

FINANCIAL REVIEW

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes as at December 31, 2007 and 2006 and for each of the three years in the period ended December 31, 2007, included elsewhere in this Annual 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.

Overview

We are the largest and most diversified telecommunications company in the Philippines. We have organized our business into three main segments:

- **Wireless**— wireless telecommunications services provided through our cellular service providers namely, Smart Communications, Inc., or Smart, and Pilipino Telephone Corporation, or Piltel; Smart Broadband, Inc., or SBI, our wireless broadband provider; Wolfpac Mobile, Inc., or Wolfpac, our wireless content operator; Mabuhay Satellite Corporation, or Mabuhay Satellite, and ACeS Philippines Cellular Satellite Corporation, or ACeS Philippines, our satellite 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 PLDT Clark Telecom, Inc., or ClarkTel, PLDT Subic Telecom, Inc., or SubicTel, PLDT-Maratel, Inc., or Maratel, Piltel, PLDT Global Corporation, or PLDT Global, and Bonifacio Communications Corporation, or BCC, which together account for approximately 3% of our consolidated fixed line subscribers; and
- **Information and Communications Technology or ICT**— information and communications infrastructure and services for internet applications, internet protocol-based, or IP-based, solutions and multimedia content delivery provided by ePLDT, Inc., or ePLDT; (1) customer interaction services (formerly referred to as call center services) provided under the umbrella brand name *ePLDT Ventus*, through ePLDT Ventus, Inc., or Ventus, Parlance Systems, Inc., or Parlance, and Vocativ Systems, Inc., or Vocativ; (2) knowledge processing solutions services (formerly referred to as business process outsourcing) provided by SPi Technologies, Inc. and its subsidiaries, or SPi Group (consolidated on July 11, 2006); and (3) internet access and online gaming services provided by Infocom Technologies, Inc., or Infocom, Digital Paradise, Inc., or Digital Paradise, Digital Paradise Thailand, Ltd., or Digital Paradise Thailand, netGames, Inc., or netGames, Airborne Access Corporation, or Airborne Access and Level Up!, Inc., or Level Up!.

Change in Accounting Policy

Voluntary Change in Revenue Recognition Policy for Installation Fees

In 2007, we changed our revenue recognition policy for fixed line installation fees and have elected to defer and amortize our installation fees and its corresponding costs over the expected average periods of the customer relationship of our fixed line subscribers. Prior to 2007, we recognized installation fees and its corresponding cost outright. The change in revenue recognition policy was made to better reflect the expected utility of installation fees over the term of customer relationship. We accounted for the change in accounting policy retroactively and accordingly restated our comparative financial statements to conform with the said change. Please see *Note 2 - Summary of Significant Accounting Policies and Practices* to the accompanying audited consolidated financial statements.

Summary Results of Operations

The table below shows the contribution by each of our business segments to our total revenues, expenses and net income (loss) attributable to equity holders for the years ended December 31, 2007, 2006 and 2005. 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, 2007					
Total Revenues	Php93,359	Php51,783	Php10,799	(Php9,839)	Php146,102
Service	86,497	48,551	10,055	(9,627)	135,476
Non-service	2,054	281	267	(122)	2,480
Foreign exchange gains (losses)	2,649	465	(138)	–	2,976
Interest income	1,186	296	21	–	1,503
Other income	973	2,190	594	(90)	3,667
Expenses	47,628	44,115	11,010	(9,908)	92,845
Income (Loss) before Income Tax	45,731	7,668	(211)	69	53,257
Net Income (Loss)	30,730	5,273	(94)	69	35,978
Net Income Attributable to Equity Holders of PLDT	30,635	5,270	30	69	36,004

	Wireless	Fixed Line	ICT	Inter-segment Transactions	Total
	(in millions)				
For the year ended December 31, 2006⁽¹⁾					
Total Revenues	Php84,465	Php55,056	Php6,925	(Php9,142)	Php137,304
Service	78,383	49,176	6,337	(8,920)	124,976
Non-service	2,457	79	553	(122)	2,967
Foreign exchange gains (losses)	1,722	354	(109)	-	1,967
Interest income	1,197	441	16	-	1,654
Other income	706	5,006	128	(100)	5,740
Expenses	47,611	49,330	7,274	(9,142)	95,073
Income (Loss) before Income Tax	36,854	5,726	(349)	-	42,231
Net Income (Loss)	30,376	5,277	(312)	-	35,341
Net Income (Loss) Attributable to Equity Holders of PLDT	30,096	5,275	(233)	-	35,138
For the year ended December 31, 2005⁽¹⁾					
Total Revenues	Php83,340	Php52,306	Php3,423	(Php6,542)	Php132,527
Service	74,677	49,705	2,953	(6,231)	121,104
Non-service	3,036	41	351	(116)	3,312
Foreign exchange gains (losses)	3,047	1,889	(30)	-	4,906
Interest income	1,135	385	15	-	1,535
Equity share in net income of associates	-	-	7	-	7
Other income	1,445	286	127	(195)	1,663
Expenses	44,876	52,171	3,365	(6,542)	93,870
Income before Income Tax	38,464	135	58	-	38,657
Net Income	33,664	792	46	-	34,502
Net Income Attributable to Equity Holders of PLDT	33,222	791	122	-	34,135

(1) 2006 and 2005 have been restated to reflect the change in revenue recognition policy for installation fees.

2007 Compared to 2006

Wireless

Total Revenues

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

The following table summarizes our service and non-service total revenues from our wireless business for the years ended December 31, 2007 and 2006 by service segment:

	2007	%	2006	%	Increase (Decrease)	
					Amount	%
	(in millions)					
Wireless Services:						
Service Revenues						
Cellular	Php82,334	88	Php75,605	90	Php6,729	9
Wireless broadband, satellite and others	4,163	5	2,778	3	1,385	50
	86,497	93	78,383	93	8,114	10
Non-Service Revenues						
Sale of cellular handsets and SIM-packs	2,054	2	2,457	3	(403)	(16)
Foreign Exchange Gains – net	2,649	3	1,722	2	927	54
Interest Income	1,186	1	1,197	1	(11)	(1)
Other Income	973	1	706	1	267	38
Total Wireless Revenues	Php93,359	100	Php84,465	100	Php8,894	11

Service Revenues

Our wireless service revenues increased by Php8,114 million, or 10%, to Php86,497 million in 2007 as compared with Php78,383 million in 2006, mainly as a result of the growth in the cellular and wireless broadband subscriber base, an increase in inbound international traffic and inbound roaming revenues, partially offset by an increase in interconnection costs and the unfavorable effect of the appreciation of the Philippine peso on dollar-linked revenues. As a percentage of our total wireless revenues, service revenues contributed 93% in 2007 and 2006.

Cellular Service

Our cellular service revenues consist of: (i) 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 content costs and discounts given to dealers and retailers; (ii) monthly service fees from postpaid subscribers, including (a) toll charges for national and international long distance calls; (b) charges for calls and text messages in excess of allocated free local calls and text messages, respectively; and (c) charges for value-added services, net of related content provider costs; (iii) 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 services; and (iv) other charges, including those for reconnection and migration.

Our cellular service revenues in 2007 amounted to Php82,334 million, an increase of Php6,729 million, or 9%, from Php75,605 million in 2006. Cellular service revenues accounted for 95% of our wireless service revenues in 2007 as compared to 96% in 2006.

Smart markets nationwide cellular communications services under the brand names *Smart Buddy*, *Smart Gold*, and *Smart Infinity*. *Smart Buddy* is a prepaid service while *Smart Gold* and *Smart Infinity* are postpaid services, which are all provided through Smart's digital network. Piltel markets its cellular prepaid service under the brand name *Talk 'N Text* which is provided through Smart's network.

Since 2006, Smart and Piltel have focused on segmenting the market by offering sector-specific, value-driven packages for its prepaid subscribers. These include new varieties of our top-up service which provide a fixed number of messages with prescribed validity periods and call packages which allow a fixed number of calls of preset duration. Starting out as purely on-network (Smart-to-Smart) packages, Smart's top-up services now offer text message bundles available to all networks. Smart also continues to offer *Smart 258*, a registration-based service which offers unlimited on-network (Smart-to-Smart) text messaging in various load denominations with designated expiration periods.

Smart also has a roster of 3G services which it commercially launched in May 2006. These services include video calling, video streaming, high-speed internet browsing and downloading of special 3G content, offered at rates similar to those of 2G services.

The following table summarizes key measures of our cellular business as at and for the years ended December 31, 2007 and 2006:

	2007	2006	Increase	
			Amount	%
			(in millions)	
Cellular service revenues	Php82,334	Php75,605	Php6,729	9
<i>By service type</i>				
Prepaid	80,197	73,893	6,304	9
Postpaid	74,284	68,846	5,438	8
Postpaid	5,913	5,047	866	17
<i>By component</i>				
Voice	80,197	73,893	6,304	9
Data	36,105	35,221	884	3
Data	44,092	38,672	5,420	14
<i>Others⁽¹⁾</i>	2,137	1,712	425	25

(1) Refers to other non-subscriber-related revenues consisting primarily of inbound international roaming fees, revenues from Smart's public calling offices and a small number of leased line contracts, revenues from *Wolfpac* and other Smart subsidiaries and revenue share in PLDT's *WeRoam* and PLDT Landline Plus services.

	2007	2006	Increase (Decrease)	
			Amount	%
Cellular subscriber base	30,041,030	24,175,384	5,865,646	24
Prepaid	29,699,150	23,856,821	5,842,329	24
Smart	19,997,324	16,882,442	3,114,882	18
Piltel	9,701,826	6,974,379	2,727,447	39
Postpaid	341,880	318,563	23,317	7
Systemwide traffic volumes (in millions)				
Calls (in minutes)	6,355	5,667	688	12
Domestic – outbound	3,799	3,437	362	11
International	2,556	2,230	326	15
Inbound	2,355	2,065	290	14
Outbound	201	165	36	22
SMS count	214,919	238,362	(23,443)	(10)
Text messages	212,974	235,957	(22,983)	(10)
Standard	25,289	32,065	(6,776)	(21)
Bucket-Priced	187,420	203,669	(16,249)	(8)
International	265	223	42	19
Value-Added Services	1,903	2,370	(467)	(20)
Financial Services	42	35	7	20

Revenues attributable to our cellular prepaid service amounted to Php74,284 million in 2007, an 8% increase over the Php68,846 million earned in 2006. Prepaid service revenues in 2007 and 2006 accounted for 93% of voice and data revenues. Revenues attributable to Smart's postpaid service amounted to Php5,913 million in 2007, a 17% increase over the Php5,047 million earned in 2006, and accounted for 7% of voice and data revenues in 2007 and 2006.

Voice Services

Cellular revenues from voice services, which include all voice traffic and voice value-added services such as voice mail and international roaming, increased by Php884 million, or 3%, to Php36,105 million in 2007 from Php35,221 million in 2006 primarily due to an increase in domestic voice, international long distance and voice roaming revenues, and domestic and international inbound revenues partially offset by the unfavorable effect of a higher level of peso appreciation in 2007. The increase in domestic and international outbound and inbound revenues may be attributed to increased traffic mainly on account of subscriber growth. Cellular voice services accounted for 44% of cellular service revenues in 2007 as compared to 47% in 2006.

Air time rates for postpaid subscribers vary depending on the type of postpaid plan selected by subscribers.

Data Services

Cellular revenues from data services, which include all text messaging-related services as well as value-added services, increased by Php5,420 million, or 14%, to Php44,092 million in 2007 from Php38,672 million in 2006. Cellular data services accounted for 54% of cellular service revenues in 2007 as compared to 51% in 2006.

The following table shows the breakdown of our cellular data revenues for the years ended December 31, 2007 and 2006:

	2007	2006	Increase (Decrease)	
			Amount	%
			(in millions)	
Text messaging				
Domestic	Php39,430	Php32,763	Php6,667	20
Standard	19,289	21,709	(2,420)	(11)
Bucket-Priced	20,141	11,054	9,087	82
International	1,835	1,886	(51)	(3)
	41,265	34,649	6,616	19
Value-added services				
Standard ⁽¹⁾	1,802	2,809	(1,007)	(36)
Rich Media ⁽²⁾	352	287	65	23
Pasa Load	594	854	(260)	(30)
	2,748	3,950	(1,202)	(30)
Financial services				
Smart Money	75	68	7	10
Mobile Banking	4	5	(1)	(20)
	79	73	6	8
Total	Php44,092	Php38,672	Php5,420	14

(1) Includes standard services such as info-on-demand, ringtone and logo download, etc.

(2) Includes Multimedia Messaging System, Wireless Application Protocol, General Packet Radio Service, or GPRS, etc.

Text messaging-related services contributed revenues of Php41,265 million in 2007, an increase of Php6,616 million, or 19%, compared to Php34,649 million in 2006, and accounted for 94% and 90% of the total cellular data revenues in 2007 and 2006, respectively. The increase in revenues from text messaging-related services resulted mainly from Smart's various bucket-priced text promotional offerings which more than offset the decline in our standard texting services. Text messaging revenues from the various bucket plans totaled Php20,141 million in 2007, an increase of Php9,087 million, or 82%, compared to Php11,054 million in 2006. On the other hand, standard text messaging revenues declined by Php2,420 million, or 11%, to Php19,289 million in 2007 compared to Php21,709 million in 2006.

Standard text messages totaled 25,289 million in 2007, a decrease of 6,776 million, or 21%, from 32,065 million in 2006 mainly due to a shift to bucket-priced text services. Bucket-priced text messages in 2007 totaled 187,420 million, a decrease of 16,249 million, or 8%, as compared to 203,669 million in 2006 mainly on account of the introduction in late 2006 of low-denomination text packages with a fixed number of SMS including off-network messages. While these promotional text offerings resulted in reduced traffic for Smart 258 Unlimited Text service, the yield per SMS improved significantly resulting in increased text revenues.

Value-added services, which contributed revenues of Php2,748 million in 2007, decreased by Php1,202 million, or 30%, from Php3,950 million in 2006 primarily due to lower usage of standard services and Pasa Load owing to the introduction of low-denomination top-ups, partially offset by higher usage of rich media services in 2007 as compared to 2006.

Subscriber Base, ARPU and Churn Rates

In 2007, Smart and Piltel cellular subscribers totaled 30,041,030, an increase of 5,865,646, or 24%, over their combined cellular subscriber base of 24,175,384 in 2006. Prepaid subscribers accounted for 99% of our total subscriber base in 2007 and 2006. Our cellular prepaid subscriber base grew by 24% to 29,699,150 in 2007 from 23,856,821 in 2006, while our postpaid subscriber base increased by 7% to 341,880 in 2007 from 318,563 in 2006. Prepaid and postpaid subscribers reflected net subscriber activations of 5,842,329 and 23,317, respectively, in 2007.

Our net subscriber activations for the years ended December 31, 2007 and 2006 were as follows:

	2007	2006	Increase (Decrease)	
			Amount	%
Prepaid	5,842,329	3,728,278	2,114,051	57
Smart	3,114,882	1,738,324	1,376,558	79
Piltel	2,727,447	1,989,954	737,493	37
Postpaid	23,317	38,485	(15,168)	(39)
Total	5,865,646	3,766,763	2,098,883	56

The following table summarizes our cellular ARPUs for the years ended December 31, 2007 and 2006:

	Gross		Increase (Decrease)		Net		Increase (Decrease)	
	2007	2006	Amount	%	2007	2006	Amount	%
Prepaid								
Smart	Php312	Php339	(Php27)	(8)	Php254	Php289	(Php35)	(12)
Piltel	221	226	(5)	(2)	184	194	(10)	(5)
Prepaid – Blended	285	308	(23)	(7)	233	263	(30)	(11)
Postpaid – Smart	2,091	1,904	187	10	1,485	1,407	78	6
Prepaid and Postpaid Blended	307	330	(23)	(7)	248	278	(30)	(11)

ARPU is computed for each month by dividing the revenues for the relevant services for the month by the average of the number of subscribers at the beginning and at the end of the month. Gross monthly ARPU is computed by dividing the revenues for the relevant services, gross of discounts and allocated content-provider costs, including interconnection income but excluding inbound roaming revenues, by the average number of subscribers. Net monthly ARPU, on the other hand, is calculated based on revenues net of discounts and allocated content-provider costs and interconnection income net of interconnection expense. ARPU for any period of more than one month is calculated as the simple average of the monthly ARPUs in that period.

Prepaid service revenues consist mainly of charges for subscribers' actual usage of their loads. Prepaid blended ARPU in 2007 was Php285, a decrease of 7%, compared to Php308 in 2006. The average outbound domestic and international voice as well as the average value-added services and inbound revenue per subscriber declined in 2007 compared to 2006, but were partly offset by an increase in the average text messaging revenue per subscriber. On a net basis, prepaid blended ARPU in 2007 was Php233, a decrease of 11%, compared to Php263 in 2006.

Monthly ARPU for Smart's postpaid services is calculated in a manner similar to that of prepaid service, except that the revenues consist mainly of monthly service fees and charges on usage in excess of the monthly service fees.

Gross monthly ARPU for postpaid subscribers increased by 10% to Php2,091 while net monthly ARPU increased by 6% to Php1,485 in 2007 as compared to Php1,904 and Php1,407 in 2006, respectively. Prepaid and postpaid monthly gross blended ARPU was Php307 in 2007, a decrease of 7%, compared to Php330 in 2006. Monthly net blended ARPU decreased by 11% to Php248 in 2007 as compared to Php278 in 2006.

Our quarterly prepaid and postpaid ARPUs for the years ended December 31, 2007 and 2006 were as follows:

	Prepaid				Postpaid	
	Smart		Piltel		Smart	
	Gross	Net	Gross	Net	Gross	Net
2007						
First Quarter	Php323	Php267	Php228	Php187	Php2,045	Php1,483
Second Quarter	324	265	233	198	2,141	1,526
Third Quarter	293	239	206	173	2,073	1,464
Fourth Quarter	307	244	216	177	2,105	1,467
2006						
First Quarter	Php356	Php294	Php245	Php207	Php1,867	Php1,386
Second Quarter	344	294	234	202	1,920	1,414
Third Quarter	323	280	213	184	1,891	1,403
Fourth Quarter	332	286	213	184	1,939	1,425

Churn, or the rate at which existing subscribers have their service cancelled in a given period, is computed based on total disconnections in the period, net of reconnections in the case of postpaid subscribers, divided by the average of the number of subscribers at the beginning and at the end of a month, all divided by the number of months in the same period.

We recognize a prepaid cellular subscriber as an active subscriber when that subscriber activates and uses the SIM card in the subscriber's handset, which contains pre-stored air time. The pre-stored air time, which is equivalent to Php1 plus 50 free SMS for *Smart Buddy* and 25 free SMS for *Talk 'N Text*, can only be used upon purchase or reload of air time of any value. Subscribers can reload their air time by purchasing prepaid "call and text" cards; by purchasing additional air time "over-the-air" via *Smart Load*, *All Text* or *Smart Connect*; and by receiving loads of Php2, Php5, Php10 and Php15 via *Pasa Load*, or through their handsets using *Smart Money*. Reloads have validity periods ranging from one day to two months, depending on the amount reloaded. 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 current policy is to recognize a prepaid subscriber as "active" only when the subscriber activates and uses the SIM card and reloads at least once during the month of initial activation or in the immediate succeeding month.

For Smart prepaid, the average monthly churn rate for 2007 and 2006 were 3.5% and 3.1%, respectively, while the average monthly churn rate for *Talk 'N Text* subscribers in 2007 and 2006 were 3.5% and 3.3%, respectively.

The average monthly churn rate for Smart's postpaid subscribers for 2007 was 1.3% compared to 1.2% in 2006. Smart's policy is to redirect outgoing calls to an interactive voice response system if the postpaid subscriber's account is either 45 days overdue or the subscriber has exceeded the prescribed credit limit. If the subscriber does not make a payment within 44 days of redirection, the account is disconnected. Within this 44-day period, a series of collection activities are implemented, involving the sending of a collection letter, call-out reminders and collection messages via text messaging.

