Communications and DoCoMo.

Exchange Controls and Other Limitations Affecting Securities Holders

In Circular No. 1389 dated November 10, 1993, as amended by Circular No. 224 dated January 26, 2000, of the BSP, foreign investments in the shares of stock of Philippine companies listed in the PSE may be registered either with the BSP or with an investor's designated custodian bank. The foreign investments in listed shares of stock, which are duly registered with the BSP or with a custodian bank duly designated by the foreign investor, are entitled to full and immediate capital repatriation and dividend and interest remittance privileges. Without the need to obtain prior BSP approval, commercial banks are authorized to sell and to remit the equivalent foreign exchange (at the exchange rate prevailing at the time of actual remittance) representing sales and divestment proceeds or dividends of a duly registered foreign equity investment upon presentation of a BSP Registration Document (BSRD) together with other supporting documents. The BSRD is issued by the BSP or the custodian bank upon registration of the foreign investment and serves as the authority to repatriate such divestment and sales proceeds or remittance of cash dividends. Effective April 3, 2000, only pre-numbered BSRD forms, printed on BSP security paper may be used and issued as proof of registration of foreign investments in accordance with existing BSP rules. The remitting commercial bank must submit to the BSP a statement of remittance together with the supporting documents within two banking days from date of actual remittance. Foreign investments not duly registered with the BSP or with the investor's designated custodian bank are not entitled to repatriation and remittance privileges through the banking system except capital repatriation or dividend remittance of direct foreign equity investments made prior to March 15, 1973 when BSP registration was not yet required. The BSP should be notified of the transfer of sale of foreign investments in

equity or securities already registered with the BSP, in order that the registration of the foreign investment may be transferred in the name of the transferee or purchaser.

Cash dividends on PLDT's stock are paid in Philippine peso, except dividends on the Series VI Convertible Preferred Stock, which are paid in U.S. dollars. PLDT's Transfer Agent and Dividend Paying Agent for its Series VI Convertible Preferred Stock, Hongkong and Shanghai Banking Corporation, converts and remits in U.S. dollars, at the prevailing exchange rate, cash dividends due to holders of the Series VI Convertible Preferred Stock. PLDT's Transfer Agent for its common stock, The Hongkong and Shanghai Banking Corporation, which also acts as dividend paying agent, converts and remits in U.S. dollars, at the prevailing exchange rate, cash dividends due all common shareholders residing outside the Philippines. Under the above-mentioned regulations, PLDT has been able to remit the cash dividends due to shareholders residing outside the Philippines. As at December 31, 2006, approximately 86% of PLDT's outstanding shares of common and preferred stock were held by Philippine persons. For certain restrictions on the declaration and payment of dividends by PLDT, see *Note 14 Preferred Stock Subject to Mandatory Redemption* and *Note 15 Stockholders Equity* to the accompanying consolidated financial statements in Item 18.

Principal of and interest on PLDT's 10.5% Notes due 2009, 11.375% Notes due 2012 and 8.35% Notes due 2017 are payable in U.S. dollars which may be purchased from the local banking system either pursuant to the registration of such Notes with the BSP or otherwise pursuant to specific BSP approval of such payment. Such principal and interest may also be paid utilizing PLDT's own dollar resources without necessity of BSP approval. The BSP, with the approval of the President of the Philippines, may, however, restrict the availability of foreign exchange during an exchange crisis, when an exchange crisis is imminent, or in times of national emergency.

Taxation

The following is a description of the material Philippine and United States federal income tax consequences to United States Holders (as defined below) of owning shares of Common Stock and ADSs. It applies to you only if you hold your Common Stock or ADSs as capital assets for tax purposes. This section does not apply to you if you are a member of a special class of holders subject to special rules, including a dealer in securities, a trader in securities that elects to use a mark-to-market method of accounting for securities holdings, a tax-exempt organization, a life insurance company, a person liable for alternative minimum tax, a person that actually or constructively owns 10% or more of PLDT's voting stock, a person that holds Common Stock or ADSs as part of a straddle or a hedging or conversion transaction, or a United States Holder (as defined below) whose functional currency is not the U.S. dollar.

This section is based on the United States Internal Revenue Code of 1986, as amended (the "U.S. Tax Code"), its legislative history, existing and proposed regulations, published rulings and court decisions, and the laws of the Philippines including the Philippine National Internal Revenue Code of 1997 (the "Philippine Tax Code") all as currently in effect, as well as on the Convention Between the Philippines and the United States (the "Philippines-United States Tax Treaty"). These laws are subject to change, possibly on a retroactive basis. In addition, this section is based in part on the representations of the Depositary and the assumption that each obligation in the Deposit Agreement and any related agreement will be performed according to its terms.

You are a United States Holder if you are a beneficial owner of Common Stock or ADSs and you are a citizen or resident of the United States, a domestic corporation, an estate whose income is subject to United States federal income tax regardless of its source, or a trust if a United States court can exercise primary supervision over the trust's administration and one or more United States persons are authorized to control all substantial decisions of the trust.

In general, taking into account the earlier assumptions, for United States federal income tax purposes, if you hold ADRs evidencing ADSs, you will be treated as the owner of the shares represented by those ADRs. Exchanges of shares for ADRs, and ADRs for shares, generally will not be subject to United States federal income tax.

This discussion addresses only United States federal income taxation and Philippine income taxation, estate and donor's taxation, stock transaction taxation and documentary stamp taxes.

Philippine Taxation

Taxes on Exchange of ADSs for Common Stock

Philippine capital gains or stock transaction taxes and documentary stamp taxes may be payable upon the transfer of shares of Common Stock to a holder of ADRs to a holder of GDRs. See [Capital Gains Tax and Stock Transaction Tax](#) and [Documentary Stamp Taxes](#).

Taxation of Dividends

Under the Philippine Tax Code, dividends paid by a Philippine corporation to citizens of the Philippines and resident aliens in the Philippines are subject to a final withholding tax of 10% while those paid to non-resident aliens engaged in trade or business within the Philippines are subject to a final withholding tax of 20%. Dividends paid to non-resident aliens not engaged in trade or business within the Philippines are subject to a final withholding tax of 25%. Dividends paid by a Philippine corporation to other Philippine corporations or to resident non-Philippine corporations are not subject to tax. Dividends paid to non-resident non-Philippine corporations not engaged in a trade or business in the Philippines by Philippine corporations shall be subject to a final withholding tax of 15%, subject to the condition that the country in which the non-resident non-Philippine corporation is domiciled either (i) allows a credit against the tax due from the non-resident non-Philippine corporation taxes deemed to have been paid in the Philippines equivalent to 20% effective November 1, 2005 (which represents the difference between the regular income tax on non-resident non-Philippine corporations of 35% effective November 1, 2005 and the 15% tax on dividends) (this condition is not satisfied in the case of corporations domiciled in the United States if such corporations own less than 10% of the voting stock of PLDT) or (ii) imposes no income taxes on dividends received

by such non-resident non-Philippine corporations from Philippine corporations (this condition is not satisfied in the case of corporations domiciled in the United States). If neither of the foregoing conditions are met, the dividends paid to the non-resident non-Philippine corporation shall be subject to the regular income tax rate of 35% effective November 1, 2005. Under rulings issued by Philippine tax authorities, Hong Kong is viewed as falling within clause (ii) and, thus, companies that are organized in Hong Kong that are not engaged in trade or business in the Philippines may be entitled to the benefit of the 15% rate. Such rulings, however, were based upon the laws of Hong Kong as in effect at the time such rulings were issued, and any subsequent changes in the relevant laws of Hong Kong may affect the validity of such rulings. PLDT reserves the right to change the rate at which it makes payments of withholding tax whenever it deems it appropriate under applicable law.

If the holder of Common Stock is a non-resident foreign partnership, which is treated as a corporation for Philippine tax purposes, dividends on the Common Stock should be subject to a final withholding tax of 35% effective November 1, 2005. Cede & Co., the partnership nominee of Depository Trust Company (DTC), should qualify as a non-resident foreign partnership that would be treated as a corporation for Philippine tax purposes.

In certain circumstances where the holder holds Common Stock, a tax treaty rate may be applicable with respect to the Philippine withholding tax. For instance, holders under such circumstances and as to which the Philippines-United States Tax Treaty would be applicable would be eligible for a treaty rate of 25% (or 20% in certain instances). The 20% treaty rate is generally not applicable in the case of non-resident non-Philippine corporations domiciled in the United States which own less than 10% of the voting stock of PLDT. Holders are required, however, to establish to the Philippine taxing authorities their eligibility for such treaty rate. Philippine tax authorities have prescribed, through an administrative issuance, procedures for availment of tax treaty relief. PLDT intends to pay withholding tax at the reduced treaty rate in respect of shares the registered holder of which is Cede & Co., on the basis that Cede & Co. is a resident of the United States for purposes of the Philippines-United States Tax Treaty. PLDT reserves the right to change the rate at which it makes payments of withholding tax whenever it deems it appropriate under applicable law.

Capital Gains Tax and Stock Transaction Tax

The Philippine Tax Code provides that gain from the sale of shares of stock in a Philippine corporation shall be treated as derived entirely from sources within the Philippines, regardless of where the shares are sold. Subject to applicable tax treaty rates, the rate of tax on such gain, where the share is not disposed of through the Philippine Stock Exchange, is a final tax of 5% for gains not exceeding Php100,000 and a final tax of 10% for gains in excess of that amount. The rate is the same for both non-resident individuals and non-resident non-Philippine corporations. While this tax is not collected through withholding, the Philippine Tax Code prohibits a transfer from being recorded on the books of the corporation unless the Philippine Commissioner of Internal Revenue certifies that the tax has been paid or certain other conditions are met.

The sale of shares which are listed in and sold through the PSE are subject to the stock transaction tax imposed at the rate of 1/2 of 1% of the gross selling price. This tax is required to be collected and paid to the government by the selling stockbroker on behalf of his client. Sales of shares other than through a Philippine stock exchange will be subject to Philippine capital gains tax in the manner described above.

Under the Philippines-United States Tax Treaty, gains derived by a United States resident from the sale of shares of stock of a Philippine corporation will not be subject to capital gains tax where the share is not disposed of through the Philippine Stock Exchange, unless the shares are those of a corporation over 50% of the assets of which consist of real property interests located in the Philippines. PLDT does not believe that it currently is such a corporation.

Documentary Stamp Taxes

The Philippines imposes a documentary stamp tax upon transfers of shares of stock issued by a Philippine corporation at a rate of Php0.75 on each Php200, or fractional part thereof, of the par value of the shares. The documentary stamp tax is collectible wherever the document is made, signed, issued, accepted or transferred, when the obligation or right arises from Philippine sources or the property is situated in the Philippines. Effective March 20, 2004, the documentary stamp tax rate upon transfer of shares of stock issued by a Philippine corporation was decreased from Php1.50 to Php0.75 on each Php200, or fractional part thereof, of the par value of the shares. However, the imposition of documentary stamp tax on secondary transfer of shares of stock of a Philippine Corporation which is listed and traded through the facilities of the Philippine Stock Exchange is suspended for a period of five years counted from the same effective date.

Estate and Donor's Taxes

Shares of stock issued by a corporation organized or constituted in accordance with Philippine law are deemed to have a Philippine situs and their transfer by way of succession or donation is subject to Philippine estate and gift taxes. The transfer of shares of stock by a deceased individual to his heirs by way of succession, whether such an individual was a citizen of the Philippines or an alien, regardless of residence, will be subject to Philippine estate tax at progressive rates ranging from 5% to 20% if the net estate is over Php200,000. Individual and corporate shareholders, whether or not citizens or residents of the Philippines, who transfer the Equity Securities by way of gift or donation will be liable for Philippine donor's tax on such transfers at progressive rates ranging from 2% to 15%, if the net gifts made during the calendar year exceed Php100,000. The rate of tax with respect to net gifts made to a stranger, who is not a brother, sister, spouse, ancestor, lineal descendant or relative by consanguinity in the collateral line within the fourth degree of relationship of the donor, is a flat rate of 30%. Estate and gift taxes will not be collected in respect of intangible personal property such as the Equity Securities:

- if the deceased at the time of death, or the donor at the time of donation, was a citizen and resident of a foreign country which at the time of his death or donation did not impose a transfer tax of any character in respect of intangible personal property of citizens of the Philippines not residing in that foreign country, or
- if the laws of the foreign country of which the deceased or the donor was a citizen and resident at the time of his death or donation allow a similar exemption from transfer or death taxes of every character or description in respect of

intangible personal property owned by citizens of the Philippines not residing in that foreign country.

Shares of stock of a deceased shareholder or shares that have been donated may not be transferred on the books of the corporation without a certificate from the Philippine Commissioner of Internal Revenue that the applicable estate or donor's taxes have been paid. In the case of ADRs, however, there is no corresponding requirement, unless a transfer of the ADRs would also entail a change in the registration of the underlying shares.

United States Federal Taxation

For United States federal income tax purposes, United States Holders of ADRs will be treated as the owners of the underlying shares of Common Stock. Deposits and withdrawals by United States Holders of shares of Common Stock in exchange for ADRs will not be subject to United States federal income tax.

Taxation of Dividends

Under the United States federal income tax laws, and subject to the passive foreign investment company, or PFIC, rules discussed below, if you are a United States Holder, the gross amount of any dividend we pay out of our current or accumulated earnings and profits (as determined for United States federal income tax purposes) is subject to United States federal income taxation. If you are a non-corporate United States Holder, dividends paid to you in taxable years beginning before January 1, 2011 that constitute qualified dividend income will be taxable to you at a maximum tax rate of 15% provided that, in the case of Common Stock or ADSs, you hold the Common Stock or ADSs for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date. Dividends we pay with respect to the Common Stock or ADSs generally will be qualified dividend income.

You must include any Philippine tax withheld from the dividend payment in this gross amount even though you do not in fact receive it. The dividend is taxable to you when you, in the case of Common Stock, or the Depositary, in the case of ADSs, receive the dividend, actually or constructively. The dividend will not be eligible for the dividends-received deduction generally allowed to United States corporations in respect of dividends received from other United States corporations. The amount of the dividend distribution that you must include in your income as a United States Holder will be the U.S. dollar value of the Philippine peso payments made, determined at the spot Philippine peso/U.S. dollar rate on the date the dividend distribution is includible in your income, regardless of whether the payment is in fact converted into U.S. dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date you include the dividend payment in income to the date you convert the payment into U.S. dollars will be treated as ordinary income or loss and will not be eligible for the special tax rate applicable to qualified dividend income. The gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes. Distributions in excess of current and accumulated earnings and profits, as determined for United States federal income tax purposes, will be treated as a non-taxable return of capital to the extent of your basis in the Common Stock or ADSs and thereafter as capital gain.

Subject to certain limitations, the Philippine tax withheld in accordance with the Philippines-United States Tax Treaty and paid over to the Philippines will be creditable or deductible against your United States federal income tax liability. Special rules apply in determining the foreign tax credit limitation with respect to dividends that are subject to the maximum 15% tax rate.