Wireless Broadband, Satellite and Other Services

Our revenues from wireless broadband, satellite and other services consist mainly of rentals received for the lease of Mabuhay Satellite's transponders, wireless broadband service revenues from SBI, charges for ACeS Philippines' satellite information and messaging services and service revenues generated from PLDT Global's subsidiaries. Gross revenues from these services for 2007 amounted to Php4,163 million, an increase of Php1,385 million, or 50%, from Php2,778 million in 2006 principally due to the growth in our wireless broadband business partially offset by lower satellite transponder rental revenues owing to lower rental charges and number of transponders being leased out and higher level of the peso appreciation in 2007.

SBI offers a number of wireless broadband services and had 301,738 subscribers in 2007 as compared to 121,867 in 2006. *SmartBro*, the fixed wireless broadband service of Smart linked to Smart's wireless broadband-enabled base stations, allows people to connect to the internet using an outdoor aerial antenna installed in a subscriber's home. Wireless broadband revenues contributed Php2,389 million in 2007, increasing by Php1,566 million, or 190%, from Php823 million in 2006.

On November 22, 2007, we introduced *SmartBro Plug-It* which offers instant internet access, through the use of a wireless modem, in places where there is Smart network coverage. Subscribers to this plan will just have to plug the data modem to be able to access the internet with speeds ranging from 384 to 512 kbps. The monthly service fee of Php799 includes 40 hours per month of free internet usage. A one-time charge for the modem costs Php1,200.

We also offer *PLDT WeRoam*, a wireless broadband service, running on the PLDT Group's nationwide wireless network (using GPRS, EDGE and WiFi technologies). Principally targeted at the corporate market, this service had 13,066 subscribers in 2007 compared to 9,623 subscribers in 2006 and contributed Php142 million to our data revenues, increasing by Php66 million, or 87%, from Php76 million in 2006.

Non-Service Revenues

Our wireless non-service revenues consist of proceeds from sales of cellular handsets and cellular SIM-packs.

Our wireless non-service revenues decreased by Php403 million, or 16%, to Php2,054 million in 2007 as compared to Php2,457 million in 2006 primarily due to a lower volume of postpaid and prepaid handsets sold and a lower average revenue per cellular handset and cellular SIM-pack, partly offset by a higher volume of cellular SIM-packs sold in 2007.

Foreign Exchange Gains – net

Our net wireless foreign exchange gains increased by Php927 million, or 54%, to Php2,649 million in 2007 as compared to Php1,722 million in 2006 primarily due to effect of revaluation of net foreign currency-denominated liabilities as a result of the higher level of peso appreciation to the U.S. dollar in 2007 as compared to 2006.

Interest Income

Our wireless interest income decreased by Php11 million, or 1%, to Php1,186 million in 2007 as compared to Php1,197 million in 2006 primarily due to lower interest rate.

Other Income

All other income/gains such as rental income, gain on disposal of property which do not fall under service and non-service revenues, are included under this classification. Our wireless business segment generated other income of Php973 million in 2007, an increase of Php267 million, or 38%, as compared to Php706 million in 2006.

Expenses

Expenses associated with our wireless business in 2007 amounted to Php47,628 million, an increase of Php17 million, from Php47,611 million in 2006. A significant portion of this increase was attributable to higher depreciation and amortization, professional and other contracted services, rent, and selling and promotion expenses, partially offset by lower financing costs, asset impairment expense and cost of sales. As a percentage of our total wireless revenues, expenses associated with our wireless business accounted for 51% and 56% in 2007 and 2006, respectively.

Cellular business expenses accounted for 91% of our wireless business expenses, while wireless broadband, satellite and other business expenses accounted for the remaining 9% of our wireless business expenses in 2007 and 2006.

The following table summarizes the breakdown of our total wireless-related expenses for the years ended December 31, 2007 and 2006 and the percentage of each expense item to the total:

	2007		2006		Increase (Decrease)	
	Amount	%	Amount	%	Amount	%
			(in millions)			
Wireless Services:						
Depreciation and amortization	Php12,202	26	Php10,752	22	Php1,450	13
Rent	8,751	18	7,887	16	864	11
Compensation and employee benefits ⁽¹⁾	4,608	10	5,041	11	(433)	(9)
Cost of sales	4,445	9	4,887	10	(442)	(9)
Selling and promotions	3,804	8	3,013	6	791	26
Repairs and maintenance	3,634	8	3,646	8	(12)	-
Professional and other contracted services	3,238	7	1,831	4	1,407	77
Financing costs	2,299	5	4,658	10	(2,359)	(51)
Taxes and licenses	1,348	3	1,018	2	330	32
Communication, training and travel	1,083	2	891	2	192	22
Insurance and security services	783	2	797	2	(14)	(2)
Asset Impairment	563	1	2,220	5	(1,657)	(75)
Amortization of intangible assets	158	-	312	1	(154)	(49)
Gain on derivative transactions – net	(278)	(1)	(39)	-	(239)	613
Other expenses	990	2	697	1	293	42
Total	Php47,628	100	Php47,611	100	Php17	-

(1) Includes salaries and employee benefits, long-term incentive plan, or LTIP, pension and manpower rightsizing program, or MRP, costs.

Depreciation and amortization charges increased by Php1,450 million, or 13%, to Php12,202 million in 2007 principally due to an increase in our depreciable asset base mainly transmission facilities, 2G, 3G and broadband networks, and broadband customer-deployed equipment.

Rent expenses increased by Php864 million, or 11%, to Php8,751 million on account of an increase in DFON facilities and transmission circuits leased by Smart from PLDT, as well as higher site rental expenses. In 2007, we had 5,001 GSM cell sites and 7,825 base stations, compared with 4,377 GSM cell sites and 6,099 base stations in 2006.

Compensation and employee benefits expenses decreased by Php433 million, or 9%, to Php4,608 million primarily due to lower accrued LTIP partly offset by higher accrued bonuses and employees' basic pay increase of Smart. Smart and subsidiaries' employee headcount increased by 57 to 5,363 in 2007 as compared to 5,306 in 2006. For further discussion on our LTIP, please see *Note 23 – Share-based Payments and Employee Benefits* to the accompanying audited consolidated financial statements.

Cost of sales decreased by Php442 million, or 9%, to Php4,445 million due to lower average cost of cellular handsets and cellular SIM-packs.

Selling and promotion expenses increased by Php791 million, or 26%, to Php3,804 million due to higher advertising, merchandising and commission expenses, partly offset by a decrease in printing costs of prepaid cards with the prevalence of e-Loading.

Repairs and maintenance expenses decreased by Php12 million to Php3,634 million mainly due to lower repairs and maintenance costs for network facilities and a decrease in fuel costs for power generation, partly offset by an increase in IT software and hardware repairs and maintenance costs, as well as higher electricity cost for cell sites.

Professional and other contracted services increased by Php1,407 million, or 77%, to Php3,238 million primarily due to higher expenses for consultancy, contracted and technical services, market research and advisory fees. We changed the estimated useful life of a prepaid management fee to effectively end in 2007. Please see *Note 22 – Related Party Transactions* to the accompanying audited consolidated financial statements for further discussion.

Our financing costs decreased by Php2,359 million, or 51%, to Php2,299 million in 2007 from Php4,658 million in 2006 on account of lower accretion on financial liabilities due to the settlement of Piltel's debt in 2006. The breakdown of our financing costs for our wireless business for the years ended December 31, 2007 and 2006 is as follows:

	2007	2006	Change	
			Amount	%
			(in millions)	
Interest on loans and related items	Php1,581	Php1,634	(Php53)	(3)
Accretion on financial liabilities – net	877	3,105	(2,228)	(72)
Financing charges	12	37	(25)	(68)
Dividends on preferred stock subject to mandatory redemption	17	130	(113)	(87)
Capitalized interest	(188)	(248)	60	(24)
	Php2,299	Php4,658	(Php2,359)	(51)

Taxes and licenses increased by Php330 million, or 32%, to Php1,348 million primarily due to higher non-creditable input tax and the payment of previously disputed Philippine National Telecommunications Commission, or NTC, licenses and fees, partly offset by lower business-related taxes and licenses.

Communication, training and travel expenses increased by Php192 million, or 22%, to Php1,083 million mainly due to higher mailing and courier charges, travel and training expenses.

Insurance and security services decreased by Php14 million, or 2%, to Php783 million primarily due to the decrease in site security expenses and lower charges on insurance contracts.

Asset impairment decreased by Php1,657 million, or 75%, to Php563 million due to Mabuhay Satellite's asset impairment charge recognized in 2006 as a result of the reduction in value of Agila II satellite given the difficulty in generating cash flows with the satellite nearing its end-of-life and other events affecting its business and lower level of impairment charge for subscriber accounts receivables.

Amortization of intangible assets decreased by Php154 million, or 49%, to Php158 million mainly due to intangible assets relating to technology application and customer list arising from the acquisition of Wolfpac which was fully amortized by November 2006.

Gain on derivative transactions – net increased by Php239 million, or 613%, to Php278 million primarily due to a Php270 million gain on U.S. dollar forward exchange contracts entered into by Smart in 2007 to hedge U.S. dollar-linked revenues and loan proceeds from an undrawn loan facility and an Php8 million gain on embedded derivatives. Gain of Php39 million in 2006 was on embedded derivatives relating to service and purchase contracts.

Other expenses increased by Php293 million, or 42%, to Php990 million primarily due to higher various business and operational-related expenses.

Provision for Income Tax

Provision for income tax increased by Php8,523 million, or 132%, to Php15,001 million in 2007 from Php6,478 million in 2006. In 2007, the effective tax rate for our wireless business was 33% as compared to 18% in 2006 mainly due to the recognition of deferred tax assets of Piltel in 2006 complemented by higher taxable income in 2007. We currently expect that our effective corporate tax rate will be at a similar level in 2008. Furthermore, while the National Internal Revenue Code provides that our regular income tax rate will be reduced to 30% effective January 1, 2009, there can be no assurance whether and when such reduction in the regular corporate income tax rate will be implemented.

Net Income

Our wireless business segment recorded a net income of Php30,730 million in 2007, an increase of Php354 million, or 1%, over Php30,376 million registered in 2006 on account of higher cellular revenues, partially offset by higher provision for income taxes and expenses.

Fixed Line

Total 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 2007 totaled Php51,783 million, a decrease of Php3,273 million, or 6%, from Php55,056 million in 2006.

The following table summarizes revenues from our fixed line business for the years ended December 31, 2007 and 2006 by service segment:

	2007	%	2006 ⁽¹⁾	%	Increase (Decrease)	
					Amount	%
					(in millions)	
Fixed line services:						
Service Revenues						
Local exchange	Php16,205	31	Php16,965	31	(Php760)	(4)
International long distance	8,674	17	9,933	18	(1,259)	(13)
National long distance	6,338	12	6,921	12	(583)	(8)
Data and other network	15,921	31	13,725	25	2,196	16
Miscellaneous	1,413	3	1,632	3	(219)	(13)
Non-Service Revenues	48,551	94	49,176	89	(625)	(1)
Sale of computers, cellular handsets and SIM-packs	281	-	79	-	202	256
Foreign Exchange Gains – net	465	1	354	1	111	31
Interest Income	296	1	441	1	(145)	(33)
Other Income	2,190	4	5,006	9	(2,816)	(56)
Total Fixed Line Revenues	Php51,783	100	Php55,056	100	(Php3,273)	(6)

(1) 2006 has been restated to reflect the change in revenue recognition policy for installation fees.

Service Revenues

Local Exchange Service

Our local exchange service revenues consist of: (i) flat monthly fees for our postpaid and fixed charges for our bundled voice and data services; (ii) amortization of installation charges and other one-time fees associated with the establishment of customer service; (iii) revenues from usage of prepaid cards for calls within the local area and any unused peso value of expired prepaid cards; and (iv) 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 as at and for the years ended December 31, 2007 and 2006:

	2007	2006	Increase (Decrease)	
			Amount	%
Total local exchange service revenues ⁽¹⁾ (in millions)	Php16,205	Php16,965	(Php760)	(4)
Number of fixed line subscribers	1,724,702	1,776,647	(51,945)	(3)
Number of fixed line employees	8,080	8,711	(631)	(7)
Number of fixed line subscribers per employee	213	204	9	4

(1) 2006 has been restated to reflect the change in revenue recognition policy for installation fees.

Revenues from our local exchange service decreased by Php760 million, or 4%, to Php16,205 million in 2007 from Php16,965 million in 2006. The decrease was primarily due to the appreciation of the Philippine peso which required us to make downward adjustments in our monthly local service rates pursuant to the currency exchange rate adjustment mechanism authorized by the NTC and the decrease in prepaid subscribers, partially offset by the increase in postpaid billed lines. The percentage contribution of local exchange revenues to our total fixed line service revenues decreased to 33% in 2007 as compared to 35% in 2006.

Initially intended as an affordable alternative telephone service for consumers under difficult economic conditions, our prepaid fixed line services now form an important part of our overall churn and credit risk exposure management strategy. PLDT has consolidated its prepaid fixed line service into one – *Telepwede*, which is funded by e-Loads (available at Smart or PLDT e-Load retailers). *Telepwede* subscribers are charged Php115 to receive incoming calls and can reload for as low as Php30 to make outgoing calls. Local call rates are made more affordable at Php2 per call, unlimited.

In March 2007, PLDT launched the *PLDT Landline Plus*, a postpaid fixed wireless service where subscribers to the service benefit from a text-capable home phone. The monthly service fee is at Php600 with 600 local minutes free and Php1,000 with 1,000 local minutes free for residential and business subscribers, respectively. As at December 31, 2007, there were a total of 33,369 *PLDT Landline Plus* subscribers.

International Long Distance Service

Our international long distance service revenues, which we generate through our international gateway facilities, consist of: (i) 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; (ii) access charges paid to us by other Philippine telecommunications carriers for terminating inbound international calls to our local exchange network; and (iii) 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, 2007 and 2006:

	2007	2006	Increase (Decrease)	
			Amount	%
Total international long distance service revenues (in millions)	Php8,674	Php9,933	(Php1,259)	(13)
Inbound	7,127	8,378	(1,251)	(15)
Outbound	1,547	1,555	(8)	(1)
International call volumes (in million minutes, except call ratio)	2,280	2,177	103	5
Inbound	2,007	1,984	23	1
Outbound	273	193	80	41
Inbound-outbound call ratio	7.4:1	10.3:1	-	-

Our total international long distance service revenues decreased by Php1,259 million, or 13%, to Php8,674 million in 2007 from Php9,933 million in 2006 primarily due to the appreciation of the Philippine peso and a decrease in average termination rates for inbound calls partially mitigated by an increase in inbound and outbound call volumes. The percentage contribution of international long distance service revenues to our total fixed line service revenues decreased to 18% in 2007 from 20% in 2006.

Our revenues from inbound international long distance service decreased by Php1,251 million, or 15%, to Php7,127 million owing to the appreciation of the Philippine peso to the U.S. dollar coupled with a decrease in average termination rate per minute due to the change in call mix with more traffic terminating to cellular operators where the net revenue retained by us is lower. These decreasing effects were partially offset by a slight increase in inbound traffic volume by 23 million minutes to 2,007 million minutes in 2007. The appreciation of the Philippine peso to the U.S. dollar with average exchange rates of Php45.900 in 2007 and Php51.165 in 2006 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 Php8 million, or 1%, to Php1,547 million in 2007 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 higher level of the appreciation of Philippine peso in 2007, which more than offset the increase in outbound international call volumes in 2007.

National Long Distance Service

Our national long distance service revenues consist of: (i) 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; (ii) access charges received from other telecommunications carriers for calls carried through our backbone network and/or terminating to our customers; and (iii) 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, 2007 and 2006:

	2007	2006	Decrease	
			Amount	%
Total national long distance service revenues (in millions)	Php6,338	Php6,921	(Php583)	(8)
National long distance call volumes (in million minutes)	2,183	2,251	(68)	(3)

Our national long distance service revenues decreased by Php583 million, or 8%, to Php6,338 million in 2007 from Php6,921 million in 2006 primarily due to a decrease in call volumes coupled with a lower average revenue per minute in 2007 in relation to our various bundled promotions. The percentage contribution of national long distance revenues to our fixed line service revenues accounted for 13% in 2007 and 14% in 2006.

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, 2007 and 2006:

	2007	2006	Increase (Decrease)	
			Amount	%
Data and other network service revenues (in millions)	Php15,921	Php13,725	Php2,196	16
Number of DSL broadband subscribers	264,291	133,159	131,132	98
Number of <i>PLDT Vibe</i> narrowband subscribers	230,995	297,250	(66,255)	(22)

In 2007, our data and other network services posted revenues of Php15,921 million, an increase of Php2,196 million, or 16%, from Php13,725 million in 2006 primarily due to increases in leased lines, IP-based and packet-based data services, particularly Diginet and DFON rental, and *PLDT DSL* mitigated by lower *PLDT Vibe* services. The percentage contribution of this service segment to our fixed line service revenues increased to 33% in 2007 from 28% in 2006.

IP-based products include *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*, PLDT's dial-up/narrowband internet service, is targeted for light to medium residential or individual internet users. I-Gate, our dedicated leased line internet access service, on the other hand, is targeted at enterprises and value-added service providers.

DSL contributed revenues of Php3,880 million in 2007, an increase of Php748 million, or 24%, from Php3,132 million in 2006 primarily due to an increase in the number of subscribers which was partially offset by lower ARPU as a result of launching of lower plans as part of promotions. DSL reached 264,291 subscribers in 2007 compared with 133,159 subscribers in 2006.

PLDT Vibe revenues decreased by Php128 million, or 33%, to Php259 million in 2007 from Php387 million in 2006 primarily due to lower number of plan subscribers as well as the declining usage of *Vibe* prepaid. *PLDT Vibe* subscribers decreased to 230,995 in 2007 from 297,250 in 2006. The declining number of *Vibe* plans and regular monthly users for *Vibe* prepaid may be attributed to the migration from *Vibe* dial-up to DSL which is now priced more competitively.

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, other Global Service Providers such as BT-infonet, Orange Business and Verizon; ISDN has also taken up much subscription from corporate customers, especially the Primary Rate Interface type, I-Gate, Diginet, BRAINS, IP-VPN and *Shops.work*, among others – continue to provide us with a stable revenue source.

On October 17, 2007, PLDT teamed up with Intel and IBM to offer the Simplified Networks on Auto Pilot, or SNAP, a turn-key and cost-effective IT networking solution that can help companies increase their profitability and competitiveness. For a flat monthly fee arrangement, SNAP handles a company's IT requirements which includes the latest desktops and laptops, server solutions, technical support and broadband connectivity.

Diginet, our domestic private leased line service, has been providing Smart's increasing fiber optic and leased line data requirements. Diginet revenues increased by Php478 million, or 7%, to Php7,291 million in 2007 as compared to Php6,813 million in 2006 mainly due to Smart's DFON rental of Php5,565 million and Php4,940 million in 2007 and 2006, respectively.

Miscellaneous

Miscellaneous service revenues are derived mostly from directory advertising and facilities management and rental fees. In 2007, these revenues decreased by Php219 million, or 13%, to Php1,413 million from Php1,632 million in 2006 mainly due to a decline in facilities management fees and rental income owing to lower co-location charges. The percentage contribution of miscellaneous service revenues to our total fixed line service revenues was 3% in 2007 and 2006.

Non-Service Revenues

Non-service revenues increased by Php202 million, or 256%, to Php281 million in 2007 from Php79 million in 2006 primarily due to an increase in subscriptions for our DSL service that is bundled with computers and thus resulted in higher computer sales.

Foreign Exchange Gains – net

Our net fixed line foreign exchange gains increased by Php111 million, or 31%, to Php465 million in 2007 from Php354 million in 2006 primarily due to revaluation of net foreign currency-denominated liabilities as a result of higher level of the appreciation of the Philippine peso to the U.S. dollar in 2007 as compared to 2006.

Interest Income

Interest income of our fixed line business segment decreased by Php145 million, or 33%, to Php296 million in 2007 from Php441 million in 2006 primarily due to lower level of interest rates.

Other Income

All other income/gains such as rental income and gain on disposal of property, which do not fall under service and non-service revenues, are included under this classification. In 2007, our fixed line business segment registered a decrease in other income of Php2,816 million, or 56%, to Php2,190 million from Php5,006 million in 2006 largely due to the net reversal of a provision for onerous contract amounting to Php3,529 million related to the change in the Air Time Purchase Agreement with AIL (please see *Note 2 – Summary of Significant Accounting Policies and Practices* and *Note 22 – Related Party Transactions* to the accompanying audited consolidated financial statements for further discussion).

Expenses

Expenses related to our fixed line business totaled Php44,115 million in 2007, a decrease of Php5,215 million, or 11%, as compared to Php49,330 million in 2006. The decrease was primarily due to lower depreciation and amortization, financing costs and loss on derivative transactions, partially offset by higher professional and other contracted services, provisions, rent, repairs and maintenance, and taxes and licenses.

The following table shows the breakdown of our total fixed line-related expenses for the years ended December 31, 2007 and 2006 and the percentage of each expense item to the total:

	2007		2006		Increase (Decrease)	
	Amount	%	Amount	%	Amount	%
	(in millions)					
Fixed line services:						
Depreciation and amortization	Php15,477	35	Php20,406	41	(Php4,929)	(24)
Compensation and employee benefits ⁽¹⁾	10,411	24	10,298	21	113	1
Financing costs	4,657	11	6,173	13	(1,516)	(25)
Repairs and maintenance	3,772	9	3,553	7	219	6
Rent	1,799	4	1,579	3	220	14
Professional and other contracted services	1,727	4	1,082	2	645	60
Selling and promotions	1,707	4	1,736	4	(29)	(2)
Loss on derivative transactions – net	1,530	3	1,893	4	(363)	(19)
Taxes and licenses	877	2	659	1	218	33
Provisions	666	1	38	–	628	1,653
Communication, training and travel	466	1	507	1	(41)	(8)
Insurance and security services	439	1	498	1	(59)	(12)
Cost of sales	145	–	159	–	(14)	(9)
Asset impairment	43	–	54	–	(11)	(20)
Other expenses	399	1	695	2	(296)	(43)
Total	Php44,115	100	Php49,330	100	(Php5,215)	(11)

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

Depreciation and amortization charges decreased by Php4,929 million, or 24%, to Php15,477 million due to higher additional depreciation charges recognized by PLDT in 2006 on certain properties and equipment affected by our NGN roll-out. In 2007, we recognized additional depreciation of the Php734 million relating to Piltel's equipment that were also affected by our continuing network upgrade and expansion.

Compensation and employee benefits expenses increased by Php113 million, or 1%, to Php10,411 million primarily due to an increase in pension benefits and cost associated with our MRP and the effect of collective bargaining agreement-related increases in salaries and employee benefits, partially offset by the lower LTIP costs. Over the past years, PLDT has been implementing its MRP in line with the challenges being faced by the fixed line business as significant changes in technology, increasing competition and shifting market preferences to cellular use have reshaped the future of our fixed line business. Total MRP costs in 2007 and 2006 amounted to Php564 million and Php414 million, respectively. For further discussion on our LTIP, please see *Note 23 – Share-based Payments and Employee Benefits* to the accompanying audited consolidated financial statements.

Financing costs decreased by Php1,516 million, or 25%, to Php4,657 million largely due to lower interest on loans and related items. This was partially offset by higher financing charges in relation to costs incurred in the consent solicitation of holders of our 11.375% Notes due 2012, 10.5% Notes due 2009 and 8.35% Notes due 2017, or the Notes, and the amendment of the covenants of our Notes, as discussed in *Note 18 – Interest-bearing Financial Liabilities* to the accompanying audited consolidated financial statements.

The breakdown of financing costs for our fixed line business for the years ended December 31, 2007 and 2006 is as follows:

	2007		2006		Change	
	Amount	%	Amount	%	Amount	%
	(in millions)					
Interest on loans and related items	Php4,642		Php6,254		(Php1,612)	(26)
Accretion on financial liabilities – net	185		206		(21)	(10)
Financing charges	184		14		170	1,214
Capitalized interest	(354)		(301)		(53)	18
	Php4,657		Php6,173		(Php1,516)	(25)

Repairs and maintenance expenses increased by Php219 million, or 6%, to Php3,772 million primarily due to higher maintenance costs of central office and telecoms equipment and domestic cable and wire facilities as more operating and maintenance-related restorations were incurred in 2007 as compared to 2006.

Rent expenses increased by Php220 million, or 14%, to Php1,799 million due to the settlement of pole rental charges with Visayan Electric Company, Inc. and an increase in international leased circuit charges, partially offset by a decrease in transponder lease.

Professional and other contracted services increased by Php645 million, or 60%, to Php1,727 million primarily due to PLDT's higher consultancy service fees coupled with higher contracted fees for technical and advisory services.

Selling and promotion expenses decreased by Php29 million, or 2%, to Php1,707 million primarily as a result of a collective effort in efficient media spending in relation to various products and services, partially offset by higher public relations expenses.

Loss on derivative transactions – net decreased by Php363 million, or 19%, to Php1,530 million primarily due to lower hedging costs and the effect of the appreciation of the Philippine peso against the U.S. dollar.

Taxes and licenses increased by Php218 million, or 33%, to Php877 million mainly due to the payment of previously disputed business-related taxes.

Provisions increased by Php628 million to Php666 million primarily due to higher provision for assessments in 2007. Please see *Note 25 – Provisions and Contingencies* to the accompanying audited consolidated financial statements for further details.

Communication, training and travel expenses decreased by Php41 million, or 8%, to Php466 million due to the decrease in mailing, courier and delivery charges, and a net decrease in foreign and local travel, and training expenses.

Insurance and security services decreased by Php59 million, or 12%, to Php439 million primarily due to lower premiums on property all-risk, industrial all-risk and industrial fire insurance.

Cost of sales decreased by Php14 million, or 9%, to Php145 million due to lower computer-bundled sales in relation to our DSL promotion and *WeRoam* subscriptions.

Asset impairment decreased by Php11 million, or 20%, to Php43 million mainly due to lower impairment charge on uncollectible receivables.

Other expenses decreased by Php296 million, or 43%, to Php399 million due to lower various business and operational-related expenses.

Provision for Income Tax

Provision for income tax amounted to Php2,395 million in 2007 as compared to Php449 million in 2006 primarily due to higher taxable income as a result of lower accelerated depreciation recognized in 2007.

Net Income

In 2007, our fixed line business segment contributed a net income of Php5,273 million, a decrease of Php4 million as compared to Php5,277 million in 2006 mainly as a result of a 6% decline in our total revenues augmented by higher provision for income tax, partially offset by an 11% decrease in fixed line-related expenses, particularly depreciation and amortization.

Information and Communications Technology

Total Revenues

Our ICT business provides knowledge processing solutions, customer interaction services, internet and online gaming, and data center.

In 2007, our ICT business generated revenues of Php10,799 million, an increase of Php3,874 million, or 56%, from Php6,925 million in 2006. This increase was largely due to the full-year consolidation of the financial results of the SPi Group in 2007 and the continued increase of our customer interaction service revenues.

The following table summarizes our total revenues from our ICT business for the years ended December 31, 2007 and 2006 by service segment:

	2007		2006		Increase (Decrease)	
	Amount	%	Amount	%	Amount	%
	(in millions)					
Service Revenues						
Knowledge processing solutions	Php5,261	49	Php2,374	34	Php2,887	122
Customer interaction services	3,262	30	2,624	38	638	24
Internet and online gaming	937	9	796	12	141	18
<i>Vitro</i> TM data center	595	5	543	8	52	10
	10,055	93	6,337	92	3,718	59
Non-Service Revenues						
Point Product Sales	267	2	553	8	(286)	(52)
Foreign Exchange Losses – net	(138)	(1)	(109)	(2)	(29)	27
Interest Income	21	–	16	–	5	31
Other Income	594	6	128	2	466	364
Total ICT Revenues	Php10,799	100	Php6,925	100	Php3,874	56

Service Revenues

Service revenues generated by our ICT segment amounted to Php10,055 million in 2007, an increase of Php3,718 million, or 59%, as compared to Php6,337 million in 2006 primarily as a result of the consolidation of financial results of the SPi Group and Level Up! and the continued growth of our customer interaction services business.

Knowledge Processing Solutions

Knowledge processing solution revenues consist of: (i) editorial and content production services to the scholarly scientific, technical and medical (SSTM) journal publishing industry; (ii) digital content conversion services to information organizations; (iii) pre-press project management services to book publishers; (iv) litigation support services which involve conventional coding and electronic discovery support services for corporations, international law firms, corporate counsels and government agencies; (v) conversion services of medical record/data from handwritten or speech format to electronic format and patient scheduling, coding and compliance assistance, consulting and specialized reporting services; and (vi) revenue cycle management services for U.S. medical facilities.

We provide our knowledge processing solutions primarily through the SPi Group, which ePLDT acquired on July 11, 2006. Knowledge processing solutions contributed revenues of Php5,261 million in 2007, an increase of Php2,887 million, or 122%, from Php2,374 million in 2006 primarily as a result of the effects of the full-year consolidation of the financial results of the SPi Group and accounted for 52% and 37% of total service revenues of our ICT business in 2007 and 2006, respectively.

Customer Interaction Services

Customer interaction service revenues consist of: (i) inbound calls for customer care, product inquiries, sales and technical support based on active minutes, billable hours and full-time equivalents; (ii) outbound calls for sales and collections based on active minutes, billable hours and full-time equivalents; and (iii) service income for e-mail handling, web chat, web co-browsing, data entry and knowledge processing solutions based on transaction volume.

We provide our customer interaction services primarily through *ePLDT Ventus*. Revenues relating to our customer interaction services business increased by Php638 million, or 24%, to Php3,262 million in 2007 from Php2,624 million in 2006 primarily due to the expansion of our facilities. In total, we own and operate approximately 6,400 seats with 5,930 customer service representatives, or CSRs, in 2007 compared to approximately 5,600 seats with 5,130 CSRs in 2006. In 2006, *ePLDT Ventus* launched two new sites bringing our total customer interaction services site count to nine in 2007.

Customer interaction service revenues accounted for 33% and 41% of total service revenues of our ICT business in 2007 and 2006, respectively.

Internet and Online Gaming

Internet service revenues consist of: (i) revenues derived from actual usage of the internet access network by prepaid subscribers; (ii) monthly service fees from postpaid corporate and consumer subscribers; (iii) one-time fees generated from the reselling of internet-related solutions such as security solutions and domain registration; (iv) franchise and royalty fees for *Netopia* internet cafés; (v) 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 Php141 million, or 18%, to Php937 million in 2007 from Php796 million in 2006 primarily due to the effects of the full-year consolidation of the financial results of Level Up! which resulted in an increase in revenues by Php49 million, and an increase in Infocom's revenues by Php63 million due to additional revenues from our customer service outsourcing. Our internet and online gaming business revenues accounted for 9% and 13% of total service revenues of our ICT business in 2007 and 2006, 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: (i) monthly service fees derived from co-location services, server hosting, hardware and software maintenance services, website development and maintenance services, webhosting, data recovery security services and other value-added services; (ii) installation charges or one-time fees associated with the set-up of services and professional services of *Vitro™*'s certified professionals; and (iii) fees generated from the issuance of digital certificates and revenues derived from IT helpdesk/contact center solutions and terminals for credit, debit and credit card transactions.

In 2007, *Vitro™* contributed revenues of Php595 million, an increase of Php52 million, or 10%, from Php543 million in 2006 primarily due to an increase in co-location revenues and server hosting. *Vitro™* revenues accounted for 6% and 9% of service revenues of our ICT business in 2007 and 2006, respectively.

Please refer to *Note 9 – Investments in Associates and Joint Ventures* to the accompanying audited consolidated financial statements for further discussion on ePLDT's investments.

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 2007, non-service revenues generated by our ICT business decreased by Php286 million, or 52%, to Php267 million as compared to Php553 million in 2006 primarily due to lower revenues from sales of software and hardware licenses.

Foreign Exchange Loss – net

Our net ICT foreign exchange loss increased by Php29 million, or 27%, to Php138 million in 2007 from Php109 million in 2006 primarily due to loss on revaluation of net foreign currency assets due to the appreciation of the Philippine peso.

Interest Income

Interest income for our ICT business segment increased by Php5 million, or 31%, to Php21 million in 2007 from Php16 million in 2006 primarily due to a higher level of cash balances in 2007.

Other Income

All other income/gains which do not fall under service and non-service revenues are included under this classification. Other income generated from our ICT business increased by Php466 million, or 364%, to Php594 million in 2007 as compared to Php128 million in 2006 primarily due to the recognition of cumulative dividends and interest on ePLDT's investment in convertible securities of Stradcom International Holdings, Inc. or SIHI. On February 28, 2008, SIHI redeemed all of the convertible securities of SIHI held by ePLDT. Please see *Note 13 – Investment in Debt Securities* to the accompanying audited consolidated financial statements for further discussion of our investment in Stradcom.

Expenses

Expenses associated with our ICT business totaled Php11,010 million in 2007, an increase of Php3,736 million, or 51%, from Php7,274 million in 2006 primarily due to the effects of the full-year consolidation of the financial results of the SPi Group and Level Up! in 2007 resulting in an increase in compensation and employee benefits, professional and other contracted services, communication, training and travel, and depreciation and amortization and asset impairment, partially offset by lower cost of sales and gain on derivative transactions. As a percentage of our ICT total revenues, expenses related to our ICT business were 102% and 105% for 2007 and 2006, respectively.

The following table shows the breakdown of our total ICT-related expenses for the years ended December 31, 2007 and 2006 and the percentage of each expense item to the total:

	2007		2006		Increase (Decrease)	
	Amount	%	Amount	%	Amount	%
	(in millions)					
ICT services:						
Compensation and employee benefits ⁽¹⁾	Php5,455	50	Php3,021	41	Php2,434	81
Professional and other contracted services	1,129	10	739	10	390	53
Depreciation and amortization	934	8	711	10	223	31
Asset impairment	711	6	492	7	219	45
Rent	620	6	444	6	176	40
Communication, training and travel	523	5	276	4	247	89
Repairs and maintenance	504	5	368	5	136	37
Selling and promotions	321	3	293	4	28	10
Cost of sales	254	2	476	7	(222)	(47)
Amortization of intangible assets	232	2	138	2	94	68
Financing costs	132	1	23	-	109	474
Taxes and licenses	94	1	70	1	24	34
Insurance and security services	49	-	35	-	14	40
Equity share in net losses of associates	11	-	52	1	(41)	(79)
Gain on derivative transactions – net	(138)	(1)	(3)	-	(135)	4,500
Other expenses	179	2	139	2	40	29
Total	Php11,010	100	Php7,274	100	Php3,736	51

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

Compensation and employee benefits increased by Php2,434 million, or 81%, to Php5,455 million largely due to the full-year consolidation of the SPi Group in 2007 and the expansion of our customer interaction services business.

Professional and other contracted services increased by Php390 million, or 53%, to Php1,129 million primarily due to higher consultancy fees and subcontracted services incurred by the SPi Group related to its knowledge processing solutions.

Depreciation and amortization charges increased by Php223 million, or 31%, to Php934 million primarily due to an increase in the depreciable asset base in relation to the expansion of our customer interaction services business and the full-year consolidation of the SPi Group in 2007.

Asset impairment increased by Php219 million, or 45%, to Php711 million mainly due to ePLDT's provision for impairment of goodwill mainly from an investment by SPi and Level Up! amounting to Php1,162 million, partially offset by a provision for impairment on notes receivable amounting to Php346 million in 2006 and the reversal of impairment loss of Php616 million related to our Stradcom investment in 2007. Please see *Note 13 – Investment in Debt Securities* to the accompanying audited consolidated financial statements for further discussion of our investment in Stradcom.

Rent expenses increased by Php176 million, or 40%, to Php620 million primarily due to higher office space rentals and leased circuits from other carriers incurred by our customer interaction services business, the SPi Group and Level Up!.

Communication, training and travel expenses increased by Php247 million, or 89%, to Php523 million primarily due to the increased cost of phone lines, bandwidth and information system charges, coupled with the increase in local and foreign travel costs, mailing and courier charges, and freight and hauling charges incurred by our customer interaction service and knowledge processing solution businesses.

Repairs and maintenance expenses increased by Php136 million, or 37%, to Php504 million primarily due to higher maintenance costs for new customer interaction service facilities plus higher electricity charges for *Vitro™* and the full-year consolidation of the SPi Group and Level Up!.

Selling and promotion expenses increased by Php28 million, or 10%, to Php321 million mainly due to the SPi Group's higher advertising and marketing spending.

Cost of sales decreased by Php222 million, or 47%, to Php254 million primarily due to lower sales of software licenses and hardware products.

Amortization of intangible assets increased by Php94 million, or 68%, to Php232 million in relation to the acquisition of the SPi Group and Level Up!, as well as the acquisition of Springfield Service Corporation, or Springfield, by SPi in April 2007. Please see *Note 11 – Goodwill and Intangible Assets* to the accompanying audited consolidated financial statements for further discussion.

Financing costs increased by Php109 million, or 474%, to Php132 million in 2007 primarily due to a higher accretion on financial liabilities particularly the contingent consideration in relation to the Springfield acquisition in 2007 and a higher interest on loans and related items.

Taxes and licenses increased by Php24 million, or 34%, to Php94 million primarily due to the full-year consolidation of the SPi Group in 2007 and higher business-related taxes.

Insurance and security services increased by Php14 million, or 40%, to Php49 million primarily due to higher premium costs and an increase in the value of assets insured.

Equity share in net losses of associates amounted to Php11 million in 2007 compared to Php52 million in 2006 primarily due to a decrease in ePLDT's share in net losses of unconsolidated investee companies.

Gain on derivative transactions – net increased by Php135 million to Php138 million in 2007 primarily due to higher gains recognized by customer interaction service and knowledge processing business as a result of peso appreciation.

Other expenses increased by Php40 million, or 29%, to Php179 million mainly due to higher business-related costs, such as office supplies.

Benefit from Income Tax

Benefit from income tax increased by Php80 million, or 216%, to Php117 million in 2007 primarily due to the corresponding deferred tax effect of the amortization of intangible assets in relation to the acquisition of the SPI Group and Level Up!

Net Loss

In 2007, our ICT business segment registered a net loss of Php94 million, an improvement of 70% from a net loss of Php312 million in 2006 mainly as a result of the 56% increase in ICT-related revenues mainly from the full-year consolidation of the SPI Group and Level Up! and higher benefit from income tax in 2007, partly offset by the 51% increase in ICT-related expenses mainly from the full-year consolidation of the SPI Group.

2006 Compared to 2005

Wireless

Total Revenues

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

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

	2006	%	2005	%	Increase (Decrease)	
					Amount	%
	(in millions)					
Wireless services:						
Service Revenues						
Cellular	Php75,605	90	Php72,409	87	Php3,196	4
Wireless broadband, satellite and others	2,778	3	2,268	3	510	22
	78,383	93	74,677	90	3,706	5
Non-Service Revenues						
Sale of cellular handsets and SIM-packs	2,457	3	3,036	3	(579)	(19)
Foreign Exchange Gains - net	1,722	2	3,047	4	(1,325)	(43)
Interest Income	1,197	1	1,135	1	62	5
Other Income	706	1	1,445	2	(739)	(51)
Total Wireless Revenues	Php84,465	100	Php83,340	100	Php1,125	1

Service Revenues

Our wireless service revenues increased by Php3,706 million, or 5%, to Php78,383 million in 2006 compared to Php74,677 million in 2005, mainly as a result of the 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 revenues, service revenues contributed 93% and 90% in 2006 and 2005, respectively.