Dividends will be income from sources outside the United States. Dividends paid in taxable years beginning before January 1, 2007 generally will be passive or financial services income, and dividends paid in taxable years beginning after December 31, 2006 will, depending on your circumstances, be passive or general income which, in either case, is treated separately from other types of income for purposes of computing the foreign tax credit allowable to you.

Sale or Other Disposition of Equity Securities

Subject to the PFIC rules discussed below, a United States Holder will recognize capital gain or loss upon the sale of Common Stock or ADSs in an amount equal to the difference between such United States Holder's basis in the Common Stock or ADSs and the amount realized upon the sale. Such gain or loss generally will be long-term capital gain or loss if, at the time of sale, exchange or retirement, the Common Stock or ADSs have been held for more than one year. Capital gain of a non-corporate U.S. holder that is recognized in taxable years beginning January 1, 2011 is generally taxed at a maximum rate of 15% where the property is held for more than one year. Generally, any such gain or loss will be treated as realized income or loss from sources within the United States for foreign tax credit limitation purposes. United States Holders may not be eligible to credit against their United States federal income tax liability amounts paid in respect of the Philippine stock transaction tax. See [Philippine Taxation](#) [Capital Gains Tax](#) and [Stock Transaction Tax](#).

The U.S. Tax Code does not authorize a comparable credit for foreign gift or donor's taxes such as those imposed by the Philippines. See [Philippine Taxation](#) [Estate and Donor's Taxes](#).

Passive Foreign Investment Company Rules

We believe that the Common Stock or ADSs should not be treated as stock of a PFIC for United States federal income tax purposes, but this conclusion is a factual determination that is made annually and thus may be subject to change. If we were to be treated as a PFIC, unless the Common Stock or ADSs are marketable stock and a United States Holder elects to be taxed annually on a mark-to-market basis with respect to the Common Stock or ADSs, gain realized on the sale or other disposition of your Common Stock or ADSs would in general not be treated as capital gain. Instead, if you are a United States Holder, you would be treated as if you had realized such gain and certain "excess distributions" ratably over your holding period for the Common Stock or ADSs and would be taxed at the highest tax rate in effect for each such year to which the gain was allocated, together with an interest charge in respect of the tax attributable to each such year. In addition, dividends that you receive from us will not be eligible for the special tax

rates applicable to qualified dividend income if we are a PFIC either in the taxable year of the distribution or the preceding taxable year, but instead will be taxable at rates applicable to ordinary income.

Documents on Display

We are subject to the informational requirements of the Exchange Act, and file reports and other information with the Commission, as required by this Act. Reports and other information filed by us with the Commission may be inspected and copied at the Commission's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Commission's Public Reference Room by calling the Commission in the United States at 1-800-SEC-0330. The Commission also maintains a website that contains reports, proxy statements and other information regarding registrants that file electronically with the Commission. Copies of these materials may be obtained by mail from the public reference section of the Commission, 100 F Street, N.E., Washington, D.C. 20549, at prescribed rates. These reports and other information may also be inspected at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005, on which the American Depositary Shares representing our Common Stock are listed.

Item 11. Quantitative and Qualitative Disclosures about Market Risks

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Our operations are exposed to various risks, including liquidity risk, foreign exchange risk and interest rate risk. The importance of managing these risks has significantly increased in light of considerable change and continuing volatility in both the Philippine and international financial markets. With a view to managing these risks, we have incorporated financial risk management functions in our organization, particularly in our treasury operations and equity issues and sales of certain assets.

Liquidity Risk Management

We seek to manage our liquidity profile to be able to finance our capital expenditures and service our maturing debts. To cover our financing requirements, we currently intend to use internally generated funds and proceeds from debt and equity issues and sales of certain assets.

As part of our liquidity risk management program, we regularly evaluate our projected and actual cash flow information and continuously assess conditions in the financial markets for opportunities to pursue fund-raising initiatives. These initiatives may include bank loans, export credit agency-guaranteed facilities, and debt capital and equity market issues

Foreign Exchange Risk Management

As at December 31, 2006, the Philippine peso had appreciated by 8% against the U.S. dollar to Php49.045 to US\$1.00 from Php53.062 to US\$1.00 as at December 31, 2005. As at December 31, 2005, likewise, the peso appreciated by 6% to Php53.062 to US\$1.00 from Php56.341 to US\$1.00 as at December 31, 2004. The revaluation of our foreign currency-denominated assets and liabilities is recognized as foreign exchange gains or losses as at the balance sheet date. Since substantially all of our indebtedness is denominated in U.S. dollars, the appreciation or depreciation of the Philippine peso results in the recognition of foreign exchange gains or losses. The extent of foreign exchange gains or losses is largely dependent on the amount of foreign currency debt and hedges we carry. As at December 31, 2006, consolidated foreign currency-denominated debt amounted to Php76,647 million, a reduction from Php101,423 million as at December 31, 2005. As such, we recognized foreign exchange gains of Php2,008 million and Php4,906 million in 2006 and 2005, respectively.

The following table shows our consolidated foreign currency-denominated monetary assets and liabilities and their peso equivalents as at December 31, 2006 and 2005:

| | 2006 | | 2005 | |
|---|---------------|-------------------|-------------|-------------------|
| | U.S. Dollar | Php Equivalent(1) | U.S. Dollar | Php Equivalent(2) |
| | (in millions) | | | |
| Current Financial Assets | | | | |
| Cash and cash equivalents | US\$154 | Php7,578 | US\$244 | Php12,957 |
| Short-term investments | 92 | 4,521 | 55 | 2,934 |
| Trade and other receivables | 252 | 12,348 | 139 | 7,371 |
| Derivative assets | 1 | 47 | 1 | 37 |
| Total current financial assets | 499 | 24,494 | 439 | 23,299 |
| Noncurrent Financial Assets | | | | |
| Derivative assets | 9 | 434 | 50 | 2,648 |
| Notes receivable | | | 6 | 346 |
| Total noncurrent financial assets | 9 | 434 | 56 | 2,994 |
| Total Financial Assets | US\$508 | Php24,928 | US\$495 | Php26,293 |
| Current Financial Liabilities | | | | |
| Accounts payable | US\$122 | Php5,968 | US\$42 | Php2,227 |
| Accrued expenses and other current liabilities | 208 | 10,194 | 68 | 3,587 |
| Derivative liabilities | 2 | 108 | 3 | 192 |
| Current portion of interest-bearing financial liabilities | 327 | 16,027 | 337 | 17,867 |
| Total current financial liabilities | 659 | 32,297 | 450 | 23,873 |
| Noncurrent Financial Liabilities | | | | |
| Interest-bearing financial liabilities - net of current portion | 1,356 | 66,510 | 1,738 | 92,218 |
| Derivative liabilities | 140 | 6,872 | 109 | 5,777 |
| Preferred stock subject to mandatory redemption | 27 | 1,308 | 221 | 11,702 |
| Total noncurrent financial liabilities | 1,523 | 74,690 | 2,068 | 109,697 |
| Total Financial Liabilities | US\$2,182 | Php106,987 | US\$2,518 | Php133,570 |

(1) *The exchange rate used was Php49.045 to US\$1.00.*

(2) *The exchange rate used was Php53.062 to US\$1.00.*

While a certain percentage of our revenues is either linked to or denominated in U.S. dollars, substantially all of our indebtedness and related interest expense, a substantial portion of our capital expenditures and a portion of our operating expenses are denominated in foreign currencies, mostly in U.S. dollars.