Cellular Service

Our cellular service revenues in 2006 amounted to Php75,605 million, an increase of Php3,196 million, or 4%, from Php72,409 million in 2005. Cellular service revenues accounted for 96% and 97% of our wireless service revenues in 2006 and 2005, respectively.

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. Prepaid subscribers accounted for 99% of our total subscriber base as at December 31, 2006 and 2005. Prepaid and postpaid subscribers totaled 23,856,821 and 318,563 as at December 31, 2006, reflecting net subscriber activations of 3,728,278 and 38,485, respectively, in 2006.

The following table summarizes key measures of our cellular business as at and for the years ended December 31, 2006 and 2005:

	2006	2005	Increase (Decrease)	
			Amount	%
	(in millions)			
Cellular service revenues	Php75,605	Php72,409	Php3,196	4
By service type				
Prepaid	73,893	70,507	3,386	5
Postpaid	68,846	66,023	2,823	4
	5,047	4,484	563	13

	2006	2005	Increase (Decrease)	
			Amount	%
			(in millions)	
<i>By component</i>	<i>Php73,893</i>	<i>Php70,507</i>	<i>Php3,386</i>	<i>5</i>
Voice	35,221	35,444	(223)	(1)
Data	38,672	35,063	3,609	10
<i>Others⁽¹⁾</i>	<i>1,712</i>	<i>1,902</i>	<i>(190)</i>	<i>(10)</i>

(1) Refers to other non-subscriber-related revenues consisting primarily of inbound international roaming fees, revenues from Smart's public calling offices, revenues from Wolfpac and Smart Money Holdings Corporation and a small number of leased line contracts.

	2006	2005	Increase (Decrease)	
			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
Piitell	6,974,379	4,984,425	1,989,954	40
Postpaid	318,563	280,078	38,485	14
Systemwide traffic volumes (in millions)				
Calls (in minutes)	5,667	5,467	200	4
Domestic – outbound	3,437	3,741	(304)	(8)
International	2,230	1,726	504	29
Inbound	2,065	1,557	508	33
Outbound	165	169	(4)	(2)
SMS count	238,362	95,959	142,403	148
Text messages	235,957	93,379	142,578	153
Standard	32,065	40,806	(8,741)	(21)
Bucket-Priced	203,669	52,373	151,296	289
International	223	200	23	12
Value-Added Services	2,370	2,537	(167)	(7)
Financial Services	35	43	(8)	(19)

Voice Services

Cellular revenues from voice services, which include all voice traffic and voice value-added services such as voice mail and international roaming, decreased by Php223 million, or 1%, to Php35,221 million in 2006 from Php35,444 million in 2005 primarily due to a decrease in domestic voice revenues partially offset by an increase in international inbound revenue and a decrease in interconnection expense. The decline in domestic voice revenue may be attributed to increased competition in voice promotions as well as the re-channelling of calls to international inbound as a result of continued efforts to curb by-pass activities. The decrease in interconnection expense resulted from increased on-net voice usage brought about by bucket-priced promotions designed to encourage on-net voice services.

Air time rates for postpaid subscribers vary depending on the type of postpaid plan selected by subscribers.

Data Services

Cellular revenues from data services, which include all text messaging-related services as well as value-added services, increased by Php3,609 million, or 10%, to Php38,672 million in 2006 from Php35,063 million in 2005. Cellular data services accounted for 51% of cellular service revenues in 2006 as compared to 48% in 2005.

The following table shows the breakdown of cellular data revenues for the years ended December 31, 2006 and 2005:

	2006	2005	Increase (Decrease)	
			Amount	%
			(in millions)	
Text messaging				
Domestic	Php32,763	Php29,110	Php3,653	13
Standard	21,709	25,580	(3,871)	(15)
Bucket-Priced	11,054	3,530	7,524	213
International	1,886	1,883	3	–
	34,649	30,993	3,656	12
Value-added services				
Standard ⁽¹⁾	2,809	2,814	(5)	–
Rich Media ⁽²⁾	287	281	6	2
<i>Pasa Load</i>	854	886	(32)	(4)
	3,950	3,981	(31)	(1)
Financial services				
<i>Smart Money</i>	68	84	(16)	(19)
Mobile Banking	5	5	–	–
	73	89	(16)	(18)
Total	Php38,672	Php35,063	Php3,609	10

(1) Includes standard services such as info-on-demand, ringtone and logo download, etc.

(2) Includes Multimedia Messaging System, Wireless Application Protocol, General Packet Radio Service, or GPRS, etc.

Text messaging-related services contributed revenues of Php34,649 million in 2006, an increase of Php3,656 million, or 12%, compared to Php30,993 million in 2005, and accounted for 90% and 89% of the total cellular data revenues in 2006 and 2005, respectively. The increase in revenues from text messaging-related services resulted mainly from the *Smart 25th Unlimited Text* promotion and its variant bucket-priced text promotional offerings. Text messaging revenues from the various bucket plans totaled Php11,054 million.

Standard text messages totaled 32,065 million in 2006, a decrease of 8,741 million, or 21%, from 40,806 million in 2005 mainly due to a shift to bucket-priced text services. Bucket-priced text messages in 2006 totaled 203,669 million, an increase of 151,296 million, or 289%, as compared to 52,373 million in 2005.

Value-added services, which contributed revenues of Php3,950 million in 2006, decreased by Php31 million, or 1%, from Php3,981 million in 2005, primarily due to lower usage of standard services and *Pasa Load* owing to the introduction of low-denomination top-ups, partially offset by higher usage of rich media services in 2006 as compared to 2005.

Subscriber Base, ARPU and Churn Rates

Prepaid subscribers accounted for approximately 99% of our 24,175,384 subscribers as at December 31, 2006, while postpaid subscribers accounted for the remaining 1%. The 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 the postpaid subscriber base increased by 14% to 318,563 as at December 31, 2006 from 280,078 as at December 31, 2005.

Our net subscriber activations for the years ended December 31, 2006 and 2005 were as follows:

	2006	2005	Increase	
			Amount	%
Prepaid	3,728,278	1,194,805	2,533,473	212
Smart	1,738,324	822,830	915,494	111
Piltel	1,989,954	371,975	1,617,979	435
Postpaid	38,485	5,584	32,901	589
Total	3,766,763	1,200,389	2,566,374	214

Revenues attributable to our cellular prepaid service amounted to Php68,846 million in 2006, a 4% increase over the Php66,023 million earned in 2005. Prepaid service revenues in 2006 and 2005 accounted for 93% and 94%, respectively, of voice and data revenues. Revenues attributable to Smart's postpaid service amounted to Php5,047 million in 2006, a 13% increase over the Php4,484 million earned in 2005, and accounted for 7% and 6% of voice and data revenues in 2006 and 2005, respectively.

The following table summarizes our cellular ARPUs for the years ended December 31, 2006 and 2005:

	Gross		Increase (Decrease)		Net		Increase (Decrease)	
	2006	2005	Amount	%	2006	2005	Amount	%
Prepaid								
Smart	Php339	Php357	(Php18)	(5)	Php289	Php294	(Php5)	(2)
Piltel	226	257	(31)	(12)	194	212	(18)	(8)
Prepaid – Blended	308	332	(24)	(7)	263	274	(11)	(4)
Postpaid – Smart	1,904	1,869	35	2	1,407	1,368	39	3
Prepaid and Postpaid Blended	330	353	(23)	(7)	278	289	(11)	(4)

Prepaid service revenues consist mainly of charges for subscribers' actual usage of their loads. Gross monthly ARPU for Smart prepaid subscribers in 2006 was Php339, a decrease of 5%, compared to Php357 in 2005. The average outbound domestic and international voice revenue per subscriber declined in 2006 compared to 2005, but was offset by an increase in the average text messaging revenue and inbound international revenue per subscriber. On a net basis, ARPU in 2006 was Php289, a decrease of 2%, compared to Php294 in 2005. Gross monthly ARPU for *Talk 'N Text* subscribers in 2006 was Php226, a decrease of 12%, compared to Php257 in 2005. The decline was primarily attributable to the decrease in the average domestic outbound local voice revenue per subscriber as well as the average domestic inbound revenue per subscriber partly offset by an increase in the average text messaging revenue per subscriber. On a net basis, ARPU in 2006 decreased by 8% to Php194 from Php212 in 2005.

Gross monthly ARPU for postpaid subscribers increased by 2% to Php1,904 while net monthly ARPU increased by 3% to Php1,407 in 2006 as compared to Php1,869 and Php1,368 in 2005, respectively. Prepaid and postpaid monthly gross blended ARPU was Php330 in 2006, a decrease of 7%, compared to Php353 in 2005. Monthly net blended ARPU decreased by 4% to Php278 in 2006 as compared to Php289 in 2005.

Our quarterly prepaid and postpaid ARPUs for the years ended December 31, 2006 and 2005 were as follows:

	Prepaid				Postpaid	
	Smart		Piltel		Smart	
	Gross	Net	Gross	Net	Gross	Net
2006						
First Quarter	Php356	Php294	Php245	Php207	Php1,867	Php1,386
Second Quarter	344	294	234	202	1,920	1,414
Third Quarter	323	280	213	184	1,891	1,403
Fourth Quarter	332	286	213	184	1,939	1,425
2005						
First Quarter	Php356	Php289	Php269	Php220	Php1,767	Php1,257
Second Quarter	357	294	262	212	1,896	1,360
Third Quarter	343	285	234	194	1,889	1,389
Fourth Quarter	370	308	261	220	1,923	1,467

For Smart prepaid, the average monthly churn rate for 2006 was 3.1% compared to 4.0% in 2005, while the average monthly churn rate for *Talk 'N Text* subscribers was 3.3% in 2006 compared to 5.5% in 2005.

The average monthly churn rate for Smart's postpaid subscribers for 2006 was 1.2% compared to 2.0% in 2005. Smart's policy is to redirect outgoing calls to an interactive voice response system if the postpaid subscriber's account is either 45 days overdue or the subscriber has exceeded the prescribed credit limit. If the subscriber does not make a payment within 44 days of redirection, the account is disconnected. Within this 44-day period, a series of collection activities are implemented, involving the sending of a collection letter, call-out reminders and collection messages via text messaging.

Wireless Broadband, Satellite and Other Services

Our revenues from wireless broadband, satellite and other services consist mainly of wireless broadband service revenues for SBI, rentals received for the lease of Mabuhay Satellite's transponders, and charges for ACeS Philippines' satellite phone service and service revenues generated from a PLDT Global subsidiary's mobile virtual network operations. Gross revenues from these services for 2006 amounted to Php2,778 million, an increase of Php510 million, or 22%, from Php2,268 million in 2005 principally due to the growth in our wireless broadband business.

SBI offers a number of wireless broadband services and had 121,867 subscribers as at December 31, 2006. *SmartBro*, the fixed wireless broadband service of Smart linked to Smart's wireless broadband-enabled base stations, allows people to connect to the internet using an outdoor aerial antenna installed in a subscriber's home. Wireless broadband revenues contributed Php823 million in 2006, increasing by Php610 million, or 286%, from Php213 million in 2005.

We also offer *PLDT 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. Some of the recent enhancements to the service are the inclusion of international roaming in key roaming countries all over the world and national WiFi roaming access. Principally targeted to the corporate market, the service had 9,623 subscribers as at December 31, 2006 and contributed Php76 million in our data revenues, an increase of Php36 million, or 90%, from Php40 million in 2005.

Non-Service Revenues

Our wireless non-service revenues decreased by Php579 million, or 19%, to Php2,457 million in 2006 as compared to Php3,036 million in 2005 primarily due to lower handset sales as activations were driven more by SIM-pack sales in 2006.

Foreign Exchange Gains – net

Our net wireless foreign exchange gains decreased by Php1,325 million, or 43%, to Php1,722 million in 2006 as compared to Php3,047 million in 2005 primarily due to lower level of net foreign currency liabilities due to settlement of debt in 2006.

Interest Income

Our wireless interest income increased by Php62 million, or 5%, to Php1,197 million in 2006 as compared to Php1,135 million in 2005 primarily due to higher interest income on short-term dollar placements.

Other Income

All other income/gains such as rental income and which do not fall under service and non-service revenues are included under this classification. Our wireless business segment generated other income of Php706 million in 2006, a decrease of Php739 million, or 51%, as compared to Php1,445 million in 2005 largely due to the reversal of prior years' provision for NTC fees to align with the assessments received in 2005.

Expenses

Expenses associated with our wireless business in 2006 amounted to Php47,611 million, an increase of Php2,735 million, or 6%, from Php44,876 million in 2005. A significant portion of this increase was attributable to higher rent, asset impairment, financing costs and compensation and benefits, which were partially offset by lower cost of sales and taxes and licenses. As a percentage of our total wireless total revenues, expenses associated with our wireless business accounted for 56% and 54% in 2006 and 2005, respectively.

Cellular business expenses accounted for 98% of our wireless business expenses, while wireless broadband, satellite and other business expenses accounted for the remaining 2% of our wireless business expenses in 2006 as compared to 95% and 5%, respectively, in 2005.

The following table summarizes the breakdown of 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	%
	(in millions)					
Wireless services:						
Depreciation and amortization	Php10,752	22	Php10,156	23	Php596	6
Rent	7,887	16	5,592	12	2,295	41
Compensation and employee benefits ⁽¹⁾	5,041	11	4,249	10	792	19
Cost of sales	4,887	10	6,148	14	(1,261)	(21)
Financing costs	4,658	10	4,577	10	81	2
Repairs and maintenance	3,646	8	3,655	8	(9)	-
Selling and promotions	3,013	6	3,418	8	(405)	(12)
Asset impairment	2,220	5	575	1	1,645	286
Professional and other contracted services	1,831	4	1,656	4	175	11
Taxes and licenses	1,018	2	1,544	3	(526)	(34)
Communication, training and travel	891	2	960	2	(69)	(7)
Insurance and security services	797	2	947	2	(150)	(16)
Amortization of intangible assets	312	1	244	1	68	28
Loss (gains) on derivative transactions – net	(39)	-	118	-	(157)	(133)
Other expenses	697	1	1,037	2	(340)	(33)
Total	Php47,611	100	Php44,876	100	Php2,735	6

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

Depreciation and amortization charges increased by Php596 million, or 6%, to Php10,752 million in 2006, principally due to an increase in our depreciable asset base mainly broadband and 3G network, and customer-deployed equipment. For further details, see *Note 8 – Property, Plant and Equipment* to the accompanying audited consolidated financial statements.

Rent expenses increased by Php2,295 million, or 41%, to Php7,887 million on account of an increase in 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 employee benefits expenses increased by Php792 million, or 19%, to Php5,041 million, primarily due to higher accrued bonuses, pension benefits, LTIP 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 LTIP, please see *Note 23 – Share-based Payments and Employee Benefits* to the accompanying audited consolidated financial statements.

Cost of sales decreased by Php1,261 million, or 21%, to Php4,887 million due to a decrease in the volume of phone kits sold and the termination of SIM-swapping activities in May 2005. The breakdown of cost of sales for our wireless business for the years ended December 31, 2006 and 2005 is as follows:

	2006	2005	Decrease	
			Amount	%
			(in millions)	
Cost of cellular handsets and SIM-packs sold	Php4,688	Php5,905	(Php1,217)	(21)
Cost of satellite air time and terminal units	199	243	(44)	(18)
	Php4,887	Php6,148	(Php1,261)	(21)

Financing costs increased by Php81 million, or 2%, to Php4,658 million in 2006 from Php4,577 million in 2005 due to higher accretion on financial liabilities primarily due to higher amortization of debt discount brought about by the prepayment of Piltel's debt in 2006. This increasing effect was partially offset by: (1) lower interest expense owing to lower debt balances; (2) higher capitalized interest; and (3) lower dividends on preferred stock subject to mandatory redemption. The breakdown of our financing costs for our wireless business for the years ended December 31, 2006 and 2005 is as follows:

	2006	2005	Change	
			Amount	%
			(in millions)	
Accretion on financial liabilities – net	Php3,105	Php2,560	Php545	21
Interest on loans and related items	1,634	1,799	(165)	(9)
Dividends on preferred stock subject to mandatory redemption	130	251	(121)	(48)
Financing charges	37	52	(15)	(29)
Capitalized interest	(248)	(85)	(163)	(192)
	Php4,658	Php4,577	Php81	2

Repairs and maintenance expenses decreased by Php9 million to Php3,646 million mainly on account of lower repairs and maintenance costs for network facilities and motor vehicles which offset higher expenses for electricity and power generation as well as higher maintenance expense for IT hardware and software.

Selling and promotion expenses decreased by Php405 million, or 12%, to Php3,013 million due to lower commission, and advertising and promotions expenses as well as a decrease in printing costs of prepaid cards.

Asset impairment increased by Php1,645 million, or 286%, to Php2,220 million primarily due to 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.

Professional and other contracted services increased by Php175 million, or 11%, to Php1,831 million, primarily due to increased customer interaction service, contracted service, market research, consultancy and technical service fees.

Taxes and licenses decreased by Php526 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 Php150 million, or 16%, to Php797 million, primarily due to the decrease in site security expenses and lower amortization charges on prepaid insurance contracts.

Amortization of intangible assets increased by Php68 million, or 28%, to Php312 million mainly due to an increase in the amount of intangible assets recognized following the purchase of an additional 20% investment in Wolfpac.

Gain on derivative transactions was Php39 million in 2006, a difference of Php157 million, or 133%, from Php118 million loss on derivative transaction in 2005 primarily due to high level of peso appreciation in 2006.

Other expenses decreased by Php340 million, or 33%, to Php697 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.

Provision for Income Tax

Provision for income tax increased by Php1,678 million, or 35%, to Php6,478 million in 2006 from Php4,800 million in 2005. In 2006, the effective tax rate for our wireless business was 18% as compared to 12% in 2005 due to differences in the net movement of 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. Please see *Note 6 – Income Taxes* to the accompanying audited consolidated financial statements for further discussion.

Net Income

Our wireless business segment recorded a net income of Php30,376 million in 2006, a decrease of Php3,288 million, or 10%, over Php33,664 million registered in 2005 as the increase in our cellular revenues was more than offset by an increase in operating expenses and higher provision for income tax.

Fixed Line

Total 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 Php55,056 million, an increase of Php2,750 million, or 5%, from Php52,306 million in 2005.

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

	2006 ⁽¹⁾	%	2005 ⁽¹⁾	%	Increase (Decrease)	
					Amount	%
(in millions)						
Fixed line services:						
Service Revenues						
Local exchange	Php16,965	31	Php18,561	35	(Php1,596)	(9)
International long distance	9,933	18	12,245	23	(2,312)	(19)
National long distance	6,921	12	7,233	14	(312)	(4)
Data and other network	13,725	25	10,399	20	3,326	32
Miscellaneous	1,632	3	1,267	2	365	29
	49,176	89	49,705	94	(529)	(1)
Non-Service Revenues						
Sale of computers, cellular handsets and SIM-packs	79	–	41	–	38	93
Foreign Exchange Gains – net	354	1	1,889	4	(1,535)	(81)
Interest Income	441	1	385	1	56	15
Other Income	5,006	9	286	1	4,720	1,650
Total Fixed Line Revenues	Php55,056	100	Php52,306	100	Php2,750	5

(1) 2006 and 2005 have been restated to reflect the change in revenue recognition for installation fees.

Service Revenues

Local Exchange Service

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

	2006 ⁽¹⁾	2005 ⁽¹⁾	Increase (Decrease)	
			Amount	%
Total local exchange service revenues (in millions)	Php16,965	Php18,561	(Php1,596)	(9)
Number of fixed line subscribers	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) 2006 and 2005 have been restated to reflect the change in revenue recognition for installation fees.

Revenues from our local exchange service decreased by Php1,596 million, or 9%, to Php16,965 million in 2006 from Php18,561 million in 2005. The decrease was primarily due to a 4% decline in the number of fixed line subscribers and the appreciation of the Philippine 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 37% in 2005.

Pursuant to a currency exchange rate adjustment mechanism authorized by the Philippine 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

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

	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 increase in outbound international call volumes in 2006.

National Long Distance Service

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

	2006	2005	Decrease	
			Amount	%
Total national long distance service revenues (in millions)	Php6,921	Php7,233	(Php312)	(4)
National long distance call volumes (in million minutes)	2,251	2,348	(97)	(4)

Our national long distance service revenues decreased by Php312 million, or 4%, to Php6,921 million in 2006 from Php7,233 million in 2005, primarily due to a decrease in call volumes coupled with lower average revenue per minute in 2006 due to the change in mechanics in our Php10 per call promotion. 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 15% 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:

	2006	2005	Increase	
			Amount	%
Data and other network service revenues (in millions)	Php13,725	Php10,399	Php3,326	32
Number of DSL broadband subscribers	133,159	88,811	44,348	50
Number of <i>PLDT Vibe</i> 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 Php3,326 million, or 32%, from Php10,399 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.

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. DSL reached 133,159 subscribers as at December 31, 2006 compared with 88,811 subscribers in 2005. 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.

Diginet, our domestic private leased line service, has been providing Smart's increasing optic and leased line data requirements. Diginet revenues increased by Php2,377 million, or 54%, to Php6,813 million in 2006 as compared to Php4,436 million 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 Php365 million, or 29%, to Php1,632 million from Php1,267 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% in 2006 from 2% in 2005.

Non-Service Revenues

Non-service revenues increased by Php38 million, or 93%, to Php79 million in 2006 from Php41 million in 2005 primarily due to proceeds from computer sales in relation to our DSL promotion.

Foreign Exchange Gains – net

Our net fixed line foreign exchange gains decreased by Php1,535 million, or 81%, to Php354 million in 2006 from Php1,889 million in 2005 primarily due to the effect of lower level of net foreign denominated liabilities.

Interest Income

Interest income of our fixed line business segment increased by Php56 million, or 15%, to Php441 million in 2006 from Php385 million in 2005 primarily due to higher interest rates on temporary placements.

Other Income

All other income/gains such as rental income and gain on disposal of property, which do not fall under service and non-service revenues are included under this classification. In 2006, our fixed line business segment registered an increase in other income of Php4,720 million to Php5,006 million from Php286 million in 2005. Other income increased in 2006 largely due to the following: (1) a net reversal of a provision for onerous contract amounting to Php3,529 million related to the change in the Air Time Purchase Agreement with AIL (please see Note 25 – Provisions and Contingencies to the accompanying audited consolidated financial statements for further discussion); (2) gain on sale of fixed assets, other property and materials in the aggregate amount of Php658 million; and (3) 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).

Expenses

Expenses related to our fixed line business totaled Php49,330 million in 2006, a decrease of Php2,841 million, or 5%, as compared to Php52,171 million in 2005. The decrease was primarily due to asset impairment, financing costs and lower provisions partially offset by higher compensation and benefits and maintenance expense.

The following table shows the breakdown of our total fixed line-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)					
Fixed line services:						
Depreciation and amortization	Php20,406	41	Php20,251	39	Php155	1
Compensation and employee benefits ⁽¹⁾	10,298	21	8,541	16	1,757	21
Financing costs	6,173	13	9,111	18	(2,938)	(32)
Repairs and maintenance	3,553	7	3,309	6	244	7
Loss on derivative transactions – net	1,893	4	1,744	3	149	9
Selling and promotions	1,736	4	1,567	3	169	11
Rent	1,579	3	1,712	3	(133)	(8)
Professional and other contracted services	1,082	2	1,023	2	59	6
Taxes and licenses	659	1	625	1	34	5
Communication, training and travel	507	1	447	1	60	13
Insurance and security services	498	1	628	1	(130)	(21)
Cost of sales	159	–	53	–	106	200
Asset impairment	54	–	2,101	4	(2,047)	(97)
Provisions	38	–	196	1	(158)	(81)
Other expenses	695	2	863	2	(168)	(19)
Total	Php49,330	100	Php52,171	100	(Php2,841)	(5)

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

Depreciation and amortization charges increased by Php155 million, or 1%, to Php20,406 million due to the higher depreciation of our regular asset base from additional completed projects.

Compensation and employee benefits expenses increased by Php1,757 million, or 21%, to Php10,298 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 MRP. For further discussion on our long-term incentive plan, please see *Note 23 – Share-based Payments and Employee Benefits* to the accompanying audited consolidated financial statements.

Financing costs decreased by Php2,938 million, or 32%, to Php6,173 million largely due to lower interest on loans and related items owing to lower debt balances in 2006 as compared to 2005. This decreasing effect was partially offset by lower capitalized interest. The breakdown of financing costs for our fixed line business for the years ended December 31, 2006 and 2005 is as follows:

	2006	2005	Change	
			Amount	%
			(in millions)	
Interest on loans and related items	Php6,254	Php9,058	(Php2,804)	(31)
Accretion on financial liabilities – net	206	322	(116)	(36)
Financing charges	14	150	(136)	(91)
Capitalized interest	(301)	(419)	118	28
	Php6,173	Php9,111	(Php2,938)	(32)

Repairs and maintenance expenses increased by Php244 million, or 7%, to Php3,553 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.

Loss on derivative transactions – net increased by Php149 million in 2006, or 9%, to Php1,893 million primarily due to higher hedge cost partially offset by lower loss on bifurcated equity call option.

Selling and promotion expenses increased by Php169 million, or 11%, to Php1,736 million, primarily as a result of an increase in PLDT's promotional activities in relation to various products and services, such as PLDT's *Pwede!* campaign, coupled with higher public relations expense in 2006.

Rent expenses decreased by Php133 million, or 8%, 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 Php59 million, or 6%, to Php1,082 million primarily due to higher contracted services and bill printing fees in 2006.

Taxes and licenses increased by Php34 million, or 5%, to Php659 million, mainly on account of higher business-related taxes incurred in 2006 as compared to 2005.

Communication, training and travel expenses increased by Php60 million, or 13%, to Php507 million due to an increase in local and foreign travel and training in 2006 as compared to 2005.

Insurance and security services decreased by Php130 million, or 21%, to Php498 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 sales 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.

Asset impairment decreased by Php2,047 million, or 97%, to Php54 million mainly due to reversal of prior years' impairment charge on uncollectible receivables.

Provisions decreased by Php158 million, or 81%, to Php38 million primarily on account of an improvement in collection rates in 2006 compared to 2005 and the consequent reversal of provisions with the change in realizability of certain receivable accounts specifically identified and previously provided for.

Other expenses decreased by Php168 million, or 19%, to Php695 million due to lower office supplies consumption and printing costs resulting from PLDT's continuing cost-containing activities.

Provision for (Benefit from) Income Tax

Provision for income tax amounted to Php449 million in 2006 as compared to a benefit from income tax of Php657 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 Php5,277 million, an increase of Php4,485 million, or 566%, as compared to Php792 million in 2005 mainly as a result of an increase in other income and a 5% decrease in fixed line-related expenses, particularly financing costs and asset impairment.

Information and Communications Technology

Total Revenues

Our information and communications technology, or ICT, business is conducted by ePLDT and its subsidiaries.

In 2006, our information and communications technology business generated revenues of Php6,925 million, an increase of Php3,502 million, or 102%, from Php3,423 million in 2005. This increase was largely due to the consolidation of SPi and Level Up! and the continued increase of our customer interaction service revenues. Going forward, we expect revenues from our customer interaction service and knowledge processing solution businesses to continue to contribute significantly to our information and communications technology revenues in light of the growing demand for our customer interaction services and knowledge processing solutions.

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

	2006	%	2005	%	Increase (Decrease)	
					Amount	%
	(in millions)					
Service Revenues						
Customer interaction services	Php2,624	38	Php1,944	57	Php680	35
Knowledge processing solutions	2,374	34	–	–	2,374	100
Internet and online gaming	796	12	556	16	240	43
Vitro™ data center	543	8	453	13	90	20
	6,337	92	2,953	86	3,384	115
Non-Service Revenues						
Point Product Sales	553	8	351	10	202	58
Foreign Exchange Losses – net	(109)	(2)	(30)	(1)	(79)	263
Interest Income	16	–	15	1	1	7
Other Income	128	2	127	4	1	1
Equity in Net Income of Associates	–	–	7	–	(7)	(100)
Total ICT Revenues	Php6,925	100	Php3,423	100	Php3,502	102

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 customer interaction service business.

Customer Interaction Services

Revenues related to our customer interaction service 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: (i) 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 knowledge processing solution companies to serve their voice requirements; (ii) 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; (iii) the expansion of Ventus' existing Iloilo facility by 130 seats from approximately 370 seats in 2005 to approximately 500 seats in 2006; (iv) 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; (v) the commencement of operations at the 820-seat Ventus Pasig customer interaction services in August 2006; and (vi) the commencement of operations at the 780-seat Parlance Libertad customer interaction services in September 2006.

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

Knowledge Processing Solutions

ePLDT provide our knowledge processing solutions primarily through the SPI Group and its subsidiaries, which ePLDT acquired on July 11, 2006. In 2006, knowledge processing solutions contributed revenues of Php2,374 million, primarily from SPI services, and accounted for 37% of service revenues of our information and communications technology business in 2006.

Internet and Online Gaming

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 consolidation of Airborne Access and Level Up! in October 2005 and May 2006, respectively, 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

In 2006, Vitro™ contributed revenues of Php543 million, an increase of Php90 million, or 20%, from Php453 million in 2005, primarily due to an increase in co-location revenues and server hosting. Vitro™ revenues accounted for 9% and 15% of service revenues of our information and communications technology business in 2006 and 2005, respectively.

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 Php202 million, or 58%, to Php553 million as compared to Php351 million in 2005, primarily due to higher revenues from sales of networking equipment and software licenses.

Foreign Exchange Losses – net

Our net ICT foreign exchange loss increased by Php79 million, or 263%, to Php109 million in 2006 from Php30 million in 2005 primarily due to the effect of revaluation of net foreign denominated assets as a result of peso appreciation to U.S. dollar.

Interest Income

Interest income for our ICT business segment increased by Php1 million, or 7%, to Php16 million in 2006 from Php15 million in 2005 primarily due to higher level of cash balances.

Other Income

All other income/gains which do not fall under service and non-service revenues are included under this classification. Other income generated from our information and communications technology business slightly increased to Php128 million in 2006 from Php127 million in 2005.

Equity Share in Net Income of Associates

ePLDT's equity share in net income of associates amounted to Php7 million in 2005 due to ePLDT's share in the earnings of its unconsolidated subsidiary, ePDS, Inc.

Expenses

Expenses associated with our information and communications technology business totaled Php7,274 million in 2006, an increase of Php3,909 million, or 116%, from Php3,365 million in 2005 primarily due to the consolidation of SPi and Level Up! resulting 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 and Level Up!. As a percentage of our information and communications technology revenues, expenses related to our information and communications technology business were 105% 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 and the percentage of each expense item to the total:

	2006	%	2005	%	Increase (Decrease)	
					Amount	%
(in millions)						
ICT services:						
Compensation and employee benefits ⁽¹⁾	Php3,021	41	Php1,351	40	Php1,670	124
Professional and other contracted services	739	10	82	3	657	801
Depreciation and amortization	711	10	415	12	296	71
Asset impairment	492	7	80	2	412	515
Cost of sales	476	7	300	9	176	59
Rent	444	6	362	11	82	23
Repairs and maintenance	368	5	283	8	85	30
Selling and promotions	293	4	120	4	173	144
Communication, training and travel	276	4	98	3	178	182
Amortization of intangible assets	138	2	-	-	138	100
Taxes and licenses	70	1	36	1	34	94
Equity share in net losses of associates	52	1	-	-	52	100
Insurance and security services	35	-	14	-	21	150
Financing costs	23	-	24	1	(1)	(4)
Gain on derivative transactions – net	(3)	-	-	-	(3)	(100)
Other expenses	139	2	200	6	(61)	(31)
Total	Php7,274	100	Php3,365	100	Php3,909	116

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

Compensation and employee benefits increased by Php1,670 million, or 124%, to Php3,021 million largely due to the increased number of employees and corresponding salaries and employee benefits resulting from the expansion of our customer interaction service businesses and the consolidation of SPi and Level Up! in 2006. ePLDT's employee headcount increased by 9,564, or 208%, to 14,156 in 2006 from 4,592 in 2005.

Professional and other contracted services increased by Php657 million to Php739 million primarily due to services sub-contracted by SPi from third parties related to its knowledge processing solutions.

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 customer interaction service businesses and the consolidation of SPi in July 2006.

Asset impairment increased by Php412 million to Php492 million primarily due to the impairment of ePLDT's notes receivable from Technology Support Services, Inc.

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 customer interaction service sites in 2006 which led to increased rental of leased circuits.

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 promotion expenses increased by Php173 million, or 144%, to Php293 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 customer interaction service and knowledge processing solution businesses.

An amortization of intangible assets amounting to Php138 million was recognized in 2006 in relation to the acquisition of SPi and Level Up!. See Note 11 – Goodwill and Intangible Assets to the accompanying audited consolidated financial statements for further discussion.

Taxes and licenses increased by Php34 million, or 94%, to Php70 million due to higher business-related taxes accrued and paid in 2006 as compared to 2005.

ePLDT's equity share in net losses of associates amounted to Php52 million in 2006, primarily due to ePLDT's share in net losses of unconsolidated investee companies.

Insurance and security services increased by Php21 million, or 150%, to Php35 million, primarily due to higher premium costs and an increase in the value of assets insured in 2006 as compared to 2005.

Financing costs decreased by Php1 million, or 4%, to Php23 million, primarily due to lower interest on loans and related items partially offset by the accretion on financial liabilities in 2006. No similar transaction was incurred in 2005.

Net gain on derivative transactions was Php3 million in 2006 primarily due to mark-to-market gains arising from forward foreign exchange contracts in 2006; no similar contract in 2005.

Other expenses decreased by Php61 million, or 31%, to Php139 million mainly due to lower business-related costs as part of our cost-cutting measures.

Provision for (Benefit from) Income Tax

Benefit from income tax amounted to Php37 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 Php12 million in 2005.

Net Income (Loss)

In 2006, our information and communications technology business segment registered a net loss of Php312 million as against a net income of Php46 million in 2005 mainly as a result of a 116% increase in ICT-related expenses and the recent opening of two customer interaction service centers, partly offset by the increase in ICT revenues mainly from our customer interaction service business and the consolidation of SPI.

Plans and Prospects

We are the largest and most diversified telecommunications company in the Philippines. We offer the broadest range of telecommunications services among all operators in the Philippines. We plan to capitalize on this position to further expand our subscriber base and fortify our industry position. We also plan to maximize revenue opportunities by offering more value-driven products and services, while bundling and cross-selling voice and data offerings across our various platforms of fixed line, wireless and ICT. We intend to align as well the deployment of our fixed line and wireless platforms and technologies such that these initiatives dovetail with our delivery of services. We will continue to consider value-accretive investments in related businesses such as those in the global outsourcing and off-shoring industry.

For 2008, cash from operations will allow us to increase the level of our capital expenditures for the expansion and upgrading of our network infrastructure. We will make additional investments in our core facilities to maximize existing technologies and increase capacity. Our 2008 budget for consolidated capital expenditures is approximately Php25,000 million, of which approximately Php15,000 million is budgeted to be spent by Smart, and approximately Php9,000 million is budgeted to be spent by PLDT and the balance represents the budgeted capital spending of our other subsidiaries.

Liquidity and Capital Resources

The following table shows our consolidated cash flows for the years ended December 31, 2007, 2006 and 2005 as well as our consolidated capitalization and other selected financial data as at December 31, 2007, 2006 and 2005:

	2007	2006 ⁽¹⁾	2005 ⁽¹⁾
		(in millions)	
Cash Flows			
Net cash provided by operating activities	Php77,418	Php69,211	Php76,721
Net cash used in investing activities	31,319	35,790	11,694
Capital expenditures	24,824	20,674	14,990
Net cash used in financing activities	44,819	45,900	61,302
Net increase (decrease) in cash and cash equivalents	557	(13,189)	2,738
		2007	2006
		(in millions)	
Capitalization			
Interest-bearing financial liabilities:			
Long-term portion of interest-bearing financial liabilities - net:			
Long-term debt		Php53,372	Php63,769
Obligations under capital lease		15	106
Preferred stock subject to mandatory redemption		-	1,369
		53,387	65,244
Current portion of interest-bearing financial liabilities:			
Notes payable		493	201
Long-term debt maturing within one year		6,775	16,184
Obligations under capital lease maturing within one year		481	924
Preferred stock subject to mandatory redemption		1,015	-
		8,764	17,309
Total interest-bearing financial liabilities		62,151	82,553
Total equity		Php112,511	Php104,067
		Php174,662	Php186,620

(1) 2006 and 2005 have been restated to reflect the change in revenue recognition policy for installation fees.

	2007	2006
	(in millions)	
Other Financial Data		
Total assets	Php240,158	Php242,118
Property, plant and equipment – net	159,414	164,190
Cash and cash equivalents	17,447	16,870
Short-term investments	13,415	8,327

As at December 31, 2007, our consolidated cash and cash equivalents and short-term investments totaled Php30,862 million. Principal sources of consolidated cash and cash equivalents in 2007 were cash flows from operating activities amounting to Php77,418 million and drawings from Smart's, PLDT's and ePLDT's debt facilities aggregating Php7,647 million. These funds were used principally for dividend payments of Php28,470 million, capital outlays of Php24,824 million, total debt principal payments of Php18,258 million and interest payments of Php5,891 million.

Principal sources of consolidated cash and cash equivalents in 2006 and 2005 were cash flows from operations amounting to Php69,211 million and Php76,721 million, respectively; drawings from long-term and short-term credit facilities totaling Php9,724 million and Php211 million, respectively, in 2006, and Php5,471 million and Php329 million, respectively, in 2005; and equity funds raised through the issuance of capital stock amounting to Php66 million in 2006. These funds were used principally for capital outlays of Php20,674 million (including capitalized interest of Php549 million), payments of long-term and short-term debt totaling Php29,366 million and interest payments of Php7,528 million in 2006; and capital outlays of Php14,990 million, (including capitalized interest of Php504 million), payments of long-term and short-term debt totaling Php44,710 million, interest payments of Php10,545 million and equity funds raised through the issuance of capital stock amounting to Php285 million in 2005.

Operating Activities

Our consolidated net cash flows from operating activities in 2007 increased by Php8,207 million, or 12%, to Php77,418 million from Php69,211 million in 2006 and decreased by Php7,510 million, or 10%, from Php76,721 million in 2005.

A growing portion of our consolidated cash flow is generated by our wireless business, which accounted for 60%, 58% and 60% of our total revenues in 2007, 2006 and 2005, respectively. Revenues from our fixed line and information and communications technology services accounted for 33% and 7%, respectively, of our total revenues in 2007, 37% and 5%, respectively, in 2006 and 38% and 2%, respectively, in 2005.

Cash flows from operating activities of our wireless business amounted to Php49,616 million in 2007, an increase of Php12,331 million, or 33%, compared to Php37,285 million in 2006. The increase in our wireless business segment's cash flows from operating activities was primarily due to the decrease in our working capital requirements in 2007 owing to the settlement of various payables in 2006. However, cash flows from operating activities of our fixed line business decreased by Php5,151 million, or 17%, to Php25,274 million in 2007 compared to Php30,425 million in 2006. This decrease was primarily due to higher working capital requirements in our fixed line business in 2007 due to PLDT's contribution to its pension plan and the settlement of our LTIP in 2006 and lower collection of receivables. The overall increase in our cash flows from operating activities was primarily due to a decrease in working capital requirements with lower level of settlements of various current liabilities, partially offset by higher billings of accounts receivable. We believe that our continuing strong cash flows from operating activities on a consolidated basis will allow us to satisfy our current liabilities as our current ratio is more than 1:1 as at December 31, 2007.