As at December 31, 2006, approximately 96% of our total consolidated debts were denominated in foreign currencies, principally in U.S. dollars. Thus, a strengthening or weakening of the Philippine peso against the U.S. dollar will decrease or increase, respectively, both the principal amount of our unhedged foreign currency-denominated debts (representing 43% of our consolidated debts, or 31% net of our U.S. dollar cash balances as at December 31, 2006), and interest expense on our debt in Philippine peso terms. In addition, many of our financial ratios and other financial tests are affected by the movements in the Philippine peso to U.S. dollar exchange rate. For further information on our loan covenants, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Financing Activities Debt Financing Debt Covenants above and *Note 12 Interest-bearing Financial Liabilities* to the accompanying consolidated financial statements in Item 18.

To manage our foreign exchange risks, stabilize cash flows, and improve investment and cash flow planning, we enter into forward foreign exchange contracts, foreign currency swap contracts, currency option contracts and other hedging products aimed at reducing and/or managing the adverse impact of changes in foreign exchange rates on our operating results and cash flows. However, these hedges do not cover all of our exposure to foreign exchange risks.

Specifically, we use forward foreign exchange contracts, foreign currency swap contracts and currency option contracts to manage the foreign currency risk associated with our foreign currency-denominated loans. In order to manage hedge costs of these contracts, we utilize structures that include credit-linkage with PLDT as the reference entity, a combination of currency option contracts, and fixed to floating coupon only swap agreements. Accounted for as either cash flow hedges or transactions not designated as hedges, changes in the fair value of these instruments are recognized as accumulated other comprehensive income (loss) cumulative translation adjustments in equity until the hedged item is recognized directly as income or expense for the period.

As at December 31, 2006, PLDT's outstanding forward foreign exchange contracts, principal-only long-term cross-currency swap contracts, and currency option contracts amounted to US\$202 million, US\$550 million, and US\$174 million, respectively. Smart had no outstanding forward foreign exchange contracts as at December 31, 2006.

Interest Rate Risk Management

On a limited basis, we enter into interest rate swap agreements in order to manage our exposure to interest rate fluctuations. We make use of hedging instruments and structures solely for reducing or managing financial risks associated with our liabilities and not for trading or speculative purposes.

The tables below set out the carrying amount, by maturity, of our financial instruments that are exposed to interest rate risk for the years ended December 31, 2006 and 2005. Financial instruments that are not subject to interest rate risk were not included in the table:

Year Ended December 31, 2006

| | Below 1 year | 1-2 years | 2 | 3 years | 3-5 years | Over 5 years | Fair Value | |
|--------------------------------|---|---------------------------|---|---------------------------|--------------------------|------------------|----------------|----------------------|
| | | | | | | | In U.S. Dollar | In Philippine Dollar |
| Liabilities: | | | | | | | | |
| Long-term Debt | | | | | | | | |
| <i>Fixed Rate</i> | | | | | | | | |
| US\$ Notes (in millions) | 129 | | | 167 | | 550 | 845 | 41,463,967,349 |
| Interest rate | 7.85% to 10.625% | | | 10.50% | | 8.35% to 11.375% | | |
| US\$ Fixed Loans (in millions) | 69 | 56 | | 46 | 32 | 280 | 483 | 23,682,361,7,712 |
| Interest rate | 1.75% to 10% | 4.49% to 10% | | 4.49% to 10% | 4.515% to 4.70% | 2.25% | | |
| Philippine Peso (in millions) | | | | | 17 | | 17 | 810 21 1,035 |
| Interest rate | | | | | 15% | | | |
| <i>Variable Rate</i> | | | | | | | | |
| U.S. Dollar (in millions) | 128 | 92 | | 81 | 53 | | 355 | 17,392,355,7,392 |
| Interest rate | GOVCO s Cost + 0.20%; 0.05% to 2.75% over LIBOR | 0.05% to 2.75% over LIBOR | | 0.05% to 2.75% over LIBOR | 0.05% to 2.5% over LIBOR | | | |

| | | | | | | | |
|---|---------------------------------|---------------------|---------------------|---------------------|---------------------|---------------|---------------|
| Philippine Peso (in millions) | 6 | 11 | 11 | 23 | 51 | 2,511 | 512,511 |
| Interest rate | 3% over | MART1 + 0.75% | MART1 + 0.75% | MART1 + 0.75% | | | |
| | 90-day PHIBOR, MART1 + 0.75% | | | | | | |
| | | | | | 1,751 | 85,835 | 85,999 |
| <i>Interest rate swap (fixed to floating)</i> | | | | | | | |
| U.S. Dollar (US\$63 million) | | | | | 9 | 423 | |
| Japanese Yen (JPY7,519 million) | | | | | | | 9 423 |
| Fixed Rate on US\$ notional | 11.375% | 11.375% | 11.375% | 11.375% | 11.375% | | |
| Variable Rate on JPY notional | 8.11% over LIBOR | 8.11% over LIBOR | 8.11% over LIBOR | 8.11% over LIBOR | 8.11% over LIBOR | | |

Year Ended December 31, 2005

| | Below 1 year | 1-2 years | 2 | 3 years | 3-5 years | Over 5 years | Carrying U.S. Value In Php | Fair Value In U.S. Dollar | In Php |
|--------------------------------------|----------------|---------------------|---|-------------------|-------------------|----------------------|----------------------------------|---------------------------------|--------------|
| Liabilities: | | | | | | | | | |
| Long-term Debt | | | | | | | | | |
| <i>Fixed Rate</i> | | | | | | | | | |
| US\$ Notes (in millions) | 115 | 159 | | | 175 | 549 | 998 | 52,980 | 1,108 58,780 |
| Interest rate | 9.25% | 7.85% to 10.625% | | | 10.50% | 8.35% and 11.375% | | | |
| US\$ Fixed Loans (in millions) | 64 | 45 | | 31 | 22 | 280 | 442 | 23,451 | 327 17,350 |
| Interest rate | 4.49% to 7.75% | 4.49% to 7.58% | | 4.49% to 7.58% | 4.49% to 5.65% | 2.25% | | | |
| | 23 | 24 | | 12 | | | 59 | 3,139 | 59 3,158 |

| | | | | | | | | | |
|----------------------------------|---|---|-------------------------------------|----------------------------------|----------------------------------|--|--------------|---------------|----------------|
| Japanese Yen (in millions) | | | | | | | | | |
| Interest rate | 2.125% | 2.125% | 2.125% | | | | | | |
| Philippine Peso (in millions) | 15 | 1 | | 15 | | | 30 | 1,580 | 37 1,795 |
| Interest rate | 15.816% to 24% | | | 15.0% | | | | | |
| <i>Variable Rate</i> | | | | | | | | | |
| U.S. Dollar (in millions) | 129 | 143 | 79 | 117 | 94 | | 562 | 29,806 | 562 29,806 |
| Interest rate | GOVCO s Cost + 0.20%; 0.05% to 3.625% over LIBOR | GOVCO s Cost + 0.20%; 0.05% to 3.625% over LIBOR | 0.05% to 3.625% over LIBOR | .05% to 2.5% over LIBOR | 1% over LIBOR | | | | |
| Japanese Yen (in millions) | 5 | 5 | 3 | | | | 13 | 709 | 13 709 |
| Interest rate | 1.70% over LIBOR | 1.70% over LIBOR | 1.70% over LIBOR | | | | | | |
| Philippine Peso (in millions) | 3 | | | 2 | 7 | | 12 | 648 | 9 648 |
| Interest rate | 1% over 91-day T-bill rate, 90-day PHIBOR + 3% | | | 1% over 91-day T-bill rate | 1% over 91-day T-bill rate | | | | |
| | | | | | | | 2,116 | 12,313 | 2,115 |
| | | | | | | | | | 112,246 |

*Interest rate
swap (fixed to
floating)*

| | | | | | | | | | |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|--|----|--|----------|
| U.S. Dollar (US\$125 million) | | | | | | | 30 | | |
| Japanese Yen (JPY15,037 million) | | | | | | | | | 30 1,569 |
| Fixed Rate on US\$ notional | 11.375% | 11.375% | 11.375% | 11.375% | 11.375% | | | | |
| Variable Rate on JPY notional | 8.11% over LIBOR | 8.11% over LIBOR | 8.11% over LIBOR | 8.11% over LIBOR | 8.11% over LIBOR | | | | |

Item 12. Description of Securities Other than Equity Securities

Not Applicable.