Prior to April 2006, under restrictive covenants in certain of its loan facilities, Smart was required to obtain, and since 2002 had obtained, waivers from Finnvera and certain of its lenders for all dividend payments made by Smart to PLDT. Due to the repayment of all loan facilities by April 2006 that contained covenants restricting Smart's 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 is no longer subject to such restrictions. Cash dividends paid by Smart to PLDT for the years ended December 31, 2007 and 2006 amounted to Php26,927 million and Php20,600 million, respectively.

In 2007, Piltel paid cash dividends to various preferred shareholders in the aggregate amount of Php2,943 million, of which Php2,930 million was paid to PLDT.

Investing Activities

Net cash used in investing activities amounted to Php31,319 million in 2007, a decrease of Php4,471 million, or 12%, from Php35,790 million in 2006 primarily a net result of a decrease in investments of Php8,602 million due to the acquisition of 100% equity interests in SPi and CyMed in 2006, partially offset by an increase in capital expenditures of Php4,150 million in 2007. Payments for purchase of investments in 2007 amounted to Php2,288 million, of which Php1,687 million and Php601 million were paid for the acquisitions of a 100% equity interest in Springfield and a 30% equity interest in Blue Ocean Wireless, or BOW, respectively. Net cash used in investing activities amounted to Php35,790 million in 2006, an increase of Php24,096 million, or 206%, compared to Php11,694 million in 2005. The increase in 2006 was primarily a result of: (1) an increase in capital expenditures by Php5,684 million and (2) payments for purchase of investments by Php10,890 million in relation to the purchase of the following in 2006: (a) a 100% equity interest in SPi and CyMed aggregating Php8,847 million; (b) the final settlement of the acquisition of SBI of Php1,201 million; (c) the purchase of a 60% equity interest in Level Up! of Php381 million; (d) the acquisition of approximately 25.5% equity interest in Philweb for Php428 million; and (e) the acquisition of the remaining 20% equity in Wolfpac for Php30 million. The decrease in 2005 resulted from a decline in capital expenditures partially offset by an increase in short-term investments.

Our consolidated capital expenditures in 2007 totaled Php24,824 million, an increase of Php4,150 million, or 20%, from Php20,674 million in 2006 primarily due to Smart's and PLDT's higher capital spending. Smart's capital spending of Php14,179 million in 2007 was used primarily to further upgrade its core, access and transmission network facilities, expand its wireless broadband facilities and develop IT platforms for new businesses. PLDT's capital spending of Php9,912 million was principally used to finance the expansion and upgrade of its submarine cable facilities, fixed line data and IP-based network services. ePLDT and its subsidiaries' capital spending of Php678 million was primarily used to fund its continued customer interaction services expansion. The balance represented other subsidiaries' capital spending. Our consolidated capital expenditures in 2006 totaled Php20,674 million, an increase of Php5,684 million, or 38%, from Php14,990 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 primarily to roll-out its 3G network, further upgrade its core and transmission network facilities and expand its wireless broadband facilities, to increase capacity and coverage in respect of basic and advanced wireless services. PLDT's capital spending of Php8,902 million was principally used to finance the expansion of its fixed line data and IP-based network services. ePLDT and its subsidiaries' capital spending of Php1,132 million was primarily used to fund its continued customer interaction service expansion. The balance represented other subsidiaries' capital spending.

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.

Financing Activities

On a consolidated basis, we used net cash of Php44,819 million for financing activities in 2007, compared to Php45,900 million in 2006 and Php61,302 million in 2005. The net cash used in financing activities was mainly utilized for debt repayments, interest payments, and dividend payments distributed to PLDT common and preferred stockholders. The net cash used in financing activities in 2006 and 2005 was mainly utilized for debt repayments and interest payments by PLDT and Piltel in line with their debt reduction programs, and dividend payments distributed by PLDT to its common and preferred stockholders and interest payments.

Debt Financing

Additions to our consolidated long-term debt in 2007 totaled Php7,647 million mainly from Smart's drawings related to the financing of its network expansion projects. Payments in respect of principal and interest of our total debt amounted to Php18,258 million and Php5,891 million, respectively, in 2007, of which Php12,505 million in principal and Php4,451 million in interest were attributable to PLDT.

Our long-term debt decreased by Php19,806 million, or 25%, to Php60,147 million in 2007, largely due to debt amortizations and prepayments in line with efforts to reduce our overall debt level, and also due to the appreciation of the Philippine peso resulting to the lower peso revaluation of our foreign-currency-denominated debts. The debt levels of PLDT, Smart and Mabuhay decreased by 35%, 1% and 45% to Php33,975 million, Php24,995 million and Php1,145 million, respectively, in 2007 as compared to the levels in 2006.

In 2007, we conducted a consent solicitation of holders of our 11.375% Notes due 2012, 10.5% Notes due 2009 and 8.35% Notes due 2017, or the Notes, in respect of amendments to the terms of the Notes that allow PLDT greater flexibility to make certain restricted payments, pay dividends or distributions, while reducing PLDT's permitted leverage ratios pursuant to the terms of the Notes. These amendments to the terms of the Notes became effective on December 3, 2007, the date on which PLDT made the applicable consent payments, after holders of more than 51% of the aggregate principal amount of the Notes gave their consents for these amendments to the terms of the Notes prior to the expiration of the consent solicitation period and after the execution of relevant amendments to the indentures governing the Notes on November 21, 2007.

On May 22, 2007, PLDT entered into loan agreements with The Philippine American Life and General Insurance Company for Php400 million and The Philam Bond Fund, Inc. for Php20 million to refinance their respective participations in respect of a loan agreement relating to PLDT's borrowing of Php1,270 million in the form of peso fixed rate corporate bonds, which were repaid on June 12, 2007. Both refinancing loans will mature on June 12, 2014.

On February 15, 2007, Smart issued Php5 billion unsecured fixed rate corporate notes, made up of Series A notes amounting to Php3.8 billion and Series B notes amounting to Php1.2 billion with five and ten year terms, respectively. Series A notes were priced at 5.625%, while Series B notes were priced at 6.500%. Funds raised from the issuance of these notes have primarily been for Smart's capital expenditures for network improvement and expansion.

Approximately Php24,398 million principal amount of our consolidated outstanding long-term debt in 2007 is scheduled to mature over the period from 2008 to 2011. Of this amount, Php11,165 million is attributable to PLDT, Php12,056 million to Smart and the remainder to Mabuhay Satellite and ePLDT.

For a complete discussion of our long-term debt, see *Note 18 – Interest-bearing Financial Liabilities – Long-term Debt* to the accompanying audited consolidated financial statements.

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 Philippine Financial Reporting Standards, at relevant measurement dates, principally at the end of each quarterly period. We have complied with all of our maintenance financial ratios as required under our loan covenants and other debt instruments. Furthermore, certain of PLDT's debt instruments contain provisions pursuant to which PLDT may be required to repurchase or repay certain indebtedness in case of a change in control of PLDT.

Please see *Note 18 – Interest-bearing Financial Liabilities – Debt Covenants* to the accompanying audited consolidated financial statements for a detailed discussion of our debt 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.

As a result of our strong cash flows and lower debt levels, we have increased our dividend payout ratio to 70% of 2007 earnings per share from 60% of 2006 earnings per share.

On August 7, 2007, we declared a special dividend of Php40 per share attributable to our 2006 earnings. This special cash dividend was an incremental dividend payout representing approximately 25% of our 2006 earnings per share. As a result of such special dividend declaration, our total dividend payments attributable to our 2006 earnings increased to Php140 per share, inclusive of the regular dividends paid out of our 2006 earnings aggregating Php100 per share. With respect to our 2007 earnings, in addition to the Php60 per share dividend declared on August 7, 2007, we declared on March 4, 2008 a regular cash dividend of Php68 per share and a special cash dividend of Php56 per share, in the aggregate representing close to a 100% of our 2007 earnings per share.

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.

PLDT's current credit ratings are as follows:

Rating Agency	Credit Rating		Outlook
Standard and Poor's Ratings Services, or Standard and Poor's	Foreign Currency Rating	BB+	Stable
Moody's Investor Service, or Moody's	Foreign Currency Senior Unsecured Debt Rating	Ba2	Positive
	Local Currency Corporate Family Rating	Baa2	Positive
Fitch Ratings, or Fitch	Long-term Foreign Currency Rating	BB+	Stable
	Long-term Local Currency Rating	BB+	Stable
	Long-term Foreign Currency Issuer Default Rating, or IDR	BB+	Stable
	Long-term Local Currency Issuer Default Rating	BBB	Stable
	National Long-term Rating	AAA(ph1)	Stable

On March 19, 2008, Moody's affirmed our local currency rating and changed its outlook from stable to positive at the same time affirming our foreign currency bond Ba2 rating with a positive outlook. The rating action reflects our ability to achieve ongoing revenue growth and fund high levels of capital expenditures internally, as well as the ability to increase dividend payments to our shareholders. On January 28, 2008, Moody's affirmed our foreign currency senior unsecured debt rating from stable to positive following the change in the outlook of the Philippines Ba3 country ceiling for foreign currency bonds to positive from stable.

On November 6, 2007, Standard and Poor's, Moody's and Fitch affirmed some of our local and foreign currency ratings following the consent solicitation announcement relating to the Notes to effect certain proposed amendments that would give us more flexibility to make investments and dividend payments. The affirmation also reflects our healthy financial and dominant market positions though counterbalanced by the uncertainty of the Philippines' political and economic environment. However, any future upward ratings would be more reflective of a stabilizing economic, political and social environment reducing such uncertainties.

Off-Balance Sheet Arrangement

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 Php73 million and Php63 million from the exercise by certain officers and executives of stock options in 2007 and 2006, respectively. In addition, through our subscriber investment plan 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 Php3 million and Php4 million in 2007 and 2006, respectively.

Cash dividend payments in 2007 amounted to Php28,470 million compared to Php14,913 million paid to preferred and common shareholders in 2006. Cash dividend payments in 2006 amounted to Php14,913 million, of which Php14,447 million and Php466 million were paid to common and preferred shareholders, respectively. In 2007, there were 188.7 million PLDT common shares outstanding compared to 188.4 million common shares outstanding as at December 31, 2006.

As at February 29, 2008, a total of 7.0 million shares of PLDT's common capital stock were traded on the Philippine Stock Exchange. During the same year, the volume of trading was 7.7 million ADSs on the New York Stock Exchange.

High and low sales prices for PLDT's common shares on the PSE and ADSs on the NYSE for each of the full quarterly period during 2007 and 2006 and for the first three months of 2008 were as follows:

	Philippine Stock Exchange		New York Stock Exchange	
	High	Low	High	Low
2008				
First Quarter				
January	Php3,175.00	Php2,520.00	US\$76.72	US\$61.49
February	3,175.00	2,520.00	76.72	62.20
March	3,000.00	2,830.00	75.67	70.13
April 10	2,905.00	2,600.00	71.65	61.49
April 10	2,795.00	2,750.00	66.95	66.13
2007				
First Quarter				
January	Php2,820.00	Php2,250.00	US\$56.62	US\$45.25
Second Quarter	2,730.00	2,390.00	58.88	50.05
Third Quarter	2,950.00	2,270.00	65.16	48.00
Fourth Quarter	3,285.00	2,900.00	76.30	64.90
October	3,285.00	2,900.00	72.50	64.90
November	3,105.00	2,925.00	73.39	67.21
December	3,205.00	2,970.00	76.30	69.62

	Philippine Stock Exchange		New York Stock Exchange	
	High	Low	High	Low
2006				
First Quarter	Php1,930.00	Php1,675.00	US\$38.09	US\$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

Holders

As at February 29, 2008, there were 12,336 holders of record of PLDT's common shares. Listed below were the top 20 common shareholders, including their nationalities, the number of shares held, the amount of their holdings, and the approximate percentages of their respective shareholdings to PLDT's total outstanding common stocks:

Name of Holder of Record	Nationality	Number of Shares Held	Amount of Holding	Approximate % to Total Outstanding Common Stock
1. PCD Nominee Corporation	Various	57,898,200	Php289,491,000 }	44.60
	Filipino	26,349,198		
2. J.P. Morgan Asset Holdings (Hong Kong) Ltd.	Chinese	38,906,071	194,530,355	20.59
3. Metro Pacific Resources, Inc.	Filipino	17,112,534	85,562,670	9.06
4. Philippine Telecommunications Investments Corporation	Filipino	13,338,415	66,692,075	7.06
5. NTT Communications Corporation	Japanese	12,633,487	63,167,435	6.69
6. NTT DoCoMo, Inc.	Japanese	12,633,486	63,167,430	6.69
7. Social Security System	Filipino	5,024,789	25,123,945	2.66
8. Great Pacific Life Assurance Corp.	Filipino	726,374	3,631,870	0.38
9. Pan Malayan Management & Investment	Filipino	553,200	2,766,000	0.29
10. Manuel V. Pangilinan	Filipino	218,350	1,091,750	0.12
11. Cede & Co.	American	201,523	1,007,615	0.11
12. Albert del Rosario	Filipino	125,004	625,020	0.07
13. Edward &/or Anita Tortorici	American	96,874	484,370	0.05
14. Cesar C. Zalamea	Filipino	69,992	349,960	0.04
15. Enrique T. Yuchengco Inc.	Filipino	59,868	299,340	0.03
16. JDC Invest Realty	Filipino	47,708	238,540	0.03
17. Carmencita Reyes	Filipino	45,406	227,030	0.02
18. Bing Pua Yok	Filipino	41,578	207,890	0.02
19. Par Invest & Realty	Filipino	38,390	191,950	0.02
20. China Banking Corporation	Filipino	37,606	188,030	0.02
		186,158,053	Php930,790,265	

As at December 31, 2007, 10,857 stockholders were Philippine persons and held approximately 35% of PLDT's common capital stock. In addition, as at December 31, 2007, there was a total of approximately 42 million ADSs outstanding, substantially all of which PLDT believes were held in the United States by 372 holders.

Contractual Obligations and Commercial Commitments

Contractual Obligations

For a discussion of our contractual obligations, see *Note 24 – Contractual Obligations and Commercial Commitments* to the accompanying audited consolidated financial statements.

Commercial Commitments

As at December 31, 2007, our outstanding commercial commitments, in the form of letters of credit, amounted to Php3,782 million. These commitments will expire within one year.

Quantitative and Qualitative Disclosures about Market Risks

Our operations are exposed to various risks, including liquidity risk, foreign exchange risk, interest rate risk, credit risk and capital management. 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, equity issues and sales of certain assets.

For further discussions of these risks, see *Note 24 – Contractual Obligations and Commercial Commitments* and *Note 26 – Financial Assets and Liabilities* to the accompanying audited consolidated financial statements.

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, we do not believe inflation has had a material impact on our operations. The average inflation rate in the Philippines in 2007 was 2.8% compared to 6.2% in 2006.

Information on Independent Auditor's and Other Related Matters

Independent Auditor's Fees and Services

The following table summarizes the fees paid or accrued for services rendered by our independent auditor for the fiscal years ended December 31, 2007 and 2006:

	2007	2006
	(in millions)	
Audit Fees	Php41	Php47
All Other Fees	25	29
Total	Php66	Php76

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 auditor in connection with statutory and regulatory filings or engagements for those fiscal years. This category also includes advice on audit and accounting matters that arose during, or as a result of, the audit or the review of interim financial statements.

All Other Fees. This category consists primarily of fees with respect to our Sarbanes-Oxley Act 404 assessment, 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 auditor.

Changes in and Disagreements with Independent Auditor's on Accounting and Financial Disclosure

We have no disagreements with our independent auditor on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

AUDIT COMMITTEE REPORT

March 14, 2008

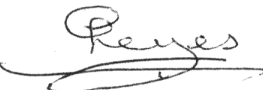
The Board of Directors
Philippine Long Distance Telephone Company

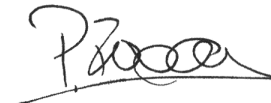
Further to our compliance with applicable corporate governance laws and rules, we confirm for 2007 that:

- Each voting member of the Audit Committee is an independent director as determined by the Board of Directors;
- In the performance of our oversight responsibilities, we have reviewed and discussed the audited financial statements of Philippine Long Distance Telephone Company and Subsidiaries, or PLDT Group, as of and for the year ended December 31, 2007 with the PLDT Group's management, which has the primary responsibility for the financial statements, and with SGV & Co., the PLDT Group's independent auditor, who is responsible for expressing an opinion on the conformity of the PLDT Group's audited financial statements with generally accepted accounting principles;
- We have discussed with SGV & Co. the matters required to be discussed by the Statement on Auditing Standards No. 61 (Communication with Audit Committees) as modified or supplemented;
- We have received written disclosures and the letter from SGV & Co. required by the Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and have discussed with SGV & Co. its independence from the PLDT Group and the PLDT Group's management;
- We have discussed with the PLDT Group's internal audit group and SGV & Co. the overall scope and plans for their respective audits. We also met with the PLDT Group's internal audit group and representatives from SGV & Co. to discuss the results of their examinations, their evaluations of the PLDT Group's internal controls and the overall quality of the PLDT Group's financial reporting;
- Based on the reviews and discussions referred to above, in reliance on the PLDT Group's management and SGV & Co. and subject to the limitations of our role, we recommended to the Board of Directors and the Board has approved, the inclusion of the PLDT Group's audited financial statements as of and for the year ended December 31, 2007 in the PLDT Group's Annual Report to the Stockholders and to the Philippine SEC on Form 17-A; and
- Based on a review of SGV & Co.'s performance and qualifications, including consideration of management's recommendation, we approved the appointment of SGV & Co. as the PLDT Group's independent auditor.


Rev. Fr. Bienvenido F. Nebres, S. J.


Corazon S. de la Paz-Bernardo


Oscar S. Reyes


Pedro E. Roxas

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

March 14, 2008

We are responsible for all information and representations contained in the consolidated financial statements of Philippine Long Distance Telephone Company and Subsidiaries (The PLDT Group) as of December 31, 2007 and 2006 and for each of the three years in the period ended December 31, 2007. Our consolidated financial statements were prepared in conformity with Philippine Financial Reporting Standards and reflect amounts that are based on our best estimates and informed judgment with an appropriate consideration to materiality.

In this regard, we maintain a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition and liabilities are recognized. We likewise disclose to our Audit Committee and our independent auditors: (i) all significant deficiencies in the design or operation of internal controls that could adversely affect our ability to record, process, and report financial data; (ii) material weaknesses in our internal controls; and (iii) any fraud that involves management or other employees who exercise significant roles in internal controls.

Our Board of Directors reviews our financial statements before these are approved and submitted to our Stockholders.

SyCip Gorres Velayo & Co., a member practice of the Ernst & Young Global, the independent auditors appointed by our Audit Committee, have audited our consolidated financial statements as of December 31, 2007 and 2006, and for each of the three years in the period ended December 31, 2007 in accordance with Philippine Standards on Auditing and have expressed their opinion on the fairness of presentation upon completion of such audit, in their report to our Stockholders and our Board of Directors dated March 14, 2008.



MANUEL V. PANGILINAN
Chairman of the Board



NAPOLEON L. NAZARENO
President and Chief Executive Officer



ANABELLE LIM-CHUA
Senior Vice President and Treasurer



JUNE CHERYL A. CABAL-FURIGAY
Vice President and Controller

SUBSCRIBED AND SWORN to before me this 28th day of March 2008, affiants exhibiting to me their passports, as follows:

<u>Name</u>	<u>Passport No.</u>	<u>Date of Expiry</u>	<u>Place of Issue</u>
Manuel V. Pangilinan	ZZ214106	May 28, 2009	DFA, Manila
Napoleon L. Nazareno	ZZ133204	March 8, 2010	DFA, Manila
Anabelle Lim-Chua	ZZ188249	May 10, 2011	DFA, Manila
June Cheryl A. Cabal-Furigay	WW235810	September 27, 2012	DFA, Manila



Notary Public
KATHRYN ROSALIE B. FADERON-DIONISIO
Notary Public for the City of Makati
Until December 31, 2008
Notarial Appointment No. 115
Roll of Attorneys No. 42738
IBP Lifetime IBP No. 05593 - 01/09/06
PTR No. 0017668 - 01/09/2008
9/F MGO Bldg. Dela Rosa St.
Legaspi Village Makati City, Metro Manila

Doc. No. 245;
Page No. 50;
Book No. III;
Series of 2008.