PART II

Item 13. Defaults, Dividend Arrearages and Delinquencies

As at December 31, 2006, Piltel had outstanding convertible bonds with a principal amount of US\$0.7 million. These were redeemed and paid, including accrued interest, on March 30, 2007. See *Note 12 Interest-bearing Financial Liabilities* to the accompanying consolidated financial statements in Item 18.

The Series C, Class I Preferred Stock of Piltel is entitled to annual cumulative cash dividends of Php0.20 per share (10% on the par value per share). As at the date of this annual report on Form 20-F, the total arrearage with respect to the Series C, Class I Preferred Stock of Piltel amounted to approximately Php7 million.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

None.

Item 15. Controls and Procedures

-

Disclosure Controls and Procedures. Our management, with the participation of our principal executive officer and principal financial officer, carried out an evaluation on the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as at December 31, 2006. Based on this evaluation, our chief executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as at December 31, 2006.

Management's Annual Report on Internal Control Over Financial Reporting. Management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed under the supervision of our principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements for external reporting purposes in accordance with PFRS and U.S. GAAP. Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with PFRS and U.S. GAAP, and that receipts and expenditures are being made only in accordance with authorizations of our management and directors; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Our management conducted an assessment of the effectiveness of our internal control over financial reporting based on the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that our internal control over financial reporting as at December 31, 2006 is effective.

Management’s assessment of the effectiveness of our internal control over financial reporting as at December 31, 2006 has been audited by Sycip Gorres Velayo & Co., an independent registered public accounting firm, as stated in their report appearing on the accompanying consolidated financial statements in Item 18, which expresses an unqualified opinion on management’s assessment and on the effectiveness of our internal control over financial reporting as at December 31, 2006.

Changes in Internal Control Over Financial Reporting. During 2006, no change to our internal control over financial reporting occurred that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Attestation Report of the Registered Public Accounting Firm. The attestation report of Sycip Gorres Velayo & Co., an independent registered public accounting firm, regarding its audit of PLDT Group’s internal control over financial reporting is set forth in Item 18 – Financial Statements .

Item 16A. Audit Committee Financial Expert

Our board of directors has determined that currently none of the members of the Audit Committee is an audit committee financial expert as defined under the applicable rules of the U.S. SEC issued pursuant to Section 407 of the Sarbanes-Oxley Act of 2002. However, our board of directors believes that the audit committee members along with its advisors, possess sufficient financial knowledge and experience. Our board of directors has appointed one of our non-independent directors, Ms. Corazon de la Paz, as Audit Committee advisor to render advice on complex financial reporting or accounting issues that may be raised in our Audit Committee’s evaluation of our financial statements and other related matters. Formerly the Chairman and a Senior Partner of Joaquin Cunanan & Company (a member firm of PricewaterhouseCoopers Worldwide), Ms. Corazon de la Paz is a certified public accountant and possesses in-depth knowledge of accounting principles (including U.S. GAAP), internal controls and procedures for financial reporting and audit committee functions, as well as extensive experience in overseeing or actively supervising the preparation, audit, analysis or evaluation of financial statements and in addressing complex and general financial reporting, accounting and audit issues.

Item 16B. Code of Business Conduct and Ethics

On March 30, 2004, our board of directors approved and adopted our Code of Business Conduct and Ethics, or Code of Ethics, that sets out our business principles and standards of behavior and business relationships.

It is our declared objective that all our actions and those of our directors, officers and employees must, at all times, be consistent with the principles of accountability, integrity, fairness and transparency.

Our Code of Ethics provides standards to foster honest and ethical behavior including the following:

1. Compliance with applicable laws, rules and regulations;
2. Ethical handling of conflicts of interest, corporate opportunities and confidential information;
3. Protection and proper use of our assets;
4. Fair dealing with our employees, customers, service providers, suppliers and competitors;
5. Compliance with our reporting and disclosure obligations to the relevant regulators and the investors;
6. Compliance with our disclosure and financial reporting controls and procedures;
7. Assessment and management of risks involved in our business endeavours; and
8. Adoption of international best practices of good corporate governance in the conduct of our business.

Corporate Governance

Our Code of Ethics was adopted to strengthen the implementation of our Corporate Governance Manual, or Governance Manual, which was adopted and approved by our board of directors in September 2002. Our Governance Manual seeks to institutionalize the principles of good governance that our board of directors and management believe to be a necessary component of sound business management.

Our Governance Manual conforms with the requirements of the Code of Corporate Governance, or Philippine SEC Governance Code, that was promulgated by the Philippine Securities and Exchange Commission, or Philippine SEC, under the Philippine SEC Memorandum Circular No. 2, Series of 2002, on April 5, 2002, in line with the Philippine Government's policy to promote corporate governance reform aimed to raise investor confidence, develop capital market and help achieve sustained growth for the Philippine corporate sector and the economy.

In compliance with the Philippine SEC Governance Code and consistent with the relevant provisions of the Securities Regulation Code and Corporation Code of the Philippines, our Governance Manual covers the following key areas:

1. The qualifications and grounds for disqualification for directorship;
2. The requirement that at least two or twenty percent of the members of our board of directors, whichever is lesser, must be independent directors and the standards/criteria for the determination of independent directors;
3. The duties and responsibilities of our board of directors and the individual directors;
4. Our board committees, specifically, the nomination committee, audit committee and executive compensation committee, the composition and the principal duties and responsibilities of such committees;
5. The role of our chairman in ensuring compliance with the corporate governance principles;
6. The role of our president/chief executive officer in ensuring that our organizational and procedural controls are adequate and effective to ensure reliability and integrity of financial and operational information, effectiveness and efficiency of operations, safeguarding of assets and compliance with laws, rules, regulations and contracts;
7. The duties and responsibilities of our corporate secretary/assistant corporate secretary in terms of the support services that they need to provide our board in upholding sound corporate governance;

8. The duties and responsibilities of the head of our internal audit organization that would provide our board of directors, management and shareholders with reasonable assurance that our key organizational and procedural controls are appropriate, adequate, effective and reasonably complied with;

9. The functions of our independent auditors that would reasonably ensure an environment of sound corporate governance as reflected in our financial records and reports; the requirement that non-audit work of the independent auditors should not conflict with their function as independent auditors; the requirement to rotate, at least once every five years, the independent auditors or the lead partner assigned to handle the independent audit of our financial statements;

10. Our commitment to respect and promote shareholders' rights such as voting right, pre-emptive right, inspection right, dividend right, appraisal right, and right to receive information about the background, business experience, compensation and shareholdings of our directors and officers and their transactions with us;

11. The requirement to appoint a compliance officer and the duties and responsibilities of such compliance officer including the establishment of an evaluation system to determine and measure compliance with the provisions of our Governance Manual; and

12. The penalties for violations of our Governance Manual.

We have also summarized in our website the differences between our corporate governance practices and those required of U.S. listed companies under NYSE Section 303A.11.