Independent Auditors' Report

The Stockholders and the Board of Directors
Philippine Long Distance Telephone Company
Ramon Cojuangco Building
Makati Avenue, Makati City, Philippines

We have audited the accompanying financial statements of Philippine Long Distance Telephone Company and Subsidiaries, which comprise the consolidated balance sheets as at December 31, 2007 and 2006, and the consolidated statements of income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2007, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

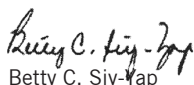
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Philippine Long Distance Telephone Company and Subsidiaries as of December 31, 2007 and 2006, and their financial performance and their cash flows for each of the three years in the period ended December 31, 2007 in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.



Betty C. Siy-Vap
Partner
CPA Certificate No. 57794
SEC Accreditation No. 0098-AR-1
Tax Identification No. 102-100-627
PTR No. 0017640, January 3, 2008, Makati City

March 14, 2008

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

December 31, 2007 and 2006

(in million pesos, except par value, per share amounts and number of shares)

	2007	2006 (As restated – Note 2)
ASSETS		
Noncurrent Assets		
Property, plant and equipment - net (Notes 2, 3, 5, 8, 18 and 26)	159,414	164,190
Investments in associates and joint ventures (Notes 2, 9, 18 and 26)	1,351	636
Investments-available-for-sale (Notes 2 and 26)	143	116
Investment in debt securities (Notes 2 and 26)	273	–
Investment properties (Notes 2, 3, 10 and 26)	577	587
Goodwill and intangible assets - net (Notes 2, 3, 5, 11 and 26)	11,721	12,214
Deferred income tax assets (Notes 2, 3, 4, 6 and 26)	13,757	19,884
Derivative financial assets (Notes 2 and 26)	59	434
Prepayments - net of current portion (Notes 16 and 26)	2,281	2,185
Advances and refundable deposits - net of current portion (Notes 2 and 26)	1,030	1,066
Total Noncurrent Assets	190,606	201,312
Current Assets		
Cash and cash equivalents (Notes 2, 12 and 26)	17,447	16,870
Short-term investments (Notes 2 and 26)	13,415	8,327
Investment in debt securities (Notes 2, 13 and 26)	1,115	–
Trade and other receivables - net (Notes 2, 3, 14, 22 and 26)	12,645	10,158
Inventories and supplies (Notes 2, 15 and 26)	1,167	1,230
Derivative financial assets (Notes 2 and 26)	897	47
Current portion of prepayments (Notes 16 and 26)	2,368	4,018
Current portion of advances and refundable deposits (Notes 2 and 26)	498	156
Total Current Assets	49,552	40,806
TOTAL ASSETS	240,158	242,118
EQUITY AND LIABILITIES		
Equity Attributable to Equity Holders of PLDT (Notes 2, 7 and 17)		
Preferred stock, Php10 par value, authorized - 822,500,000 shares; issued and outstanding - 441,650,297 shares as at December 31, 2007 and 442,375,057 shares as at December 31, 2006	4,417	4,424
Common stock, Php5 par value, authorized - 234,000,000 shares; issued and outstanding - 188,740,519 shares as at December 31, 2007 and 188,434,695 shares as at December 31, 2006	943	942
Stock options issued (Note 23)	9	40
Equity portion of convertible preferred stock (Note 18)	6	9
Capital in excess of par value	67,057	66,574
Retained earnings (Note 7)	39,576	32,328
Cumulative translation adjustments (Note 26)	(895)	(1,796)
Total Equity Attributable to Equity Holders of PLDT	111,113	102,521
Minority interest	1,398	1,546
Total Equity	112,511	104,067

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS *(continued)*

December 31, 2007 and 2006

(in million pesos, except par value, per share amounts and number of shares)

	2007	2006
		(As restated – Note 2)
Noncurrent Liabilities		
Interest-bearing financial liabilities - net of current portion (Notes 2, 8, 18, 24 and 26)	53,387	65,244
Deferred income tax liabilities (Notes 2, 3, 4, 6 and 26)	2,155	402
Derivative financial liabilities (Notes 2, 24 and 26)	7,741	6,872
Pension and other employee benefits (Notes 2, 3, 23 and 26)	4,540	2,982
Customers' deposits (Notes 24 and 26)	2,201	2,204
Deferred credits and other noncurrent liabilities (Notes 2, 3, 8, 11, 14, 19 and 26)	9,632	8,025
Total Noncurrent Liabilities	79,656	85,729
Current Liabilities		
Accounts payable (Notes 2, 20, 22, 25 and 26)	12,253	8,634
Accrued expenses and other current liabilities (Notes 2, 3, 11, 18, 21, 22, 23, 24, 25 and 26)	21,674	22,613
Derivative financial liabilities (Notes 2, 24 and 26)	242	108
Provisions for assessments (Notes 2, 22, 24, 25 and 26)	1,112	446
Current portion of interest-bearing financial liabilities (Notes 2, 8, 18, 24 and 26)	8,764	17,309
Dividends payable (Notes 2, 7, 18, 24 and 26)	1,071	774
Income tax payable (Notes 2, 6 and 26)	2,875	2,438
Total Current Liabilities	47,991	52,322
TOTAL EQUITY AND LIABILITIES	240,158	242,118

See accompanying Notes to Consolidated Financial Statements.

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2007, 2006 and 2005
(in million pesos, except earnings per common share amounts)

	2007	2006	2005
		(As restated – Note 2)	
REVENUES			
Service revenues (Notes 2, 3 and 4)	135,476	124,976	121,104
Foreign exchange gains – net (Notes 2 and 4)	2,976	1,967	4,906
Non-service revenues (Notes 2, 3, 4 and 5)	2,480	2,967	3,312
Interest income (Notes 2 and 4)	1,503	1,654	1,535
Equity share in net income of associates (Notes 2, 3 and 4)	–	–	7
Other income (Notes 2, 3 and 4)	3,667	5,740	1,663
	146,102	137,304	132,527
EXPENSES			
Depreciation and amortization (Notes 3, 4 and 8)	28,613	31,869	30,822
Compensation and employee benefits (Notes 3, 5 and 23)	20,470	18,359	14,136
Repairs and maintenance (Note 22)	7,310	6,886	6,705
Financing costs – net (Notes 2, 5, 8, 18 and 26)	7,088	10,854	13,712
Selling and promotions	5,824	5,010	5,093
Professional and other contracted services (Notes 5 and 22)	5,588	3,149	2,464
Cost of sales (Notes 5, 22 and 24)	4,844	5,522	6,501
Rent (Note 24)	2,762	2,257	2,086
Taxes and licenses (Note 25)	2,319	1,747	2,205
Communication, training and travel	1,850	1,481	1,465
Asset impairment (Notes 3, 5, 8, 9 and 11)	1,317	2,766	2,756
Insurance and security services (Note 22)	1,197	1,255	1,523
Loss on derivative transactions – net	1,044	1,851	1,862
Provisions (Notes 3, 4, 14, 15, 22, 24 and 25)	666	38	196
Amortization of intangible assets (Notes 3 and 11)	390	450	244
Equity share in net losses of associates	11	52	–
Other expenses (Note 22)	1,552	1,527	2,100
	92,845	95,073	93,870
INCOME BEFORE INCOME TAX	53,257	42,231	38,657
PROVISION FOR INCOME TAX (Notes 2, 3, 4 and 6)	17,279	6,890	4,155
NET INCOME FOR THE YEAR	35,978	35,341	34,502
ATTRIBUTABLE TO:			
Equity holders of PLDT (Note 7)	36,004	35,138	34,135
Minority interest	(26)	203	367
	35,978	35,341	34,502
Earnings Per Common Share (Note 7)			
Basic	188.42	188.03	190.13
Diluted	187.53	187.93	185.88

See accompanying Notes to Consolidated Financial Statements.

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

For the Years Ended December 31, 2007, 2006 and 2005
(in million pesos)

	Preferred Stock	Common Stock	Stock Options Issued	Equity Portion of Convertible Preferred Stock	Capital in Excess of Par Value	Retained Earnings (Deficit)	Cumulative Translation Adjustments	Equity Attributable to Equity Holders of PLDT	Minority Interest	Total Equity
Balances at January 1, 2005										
As previously reported	4,497	851	181	448	50,469	(10,478)	362	46,330	857	47,187
Effect of change in revenue recognition policy for installation fees (Note 2)	-	-	-	-	-	(501)	-	(501)	-	(501)
As restated – Note 2	4,497	851	181	448	50,469	(10,979)	362	45,829	857	46,686
Changes in equity:										
Net income for the year										
As previously reported	-	-	-	-	-	34,112	-	34,112	367	34,479
Effect of change in revenue recognition policy for installation fees (Note 2)	-	-	-	-	-	23	-	23	-	23
As restated – Note 2	-	-	-	-	-	34,135	-	34,135	367	34,502
Deferred income tax effects on cash										
flow hedges	-	-	-	-	-	-	(427)	(427)	-	(427)
Foreign currency translation differences	-	-	-	-	-	-	(62)	(62)	(36)	(98)
Net gains on available-for-sale financial investments										
	-	-	-	-	-	-	4	4	-	4
Net losses on cash flow hedges removed from cumulative translation adjustments taken to income										
	-	-	-	-	-	-	2,390	2,390	-	2,390
Net losses on cash flow hedges										
	-	-	-	-	-	-	(1,014)	(1,014)	-	(1,014)
Total income and expense for the year recognized directly in equity										
	-	-	-	-	-	-	891	891	(36)	855
Total income and expense for the year										
	-	-	-	-	-	34,135	891	35,026	331	35,357
Cash dividends (Note 7)										
	-	-	-	-	-	(11,051)	-	(11,051)	-	(11,051)
Issuance of capital stock – net of conversion (Note 17)										
	(64)	51	-	(399)	3,062	-	-	2,650	-	2,650
Exercised option shares										
	-	2	(113)	-	386	-	-	275	-	275
Cancelled options shares										
	-	-	(1)	-	1	-	-	-	-	-
Minority interest										
	-	-	-	-	-	-	-	-	(26)	(26)
Balances at December 31, 2005 (As restated – Note 2)										
	4,433	904	67	49	53,918	12,105	1,253	72,729	1,162	73,891
Balances at January 1, 2006										
As previously reported	4,433	904	67	49	53,918	12,583	1,253	73,207	1,162	74,369
Effect of change in revenue recognition policy for installation fees (Note 2)	-	-	-	-	-	(478)	-	(478)	-	(478)
As restated – Note 2	4,433	904	67	49	53,918	12,105	1,253	72,729	1,162	73,891
Changes in equity:										
Net income for the year										
As previously reported	-	-	-	-	-	35,116	-	35,116	203	35,319
Effect of change in revenue recognition policy for installation fees (Note 2)	-	-	-	-	-	22	-	22	-	22
As restated – Note 2	-	-	-	-	-	35,138	-	35,138	203	35,341
Deferred income tax effects on cash										
flow hedges	-	-	-	-	-	-	1,088	1,088	-	1,088
Foreign currency translation differences	-	-	-	-	-	-	(535)	(535)	(45)	(580)
Net losses on available-for-sale financial investments										
	-	-	-	-	-	-	(5)	(5)	-	(5)
Net losses on cash flow hedges removed from cumulative translation adjustments taken to income										
	-	-	-	-	-	-	2,855	2,855	-	2,855
Net losses on cash flow hedges										
	-	-	-	-	-	-	(6,452)	(6,452)	-	(6,452)
Total income and expense for the year recognized directly in equity										
	-	-	-	-	-	-	(3,049)	(3,049)	(45)	(3,094)

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY *(continued)*

For the Years Ended December 31, 2007, 2006 and 2005
(in million pesos)

	Preferred Stock	Common Stock	Stock Options Issued	Equity Portion of Convertible Preferred Stock	Capital in Excess of Par Value	Retained Earnings (Deficit)	Cumulative Translation Adjustments	Equity Attributable to Equity Holders of PLDT	Minority Interest	Total Equity
Total income and expense for the year	-	-	-	-	-	35,138	(3,049)	32,089	158	32,247
Cash dividends (Note 7)	-	-	-	-	-	(14,915)	-	(14,915)	-	(14,915)
Issuance of capital stock - net of conversion (Note 17)	(9)	38	-	(40)	12,566	-	-	12,555	-	12,555
Exercised option shares	-	-	(27)	-	90	-	-	63	-	63
Minority interest	-	-	-	-	-	-	-	-	226	226
Balances at December 31, 2006 (As restated - Note 2)	4,424	942	40	9	66,574	32,328	(1,796)	102,521	1,546	104,067
Balances at January 1, 2007										
As previously reported	4,424	942	40	9	66,574	32,784	(1,796)	102,977	1,546	104,523
Effect of change in revenue recognition policy for installation fees (Note 2)	-	-	-	-	-	(456)	-	(456)	-	(456)
As restated - Note 2	4,424	942	40	9	66,574	32,328	(1,796)	102,521	1,546	104,067
Changes in equity:										
Net income for the year	-	-	-	-	-	36,004	-	36,004	(26)	35,978
Deferred income tax effects on cash flow hedges	-	-	-	-	-	-	(1,126)	(1,126)	-	(1,126)
Foreign currency translation differences	-	-	-	-	-	-	(1,782)	(1,782)	(67)	(1,849)
Net gains on available-for-sale financial investments	-	-	-	-	-	-	30	30	-	30
Net losses on cash flow hedges removed from cumulative translation adjustments taken to income	-	-	-	-	-	-	5,013	5,013	-	5,013
Net losses on cash flow hedges	-	-	-	-	-	-	(1,234)	(1,234)	-	(1,234)
Total income and expense for the year recognized directly in equity	-	-	-	-	-	-	901	901	(67)	834
Total income and expense for the year	-	-	-	-	-	36,004	901	36,905	(93)	36,812
Cash dividends (Note 7)	-	-	-	-	-	(28,756)	-	(28,756)	(12)	(28,768)
Issuance of capital stock - net of conversion (Note 17)	(7)	1	-	(3)	379	-	-	370	-	370
Exercised option shares (Note 23)	-	-	(31)	-	104	-	-	73	-	73
Minority interest	-	-	-	-	-	-	-	-	(43)	(43)
Balances at December 31, 2007	4,417	943	9	6	67,057	39,576	(895)	111,113	1,398	112,511

See accompanying Notes to Consolidated Financial Statements.

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2007, 2006 and 2005
(in million pesos)

	2007	2006	2005
		(As restated – Note 2)	
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	53,257	42,231	38,657
Adjustments for:			
Depreciation and amortization (Notes 3, 4 and 8)	28,613	31,869	30,822
Interest on loans and related items - net (Note 5)	5,714	7,359	10,377
Pension (Notes 3, 5 and 23)	1,773	1,003	776
Incentive plans (Notes 3, 5 and 23)	1,448	3,150	1,214
Asset impairment (Notes 3, 5, 14, 15 and 26)	1,317	2,766	2,756
Accretion on financial liabilities - net (Notes 5 and 26)	1,161	3,314	2,882
Loss on derivative transactions - net (Notes 26)	1,044	1,851	1,862
Amortization of intangible assets (Note 11)	390	450	244
Dividends on preferred stock subject to mandatory redemption (Note 5)	17	130	251
Equity share in net losses (income) of associates (Note 4)	11	52	(7)
Loss (gain) on disposal of fixed assets (Note 8)	(527)	(158)	57
Interest income (Note 5)	(1,503)	(1,654)	(1,535)
Foreign exchange gains - net (Notes 5, 18 and 26)	(2,976)	(1,967)	(4,906)
Gain on reversal of provision for onerous contracts (Note 25)	-	(3,529)	-
Others	(374)	(845)	(179)
Operating income before changes in assets and liabilities	89,365	86,022	83,271
Decrease (increase) in:			
Trade and other receivables	(3,266)	(1,187)	(1,036)
Inventories and supplies	(76)	343	509
Prepayments	1,862	(1,513)	(3,293)
Advances and refundable deposits	(307)	1,329	(240)
Increase (decrease) in:			
Accounts payable	4,763	(9,254)	6,466
Accrued expenses and other current liabilities	4,223	1,590	2,366
Unearned revenues	82	534	(291)
Pension and other employee benefits	(6,649)	(435)	(674)
Customers' deposits	12	6	42
Asset retirement obligations	-	-	(28)
Other noncurrent liabilities	(1,167)	43	(649)
Net cash generated from operations	88,842	77,478	86,443
Income taxes paid	(11,424)	(8,267)	(9,722)
Net cash provided by operating activities	77,418	69,211	76,721
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from maturity of short-term investments	15,935	658	3,873
Interest received	1,218	1,481	1,408
Proceeds from disposal of property, plant and equipment (Note 8)	953	694	912
Proceeds from disposal of investment properties	10	72	11
Proceeds from disposal of investments-held-for-sale	7	-	-
Payments for acquisition of intangibles (Note 11)	(213)	-	-
Payments for purchase of investment in debt securities	(264)	-	-
Decrease (increase) in advances and refundable deposits	(424)	(1,054)	71
Interest paid - capitalized to property, plant and equipment (Notes 5 and 8)	(542)	(549)	(504)
Payments for purchase of investment in associates	(601)	(636)	-
Payments for purchase of investments - net of cash acquired (Note 11)	(1,687)	(10,254)	(248)
Additions to short-term investments	(21,429)	(6,166)	(2,671)
Additions to property, plant and equipment (Note 8)	(24,282)	(20,125)	(14,486)
Proceeds from collection of notes receivable	-	89	-
Advances from notes receivable	-	-	(60)
Net cash used in investing activities	(31,319)	(35,790)	(11,694)

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS *(continued)*

For the Years Ended December 31, 2007, 2006 and 2005
(in million pesos)

	2007	2006	2005
		(As restated – Note 2)	
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of long-term debt (Note 18)	7,647	9,724	5,471
Payments of long-term debt (Note 18)	(18,065)	(29,238)	(44,323)
Payments of debt issuance costs	(54)	(34)	(133)
Proceeds from notes payable	502	211	329
Payments of notes payable	(193)	(128)	(387)
Payments of obligations under finance lease	(199)	(210)	(38)
Interest paid - net of capitalized portion	(5,891)	(7,528)	(10,545)
Settlements of derivative financial instruments	(2,066)	(3,727)	(2,788)
Cash dividends paid	(28,470)	(14,913)	(10,972)
Proceeds from issuance of capital stock	76	66	285
Redemption of shares of minority interest	(15)	–	–
Proceeds from capital expenditures under long-term financing	8,746	9,159	5,326
Payments of capital expenditures under long-term financing	(6,837)	(9,282)	(3,527)
Net cash used in financing activities	(44,819)	(45,900)	(61,302)
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(703)	(710)	(987)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	577	(13,189)	2,738
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	16,870	30,059	27,321
CASH AND CASH EQUIVALENTS AT END OF YEAR	17,447	16,870	30,059

See accompanying Notes to Consolidated Financial Statements.

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Corporate Information

The Philippine Long Distance Telephone Company, or PLDT, or Parent Company, 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. Under its amended Articles of Incorporation, PLDT's corporate term is currently limited through 2028. In 1967, effective control of PLDT was sold by the General Telephone and Electronics Corporation, then 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, First Pacific Company Limited, or First Pacific, and its Philippine and other affiliates, collectively the First Pacific Group, acquired a significant interest in PLDT. On March 24, 2000, NTT Communications Corporation, or NTT Communications, through its wholly-owned subsidiary NTT Communications Capital (UK) Ltd., or NTTC-UK, became PLDT's strategic partner with approximately 14% economic and voting interest in the issued and outstanding common stock of PLDT. Simultaneous with NTT Communications' investment in PLDT, the latter acquired 100% of Smart Communications, Inc., or Smart. On March 14, 2006, NTT DoCoMo, Inc., or NTT DoCoMo, acquired from NTT Communications approximately 7% of PLDT's then outstanding common shares held by NTT Communications with NTT Communications retaining ownership of approximately 7% of PLDT's common shares. Since March 14, 2006, NTT DoCoMo has made additional purchases of shares of PLDT and together with NTT Communications beneficially owned 20.86% of the outstanding shares of PLDT's common stock as at February 29, 2008. 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 Philippine Telecommunications Investment Corporation, or PTIC, a shareholder of PLDT. This additional investment in PTIC represents an attributable interest of approximately 6.4% of the then issued common shares of PLDT and thereby raised First Pacific Group's beneficial ownership to approximately 28% of PLDT's shares of common stock as at that date. First Pacific Group had beneficial ownership of approximately 26.17% in PLDT's outstanding common stock as at February 29, 2008.