To access our Code of Ethics, Governance Manual or the differences between our corporate governance practices and those required of U.S. listed companies under NYSE Section 303A.11, please refer to:

http://www.pldt.com.ph/download/pldt-corpgov_manual.pdf OR
http://www.pldt.com.ph/cgov/downloads/pldt-corpgov_manual.pdf

http://www.pldt.com.ph/download/pldt-code_ethics.pdf OR
[http://www.pldt.com.ph/cgov/downloads/Code%20of%20Ethics\(BD_APPRVD\)-03.30.04.pdf](http://www.pldt.com.ph/cgov/downloads/Code%20of%20Ethics(BD_APPRVD)-03.30.04.pdf)

<http://www.pldt.com.ph/download/pldt-disclosure.pdf> OR
http://www.pldt.com.ph/cgov/downloads/NYSE-PLDT_CG-DISC-07.01.pdf

Chief Governance Officer

Our chief governance officer is responsible for monitoring compliance with, interpreting and deciding any issues arising from, investigating and determining violations and recommending the disciplinary actions against violators of our Governance Manual and Code of Ethics.

Board Committees

We have four board committees, namely the governance and nomination, audit, executive compensation and technology strategy committees. Each committee has a board-approved written charter that provides for such committee's composition, membership qualifications, functions and responsibilities, conduct of meetings, and reporting procedure to the board. See Item 6. Directors, Senior Management and Employees Audit, Governance and Nomination, Executive Compensation and Technology Strategy Committees for further details.

Internal Audit Organization

We have an internal audit organization that determines whether our network or risk management, control and governance processes are adequate and functioning to ensure that:

1. Risks are appropriately identified and managed;
2. Significant financial, managerial, and operating information are accurate, reliable, and timely;
3. Employees' actions are in compliance with policies, standards, procedures, and applicable laws and regulations;
4. Resources are acquired economically, used efficiently, and adequately protected;
5. Programs, plans and objectives are achieved;

6. Quality and continuous improvement are fostered in our control process;
7. Significant legislative or regulatory issues impacting us are recognized and addressed appropriately; and
8. Interaction with various governance groups occurs as needed.

To ensure independence, the head of our internal audit organization reports functionally to our audit committee and administratively to our president and chief executive officer. He is accountable to management and our audit committee in the discharge of his duties and is required to:

1. Provide annually an assessment on the adequacy and effectiveness of our processes for controlling our activities and managing our risks;
2. Report significant issues related to the processes of controlling our activities, including potential improvements to those processes, and provide information concerning such issues;
3. Periodically provide information on the status and results of the annual audit plan and the sufficiency of our internal audit organization's resources; and
4. Coordinate with and provide oversight of other control and monitoring functions (risk management, compliance, security, legal, ethics, environmental, external audit).

Our internal audit organization has a charter that has been approved by our audit committee. It seeks to comply with the Standards for the Professional Practice of Internal Auditing of The Institute of Internal Auditors in the discharge of its scope of work and responsibilities.

Policy on Employee Disclosure on Violations of the Corporate Governance Rules, Questionable Accounting or Auditing Matters, and Offenses Covered By the Company's Table of Penalties

We have expanded our written policy on the handling of employees' anonymous and non-anonymous complaints or disclosures on violations or irregularities to cover accounting, internal controls and auditing matters, as well as corporate governance rules and offenses covered by our table of penalties. Said policy also provides protection against retaliation for those employees who make such complaints or disclosures. We have likewise established dedicated structures and facilities (post office box, e-mail, hotline number, fax and website) for the submission of such disclosures or complaints.

Any employee may submit a complaint or disclosure of the above nature to the Corporate Governance Office (CGO) or the chief governance officer, verbally or in writing. The CGO shall conduct a preliminary evaluation to determine the appropriate investigating unit to which the case shall be assigned for further action.

The CGO monitors the cases reported and ensures the appropriate reporting to our audit committee, governance and nomination committee, or any other relevant committee or body on the results of the investigations and the prompt referrals of findings to the appropriate units concerned. Our committees on officer or employee discipline, as the case may be, are responsible for evaluating and approving the appropriate disciplinary action against erring officers and employees.

The public may obtain information on our Code of Ethics, Governance Manual and Charters of our Board Committees through our website. We undertake to provide a copy, without charge, to any person requesting for such copy from our chief governance officer, Rene G. Bañez, who can be reached at e-mail address rgbanez@pldt.com.ph or telephone number +632-816-8917. We also maintain a website at www.pldt.com.ph on which reports filed by us and other information may be accessed.

Item 16C. Principal Accountant Fees and Services

The following table summarizes the fees paid for services billed by our external auditors for the fiscal years ended December 31, 2006 and 2005:

| | 2006 | 2005 |
|----------------|----------------|----------------|
| | (in millions) | |
| Audit Fees | Php45.8 | Php38.1 |
| Tax Fees | | 1.0 |
| All Other Fees | 8.3 | 10.5 |
| Total | Php54.1 | Php49.6 |

Audit Fees. This category includes the audit of our annual financial statements, review of interim financial statements and services that are normally provided by the independent auditors in connection with statutory and regulatory filings or engagements for those fiscal years.

Tax Services. This category includes tax compliance, tax advice and tax planning services performed by our independent auditors.

All Other Fees. This category consists primarily of fees for consultation with respect to our IAS adoption, Sarbanes-Oxley Act 404 compliance initiatives due diligence review for certain projects and out-of-pocket and incidental expenses.

The fees presented above include out-of-pocket expenses incidental to our independent auditors' work, which amounts do not exceed 5% of the agreed-upon engagement fees.

Our Audit Committee pre-approves all audit and non-audit services as these are proposed or endorsed before these services are performed by our independent auditors.

Item 16D. Exemption from the listing Standards for Audit Committees

Not applicable.

Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchaser

Not applicable.

PART III

Item 17. Financial Statements

The Company has elected to provide the financial statements and related information specified in Item 18 in lieu of Item 17.

Item 18. Financial Statements

Index to Financial Statements

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| Report of Independent Registered Public Accounting Firm | 146 |
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Item 19. Exhibits

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See Item 18 above for details of the financial statements filed as part of this annual report.

-

Exhibits to this report:

-

- 1(a). Articles of Incorporation (incorporated by reference to PLDT's Form 20-F as filed with the Securities and Exchange Commission in May 2001)
- 1(b). By-Laws (as amended on June 28, 2005) (incorporated by reference to PLDT's Form 20-F as filed with the Securities and Exchange Commission in June 2006)
2. We have not included as exhibits certain instruments with respect to our long-term debt, the amount of debt authorized under each of which does not exceed 10% of our total assets, and we agree to furnish a copy of any such instrument to the Securities and Exchange Commission upon request.
4. Material Contracts
6. Computation of Earnings per Share
7. Calculation of Ratio of Earnings to Fixed Charges

8. Subsidiaries

12.1 Certification of Chief Executive Officer required by Rule 13a-14(a) of the Exchange Act

12.2 Certification of the Principal Financial Officer required by Rule 13a-14(a) of the Exchange Act

13.1 Certification of Chief Executive Officer required by Rule 13a-14(b) of the Exchange Act

13.2 Certification of the Principal Financial Officer required by Rule 13a-14(b) of the Exchange Act

SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

PHILIPPINE LONG DISTANCE TELEPHONE
COMPANY

By: /s/ Ma. Lourdes C. Rausa-Chan
MA. LOURDES C. RAUSA-CHAN
Senior Vice President, Corporate Affairs and Legal
Services Head and Corporate Secretary

Date: June 27, 2007

EXHIBIT INDEX

| Exhibit Number | Description of Exhibit |
|----------------|---|
| 1(a) | Articles of Incorporation (incorporated by reference to PLDT's Form 20-F as filed with the Securities and Exchange Commission in May 2001) |
| 1(b) | By-Laws (as amended on June 28, 2005) (incorporated by reference to PLDT's Form 20-F as filed with the Securities and Exchange Commission in June 2006) |
| 2 | We have not included as exhibits certain instruments with respect to our long-term debt, the amount of debt authorized under each of which does not exceed 10% of our total assets, and we agree to furnish a copy of any such instrument to the Securities and Exchange Commission upon request. |
| 4(a) | Stock Purchase and Strategic Investment Agreement, dated September 28, 1999, by and among PLDT, First Pacific Limited, Metro Pacific Corporation, Metro Pacific Asia Link Holdings, Inc., Metro Pacific Resources, Inc. and NTT Communications Corporation (incorporated by reference to PLDT's Form 6-K for the month of September 1999) |
| 4(b) | Executive Stock Option Plan (incorporated by reference to PLDT's Form 20-F as filed with the Securities and Exchange Commission in May 2001) |
| 4(c) | Master Restructuring Agreement, dated June 21, 2000, as amended on December 12, 2000 and December 19, 2000, between Piltel, Piltel (Cayman) Limited, PLDT, The Chase Manhattan Bank, as escrow agent, Metropolitan Bank and Trust Company, as administrative agent and the creditors named therein (incorporated by reference to PLDT's Form 20-F as filed with the Securities and Exchange Commission in May 2001) |
| 4(d) | The Cooperation Agreement, dated January 31, 2006, entered into by and among PLDT, First Pacific, Metro Pacific Corporation, Metro Asia Link Holdings, Inc., Metro Pacific Resources, Inc., Larouge B.V., Metro Pacific Assets Holdings, Inc., NTT Communications and DoCoMo (incorporated by reference to Schedule 13D/A (Amendment No.2) as filed with the United States Securities and Exchange Commission by Nippon Telegraph and Telephone Corporation and NTT Communications Corporation on January 31, 2006) |
| 6 | Computation of Earnings per Share |
| 7 | Calculation of Ratio of Earnings to Fixed Charges |
| 8 | Subsidiaries |
| 12.1 | Certification of Chief Executive Officer required by Rule 13a-14(a) of the Exchange Act |
| 12.2 | Certification of the Principal Financial Officer required by Rule 13a-14(a) of the Exchange Act |
| 13.1 | Certification of Chief Executive Officer required by Rule 13a-14(b) of the Exchange Act |

13.2 Certification of the Principal Financial Officer required by Rule 13a-14(b) of the Exchange Act

EXHIBIT 6

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY

Computation of Operating Income and Earnings Per Share

For the years 2002 through 2006

2006 2006(1) 2005 2004 2003 2002
(in millions, except net operating income (loss) per
common share)

1. Operating income per share

Basic

| | | | | | | |
|--|-----------|---------|-----------|-----------|-----------|-----------|
| Operating income | Php48,179 | US\$982 | Php48,514 | Php48,539 | Php33,379 | Php12,029 |
| Deduct: Dividends on preferred stock | 572 | 12 | 1,677 | 1,764 | 1,739 | 1,645 |
| Accretion of redemption value of preferred stock subject to mandatory conversion | 765 | 16 | 1,443 | 1,503 | 1,309 | 1,004 |
| Operating income applicable to common shareholders | Php46,842 | US\$955 | Php45,394 | Php45,272 | Php30,331 | Php9,380 |

Diluted

| | | | | | | |
|--|-----------|---------|-----------|-----------|-----------|-----------|
| Operating income | Php48,179 | US\$982 | Php48,514 | Php48,539 | Php33,379 | Php12,029 |
| Deduct: Dividends on preferred stock | 572 | 12 | 70 | 49 | 49 | 1,036 |
| Accretion of redemption value of preferred stock subject to mandatory conversion | 765 | 16 | 1,746 | | 1,309 | 1,004 |
| Operating income applicable to common shareholders | Php46,842 | US\$955 | Php46,698 | Php48,490 | Php32,021 | Php9,989 |

Basic

Weighted average number of common shares (in thousands)

| | | | | | | |
|---|---------|--|---------|---------|---------|---------|
| Outstanding common shares, beginning | 180,789 | | 170,214 | 169,476 | 169,361 | 168,895 |
| Effect of issuance of common shares during the year | 3,667 | | 1,855 | 252 | 52 | 200 |
| | 184,456 | | 172,069 | 169,728 | 169,413 | 169,095 |

Diluted

Weighted average number of common shares (in thousands)

| | | | | | | |
|---|---------|--|---------|---------|---------|---------|
| Outstanding common shares, beginning | 180,789 | | 170,214 | 169,476 | 169,361 | 168,895 |
| Effect of issuance of common shares during the year | 3,667 | | 1,855 | 252 | 52 | 200 |
| Weighted average number of shares under ESOP during the year(3) | | | 94 | 155 | | |
| Common share equivalent of preferred shares deemed dilutive | | | 10,858 | 22,381 | 24,222 | 22,160 |
| | 184,456 | | 183,021 | 192,264 | 193,635 | 191,255 |

Operating income per share

| | | | | | | |
|---------|-----------|--|-----------|-----------|-----------|----------|
| Basic | Php253.95 | | Php263.81 | Php266.73 | Php179.04 | Php55.47 |
| Diluted | 253.95 | | 255.15 | 252.20 | 165.37 | 52.23 |

-

(in millions, except earnings per common share)

2. Earnings per share(2)

Basic

| | | | | | | |
|--|-----------|---------|-----------|-----------|-----------|------------|
| Net income (loss) after cumulative effect of change in accounting policy | Php33,598 | US\$685 | Php40,603 | Php28,101 | Php11,046 | (Php6,158) |
| Deduct: Dividends on preferred stock | 572 | 11 | 1,677 | 1,764 | 1,739 | 1,645 |
| Accretion to redemption value of preferred stock subject to mandatory conversion | 765 | 14 | 1,443 | 1,503 | 1,309 | 1,004 |
| Net income (loss) attributable to common shareholders | Php32,261 | US\$660 | Php37,483 | Php24,834 | Php7,999 | (Php8,807) |

Diluted

| | | | | | | |
|--|-----------|---------|-----------|-----------|-----------|------------|
| Net income (loss) after cumulative effect of change in accounting policy | Php33,598 | US\$685 | Php40,603 | Php28,101 | Php11,046 | (Php6,158) |
| Deduct: Dividends on preferred stock | 572 | 11 | 70 | 285 | 1,485 | 1,645 |
| Accretion to redemption value of preferred stock subject to mandatory conversion | 765 | 14 | 1,746 | 1,503 | 1,309 | 1,004 |
| Net income (loss) applicable to common shareholders | Php32,261 | US\$660 | Php38,787 | Php26,313 | Php8,255 | (Php8,807) |

Basic

Weighted average number of common shares (in thousands)

| | | | | | |
|---|---------|---------|---------|---------|---------|
| Outstanding common shares, beginning | 180,789 | 170,214 | 169,476 | 169,361 | 168,895 |
| Effect of issuance of common shares during the year | 3,667 | 1,855 | 252 | 52 | 200 |
| | 184,456 | 172,069 | 169,728 | 169,413 | 169,095 |

Diluted

Weighted average number of common shares (in thousands)

| | | | | | |
|---|---------|---------|---------|---------|---------|
| Outstanding common shares, beginning | 180,789 | 170,214 | 169,476 | 169,361 | 168,895 |
| Effect of issuance of common shares during the year | 3,667 | 1,855 | 252 | 52 | 200 |

Weighted average number of shares under ESOP during the year(3)

94 155

Common share equivalent of preferred shares deemed dilutive:

| | | | | |
|--|---------|---------|---------|---------|
| | | 10,858 | 11,213 | 11,069 |
| | 184,456 | 183,021 | 181,096 | 180,482 |

Earnings per share(2)

| | | | | | |
|---------|-----------|-----------|-----------|----------|------------|
| Basic | Php174.90 | Php217.84 | Php146.32 | Php47.20 | (Php52.08) |
| Diluted | 174.90 | 211.93 | 145.30 | 45.72 | (52.08) |

(1) PLDT Group maintains its accounts in Philippine peso. For convenience, the peso financial information as at and for the year ended December 31, 2006 has been translated into U.S. dollars at the exchange rate of Php49.045 to US\$1.00, the peso-dollar rate as quoted through the Philippine Dealing System as at December 31, 2006.

(2) Our convertible preferred stocks were deemed anti-dilutive for the years ended December 31, 2002 and 2006. Since the amount of preferred dividends over the equivalent number of common stocks were greater than the basic earnings per share, the amounts reported for the years ended December 31, 2002 and 2006 basic and diluted earnings per common share were the same.

(3) *The dilutive effect of the outstanding options is reflected as additional share dilution in the computation of earnings per common share, see Note 20 Earnings per Common Share to the accompanying consolidated financial statements in Item 18 for further discussion.*

EXHIBIT 7**PHILIPPINE LONG DISTANCE TELEPHONE COMPANY****Calculation of Ratio of Earnings to Fixed Charges**

For the years 2002 through 2006

| | 2006 | 2006(1) | 2005 | 2004 | 2003 | 2002 |
|--|--|----------------|-------------|-------------|-------------|-------------|
| | (in millions, except ratio of earnings (loss) to fixed charges) | | | | | |
| Earnings (a) | Php52,763 | US\$1,076 | Php57,972 | Php49,155 | Php24,168 | Php11,320 |
| Fixed charges (b) | | | | | | |
| Fixed charges excluding amortization of capitalized interest | Php7,445 | US\$152 | Php10,759 | Php12,805 | Php12,747 | Php14,177 |
| Capitalized interest, net of amortization | (941) | (19) | (939) | (915) | (714) | (394) |
| | Php6,504 | 133 | Php9,820 | Php11,890 | Php12,033 | Php13,783 |
| Ratio (a/b) (2) | 8.1 | 8.1 | 5.9 | 4.1 | 2.0 | |

(1) *PLDT Group maintains its accounts in Philippine peso. For convenience, the peso financial information as at and for the year ended December 31, 2006 has been translated into U.S. dollars at the exchange rate of Php49.045 to US\$1.00, the peso-dollar rate as quoted through the Philippine Dealing System as at December 31, 2006.*

(2) *For purposes of this ratio, Earnings consist of income before provision for income tax (excluding PLDT's share in undistributed income of less than 50%-owned affiliates) and fixed charges (excluding capitalized interest). Fixed charges consist of interest (including capitalized interest, discounts and other financing costs) on all indebtedness, amortization of deferred financing costs and the estimated financing component of rent expense (i.e., one-third of rent expense).*

Due to PLDT's net loss in 2002, the coverage ratio on a consolidated basis was less than 1.0x. In order to achieve a coverage ratio of 1.0x in that year, we would have had to generate additional consolidated earnings of Php2,463 million for the year ended December 31, 2002.

EXHIBIT 8

PLDT SUBSIDIARIES

| Name of Subsidiary | Place of Incorporation | Principal Activity | Percentage of Ownership | |
|---|------------------------|---|-------------------------|----------|
| | | | Direct | Indirect |
| Wireless | | | | |
| Smart | Philippines | Cellular mobile services | 100.0 | |
| Smart Broadband | Philippines | Internet broadband and distributor | | 100.0 |
| Wolfpac | Philippines | Mobile applications developer and service provider | | 100.0 |
| Piltel | Philippines | Providing cellular and fixed line services | | 92.1 |
| Telesat | Philippines | Satellite communications services | 94.4 | |
| ACeS Philippines | Philippines | Satellite phone services | 88.5 | 11.5 |
| Mabuhay Satellite | Philippines | Satellite communications services | 67.0 | |
| Fixed Line | | | | |
| ClarkTel | Philippines | Telecommunications services | 100.0 | |
| SubicTel | Philippines | Telecommunications services | 100.0 | |
| | British Virgin Islands | Telecommunications services | 100.0 | |
| PLDT Global | | | | |
| SNMI | Philippines | Data and network services | 100.0 | |
| Maratel | Philippines | Telecommunications services | 97.5 | |
| BCC | Philippines | Telecommunications, infrastructure and related value-added services | 75.0 | |
| Information and Communications Technology | | | | |
| ePLDT | Philippines | Information and communications infrastructure for internet-based services, e-commerce, call centers and IT-related services | 100.0 | |
| Vocativ | Philippines | Call center services | | 100.0 |
| Parlance | Philippines | Call center services | | 100.0 |
| Ventus | Philippines | Call center services | | 100.0 |
| SPi and Subsidiaries (including CyMed) | Philippines | Business process outsourcing, or BPO, services | | 100.0 |
| Infocom | Philippines | Internet services | | 99.6 |
| netGames | Philippines | Publisher of online games | | 80.0 |
| Digital Paradise (formerly Netopia Computer Technologies, Inc.) | Philippines | Internet access services | | 75.0 |
| Level Up! | Philippines | Publisher of online games | | 60.0 |
| Digital Paradise Thailand | Thailand | Internet access services | | 51.0 |

Airborne Access

Philippines

Wireless internet services

51.0

CERTIFICATION

I, Napoleon L. Nazareno, certify that:

1. I have reviewed this annual report on Form 20-F of Philippine Long Distance Telephone Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and

5. The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: June 27, 2007

/s/ Napoleon L. Nazareno
Napoleon L. Nazareno

President and Chief Executive Officer

(Principal Executive Officer)

Exhibit 12.2

CERTIFICATION

I, Anabelle L. Chua, certify that:

1. I have reviewed this annual report on Form 20-F of Philippine Long Distance Telephone Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and

5. The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

Date: June 27, 2007

/s/ Anabelle L. Chua
Anabelle L. Chua

Senior Vice President and Treasurer

(Principal Financial Officer)

Exhibit 13.1

CERTIFICATION

Pursuant to 18 U.S.C. § 1350, I, Napoleon L. Nazareno, President and Chief Executive Officer of Philippine Long Distance Telephone Company, hereby certify, to my knowledge, that our annual report on Form 20-F for the year ended December 31, 2006 (the Report) fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, and that the information contained in the Report fairly presents, in all material respects, our financial condition and results of operations.

Date: June 27, 2007

/s/ Napoleon L. Nazareno
Napoleon L. Nazareno

President and Chief Executive Officer
(Principal Executive Officer)

The foregoing certification is being furnished solely pursuant to 18 U.S.C. § 1350 and is not being filed as part of the Report or as a separate disclosure document.

Exhibit 13.2

CERTIFICATION

Pursuant to 18 U.S.C. § 1350, I, Anabelle L. Chua, Senior Vice President and Treasurer of Philippine Long Distance Telephone Company, hereby certify, to my knowledge, that our annual report on Form 20-F for the year ended December 31, 2006 (the Report) fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, and that the information contained in the Report fairly presents, in all material respects, our financial condition and results of operations.

Date: June 27, 2007

/s/ Anabelle L. Chua
Anabelle L. Chua

Senior Vice President and Treasurer
(Principal Financial Officer)

The foregoing certification is being furnished solely pursuant to 18 U.S.C. § 1350 and is not being filed as part of the Report or as a separate disclosure document.

Report of Independent Registered Public Accounting Firm

The Board of Directors and the Stockholders

Philippine Long Distance Telephone Company

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Philippine Long Distance Telephone Company and Subsidiaries (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance

with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2006, and our report dated June 25, 2007 expressed an unqualified opinion thereon.

/s/Sycip Gorres Velayo & Co.

SYCIP, GORRES, VELAYO &