The common shares of PLDT are listed and traded on the Philippine Stock Exchange, or PSE. On October 19, 1994, an American Depositary Receipt, or ADR, facility was established, pursuant to which Citibank N.A., as the depository, issued ADRs evidencing American Depositary Shares, or 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 for PLDT's ADR facility. The ADSs are listed on the New York Stock Exchange, or NYSE, in the United States and are traded on the NYSE under the symbol "PHI". As at December 31, 2007, there were a total of over 42 million ADSs outstanding.

Until early 2007, the ADSs were also listed on the NYSE Arca. However, PLDT voluntarily delisted its ADSs from the NYSE Arca, effective February 12, 2007, after determining that doing so is in the best interest of PLDT and its stockholders.

PLDT operates under the jurisdiction of the Philippine National Telecommunications Commission, or NTC, which jurisdiction extends, among other things, to approving major services offered by PLDT and certain rates charged by PLDT.

Our registered office address is Ramon Cojuangco Building, Makati Avenue, Makati City, Philippines.

Our consolidated financial statements as at December 31, 2007 and 2006 and for the three years ended December 31, 2007 were approved and authorized by the board of directors on March 14, 2008, as reviewed and recommended for approval by the Audit Committee.

2. Summary of Significant Accounting Policies and Practices

Basis of Preparation

Our consolidated financial statements have been prepared under the historical cost convention except for the revaluation of derivative financial instruments, available-for-sale financial investments and investment properties that have been measured at fair values.

Our consolidated financial statements are presented in Philippine peso, PLDT's functional and presentation currency and all values are rounded to the nearest million except when otherwise indicated.

Basis of Consolidated Financial Statements Preparation

Our consolidated financial statements include the financial statements of PLDT (the "Parent Company") and those of the following subsidiaries (collectively, the "PLDT Group").

Name of Subsidiary	Place of Incorporation	Principal Activity	2007		2006	
			Percentage of Ownership			
			Direct	Indirect	Direct	Indirect
Wireless						
Smart	Philippines	Cellular mobile services	100.0	–	100.0	–
Smart Broadband, Inc., or SBI	Philippines	Internet broadband distribution	–	100.0	–	100.0
SmartConnect Holdings Pte. Ltd., or SCH	Singapore	Investment company	–	100.0	–	–
I-Contacts Corporation, or I-Contacts	Philippines	Customer Interaction Services	–	100.0	–	100.0
Wolfpac Mobile, Inc., or Wolfpac	Philippines	Mobile applications development and services	–	100.0	–	100.0
SmartConnect Global Pte. Ltd., or SGP	Singapore	International trade of satellites and GSM enabled global telecommunications	–	100.0	–	–
Wireless Card, Inc., or WCI	Philippines	Promotion of the sale and/or patronage of debit and/or charge cards	–	100.0	–	100.0
Smarthub, Incorporated, or SHI	Philippines	Development and sale of software, maintenance and support services	–	100.0	–	–
Pilipino Telephone Corporation, or PilTel	Philippines	Cellular and fixed line services	–	92.1	–	92.1
3rd Brand Pte. Ltd., or 3rd Brand	Singapore	Solutions and systems integration services	–	85.0	–	–
Telesat, Inc., or Telesat	Philippines	Satellite communications services	100.0	–	94.4	–
ACeS Philippines Cellular Satellite Corporation, or ACeS Philippines	Philippines	Satellite information and messaging services	88.5	11.5	88.5	11.5
Mabuhay Satellite Corporation, or Mabuhay Satellite	Philippines	Satellite communications services	67.0	–	67.0	–
Fixed Line						
PLDT Clark Telecom, Inc., or ClarkTel	Philippines	Telecommunications services	100.0	–	100.0	–
PLDT Subic Telecom, Inc., or SubicTel	Philippines	Telecommunications services	100.0	–	100.0	–
PLDT Global Corporation, or PLDT Global	British Virgin Islands	Telecommunications services	100.0	–	100.0	–
Smart-NTT Multimedia, Inc., or SNMI	Philippines	Data and network services	100.0	–	100.0	–
PLDT-Maratel, Inc., or Maratel	Philippines	Telecommunications services	97.5	–	97.5	–
Bonifacio Communications Corporation, or BCC	Philippines	Telecommunications, infrastructure and related value-added services	75.0	–	75.0	–
Information and Communications Technology, or ICT						
ePLDT, Inc., or ePLDT	Philippines	Information and communications infrastructure for Internet-based services, e-commerce, customer interaction services and IT-related services	100.0	–	100.0	–
SPI Technologies, Inc., or SPI, and subsidiaries, or SPI Group	Philippines	Knowledge processing solutions	–	100.0	–	100.0
ePLDT Ventus, Inc., or Ventus	Philippines	Customer interaction services	–	100.0	–	100.0
Vocativ Systems, Inc., or Vocativ	Philippines	Customer interaction services	–	100.0	–	100.0
Parlance Systems, Inc., or Parlance	Philippines	Customer interaction services	–	100.0	–	100.0
Infocom Technologies, Inc., or Infocom	Philippines	Internet access services	–	99.6	–	99.6
Digital Paradise Thailand	Thailand	Internet access services	–	87.5	–	87.5
netGames, Inc., or netGames	Philippines	Publisher of online games	–	80.0	–	80.0
Digital Paradise, Inc., or Digital Paradise	Philippines	Internet access services	–	75.0	–	75.0
Level Up! (Philippines), Inc., or Level Up!	Philippines	Publisher of online games	–	60.0	–	60.0
Airborne Access Corporation, or Airborne Access	Philippines	Wireless Internet services	–	51.0	–	51.0

Subsidiaries are fully consolidated from the date when control is transferred to the PLDT Group and cease to be consolidated from the date when control is transferred out of the PLDT Group.

The financial statements of our subsidiaries are prepared for the same reporting period as PLDT. We prepare our consolidated financial statements using uniform accounting policies for like transactions and other events with similar circumstances. All intra-group balances, income and expenses and unrealized gains and losses resulting from intra-group transactions are eliminated in full.

Minority interest represents the portion of profit or loss and net assets not held by us and are presented separately in the consolidated statements of income and within equity in the consolidated balance sheets, separately from equity attributable to equity holders of PLDT. Acquisition of minority interests is accounted for using the parent entity extension method, whereby, the difference between the consideration and the net book value of the share of the net assets acquired is recognized in goodwill.

Minority interests represent the equity interests in Piltel, Level Up!, Mabuhay Satellite, 3rd Brand, Maratel, BCC, Digital Paradise, Digital Paradise Thailand, netGames, Infocom and Airborne Access not held by the PLDT Group.

When subsidiaries are sold, the difference between the selling price and the net assets plus cumulative translation differences and unamortized goodwill is recognized in the consolidated statement of income.

Statement of Compliance

Our consolidated financial statements have been prepared in conformity with Philippine Financial Reporting Standards, or PFRS.

Changes in Accounting Policies

Our accounting policies adopted are consistent with those of the previous financial year except for policy on revenue recognition on installation fees as discussed below and the adoption of the new and amended Philippine Accounting Standards, or PAS, PFRS and Philippine Interpretations that became effective in 2007.

Voluntary Change in Revenue Recognition Policy for Installation Fees

In 2007, we changed our revenue recognition policy for installation fees and have elected to defer and amortize our installation fees and its corresponding costs over the expected average periods of the customer relationship of our subscribers. Prior to 2007, we recognized installation fees and its corresponding cost outright. Our change in revenue recognition policy was made to better reflect the expected utility of installation fees over the terms of customer relationship.

We accounted for the change in accounting policy retroactively and accordingly restated our comparative consolidated financial statements to conform to the said change. The after tax effect of the change was an increase in our consolidated net income of Php131 million, Php22 million and Php23 million for the years ended December 31, 2007, 2006 and 2005, respectively, and decrease in the retained earnings beginning of Php456 million and Php478 million as at December 31, 2007 and 2006, respectively. Basic earnings per common share increased by Php0.69, Php0.12 and Php0.17 for the years ended December 31, 2007, 2006 and 2005, respectively.

Our consolidated unearned revenues related to the unamortized installation fees amounted to Php479 million and Php682 million as at December 31, 2007 and 2006, respectively, and are included in our "Accrued expenses and other current liabilities" and "Deferred credits and other noncurrent liabilities" in the consolidated balance sheets.

Adoption of New Standards and Interpretations

Our adoption of the following new and amended standards and interpretations did not have any effect on our consolidated financial statements. Our adoption, however, gave rise to additional disclosures on the following:

- **Amendments to PAS 1, "Presentation of Financial Statements – Capital Disclosures"**. This amendment requires us to make new disclosures to enable users of the consolidated financial statements to evaluate our objectives, policies and processes for capital management. These new disclosures are shown in *Note 26 – Financial Assets and Liabilities*.
- **PFRS 7, "Financial Instruments: Disclosures"**. This standard requires disclosures that enable users of the consolidated financial statements to evaluate the significance of our financial instruments and the nature and extent of risks arising from those financial instruments. The new disclosures are included throughout the consolidated financial statements. While there has been no effect on the consolidated financial statements, comparative information has been revised where needed. These new disclosures are shown in *Note 14 – Trade and Other Receivables* and *Note 26 – Financial Assets and Liabilities*.
- **Philippine Interpretation International Financial Reporting Interpretations Committee (IFRIC) 8, "Scope of PFRS 2, Share-based Payment"**. This interpretation requires PFRS 2 to be applied to any arrangements in which the entity cannot identify specifically some or all of the goods received, in particular where equity instruments are issued for consideration which appears to be less than fair value. As equity instruments are only issued to employees in accordance with the employee share scheme, the interpretation had no impact on our consolidated financial statements.
- **Philippine Interpretation IFRIC 9, "Reassessment of Embedded Derivatives"**. This interpretation states that the date to assess the existence of an embedded derivative is the date that an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. The interpretation had no impact on our consolidated financial statements.
- **Philippine Interpretation IFRIC 10, "Interim Financial Reporting and Impairment"**. We adopted Philippine Interpretation of IFRIC 10 as at January 1, 2007, which requires that an entity must not reverse an impairment loss recognized in a previous interim period in respect of goodwill or an investments available-for-sale. As we had no impairment losses previously reversed, the interpretation had no impact on our consolidated financial statements.

Significant Accounting Policies and Practices

Investments in Associates

Investments in associates are accounted for using the equity method of accounting and are initially recognized at cost. An associate is an entity in which we have significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in associate is carried in the consolidated balance sheet at cost plus post acquisition changes in our share of net assets of the associate. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortized. Our consolidated statement of income reflects the share of the results of operations of the associates. Where there has been a change recognized directly in the equity of the associate, we recognize our share in such change and disclose this, when

applicable, in our consolidated statement of changes in equity. Profits or losses resulting from our transactions with and among our associates are eliminated to the extent of our interest in those associates.

Our reporting dates and that of our associates are identical and our associate's accounting policies conform to those used by us for like transactions and events in similar circumstances.

Investments in Joint Ventures

Investments in a joint venture that is a jointly controlled entity is accounted for using the equity method of accounting. The financial statements of the joint venture are prepared for the same reporting period as the consolidated financial statements of PLDT. Adjustments are made where necessary to bring the accounting policies in line with those of PLDT Group.

Adjustments are made in our consolidated financial statements to eliminate our share of unrealized gains and losses on transactions between PLDT and our jointly controlled entity. Losses on transactions are recognized immediately if the loss provides evidence of a reduction in the net realizable value of current assets or an impairment loss. The joint venture is carried at equity method until the date on which we cease to have joint control over the joint venture.

Foreign Currency Transactions and Translations

The functional and presentation currency of the entities under PLDT Group (except for SCH, SGP, 3rd Brand, Mabuhay Satellite, PLDT Global, Digital Paradise Thailand and SPi and certain of its subsidiaries) is the Philippine peso. Transactions in foreign currencies are initially recorded in the functional currency rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional closing rate of exchange prevailing at the balance sheet date. All differences are recognized in the consolidated statement of income except for foreign exchange losses that qualify as capitalizable borrowing costs during the construction period for exchange gains or losses are treated as taxable income or deductible expenses in the year such exchange gains or losses are realized. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operation and translated at the closing rate.

The functional currency and presentation currency of Mabuhay Satellite, PLDT Global, SPi and certain of its subsidiaries is the U.S. dollar; Thai baht for Digital Paradise Thailand and Singapore dollar for SCH, SGP and 3rd Brand. As at the reporting date, the assets and liabilities of these subsidiaries are translated into the presentation currency of the PLDT Group at the rate of exchange prevailing at the balance sheet date, and income and expenses of these subsidiaries are translated at the weighted average exchange rate for the year. The exchange differences arising on translation were recognized as a separate component of equity as cumulative translation adjustments. On disposal of these subsidiaries, the amount of deferred cumulative translation adjustments recognized in equity relating to subsidiaries are recognized in the consolidated statement of income.

Property, Plant and Equipment

Property, plant and equipment, except for land, is stated at cost less accumulated depreciation and amortization and any accumulated impairment losses. Land is stated at cost less any impairment in value. Cost includes the cost of replacing part of the property, plant and equipment when that cost is incurred, if the recognition criteria are met. Likewise, when a major inspection is performed, its cost is recognized in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are recognized in profit or loss as incurred.

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

Depreciation and amortization are calculated on a straight-line basis over the estimated useful lives of the assets.

The residual values, estimated useful lives and depreciation and amortization method are reviewed at least at each financial year-end.

Property under construction is stated at cost. This includes cost of construction, plant and equipment and other direct costs. Property under construction is not depreciated until such time that the relevant assets are completed and substantially available for their intended use.

Borrowing Costs

Borrowing costs are capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset. Capitalization of borrowing costs commences when the activities necessary to prepare the asset for intended use are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the asset is ready for their intended use. If the resulting carrying amount of the asset exceeds its recoverable amount, an impairment loss is recognized. Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds, as well as exchange differences arising from foreign currency borrowings used to finance these projects to the extent that they are regarded as an adjustment to interest costs.

All other borrowing costs are expensed as incurred.

Asset Retirement Obligations

We are legally required under various lease agreements to dismantle the installation in leased sites and restore such sites to their original condition at the end of the lease contract term. We recognize the liability measured at the present value of the estimated costs of these obligations and capitalize such costs as part of the balance of the related item of property, plant and equipment.

The amount of asset retirement obligations are accreted and such accretion is recognized as interest expense.

Investment Properties

Investment properties are initially measured at cost including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met; and excludes the costs of day to day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at fair value, which have been determined based on latest valuations performed by an independent firm of appraisers. Gains or losses arising from changes in the fair values of investment properties are included in the consolidated statement of income in the year in which they arise.

Investment properties are derecognized when they have been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Any gain or loss on the retirement or disposal of an investment property is recognized in the consolidated statement of income in the year of retirement or disposal.

Transfers are made to or from investment property only when there is a change in use. For a transfer from investment property to owner occupied property, the deemed cost for subsequent accounting is the fair value at the date of change in use. If owner occupied property becomes an investment property, we account for such property in accordance with the policy stated under property, plant and equipment up to the date of change in use.

No assets held under operating lease have been classified as investment properties.

Business Combinations and Goodwill

Business combinations are accounted for using the purchase method of accounting. This involves recognizing identifiable assets (including previously unrecognized intangible assets) and liabilities (including contingent liabilities and excluding future restructuring) of any acquired business at fair value.

Goodwill acquired in a business combination is initially measured at cost, such cost being the excess of the cost of the business combination over our interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment loss. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of our cash-generating units, or groups of our cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether our other assets or liabilities are assigned to those units or groups of units. Each unit or group of units to which the goodwill is allocated: (1) represents our lowest level at which the goodwill is monitored for internal management purposes; and (2) is not larger than a segment based on either our primary or secondary reporting format determined in accordance with PAS 14, "Segment Reporting".

Where a business combination agreement provides for an adjustment to the consideration of the combination contingent on future events or achieving specified earnings level in future periods, we recognize the estimated amount of that adjustment as part of cost of the combination and a liability at the acquisition date if the adjustment is probable and can be measured reliably. Otherwise, such adjustment is not recognized until it becomes probable and can be measured reliably in the subsequent period. Where future events do not occur or the estimate needs to be revised, the cost of the business combination initially recognized shall be adjusted accordingly. Future changes in estimates are treated as an adjustment to the cost of the combination with an adjustment to the recorded liability and goodwill.

Where goodwill forms part of a cash-generating unit, or group of cash-generating units, and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired from business combinations is initially recognized at fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment loss. The useful lives of intangible assets are assessed at the individual asset level as having either a finite or indefinite useful life.

Intangible assets with finite lives are amortized over the useful economic life using the straight-line method and assessed for impairment whenever there is an indication that the intangible assets may be impaired. At a minimum, the amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the consolidated statement of income.

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

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

Intangible assets created within the business are not capitalized and expenditures are charged against operations in the year in which the expenditures are incurred.

Research and development costs are expensed as incurred.

Impairment of Non-Financial Assets

We assess at each reporting period whether there is an indication that our property, plant and equipment, and intangible assets with finite lives may be impaired. If any such indication exists, or when the annual impairment testing for an asset is required, we make an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell or its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent from those of other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing the value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining the fair value less costs to sell, an appropriate valuation model is used.

Impairment losses of continuing operations are recognized in the consolidated statement of income.

For assets, excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, we make an estimate of recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If this is the case, the carrying amount of the asset is increased to its recoverable amount. The increase cannot exceed the carrying amount that would have been determined, net of

depreciation and amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of income. After such reversal, the depreciation and amortization charges are adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining economic useful life.

The following criteria are also applied in assessing impairment of specific assets:

Goodwill

Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating unit, or group of cash-generating units, to which the goodwill relates. Where the recoverable amount of the cash-generating unit, or group of cash-generating units, is less than the carrying amount of the cash-generating unit, or group of cash-generating units, to which goodwill has been allocated to, an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods.

Intangible assets

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level, as appropriate. We calculate the amount of impairment as being the difference between the recoverable amount of the intangible asset and its carrying amount and recognize the amount of impairment in the consolidated statement of income.

Investments in associates

After application of the equity method, we determine whether it is necessary to recognize an additional impairment loss on our investment in associates. We determine at each balance sheet date whether there is any objective evidence that our investment in an associate is impaired. If this is the case, we calculate the amount of impairment as being the difference between the recoverable amount of the investments in associates and its carrying amount and recognize the amount of impairment in the consolidated statement of income.

Cash and Cash Equivalents

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

Short-term Investments

Short-term investments are money market placements, which are highly liquid with maturities of more than three months but less than one year from date of acquisition.

Trade and Other Receivables

Trade and other receivables, categorized as loans and receivables, are recognized initially at fair value and subsequently measured at amortized cost using the effective interest rate method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that we will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the consolidated statement of income. When a trade receivable is uncollectible, it is written-off against the allowance account for trade and other receivables. Subsequent recoveries of amounts previously written-off are recognized as income in the consolidated statement of income.

Inventories and Supplies

Inventories and supplies, which include cellular phone units, materials, spare parts, terminal units and accessories, are valued at the lower of cost and net realizable value.

Cost is determined using the weighted average method. Net realizable value is the estimated selling price in the ordinary course of the business less the estimated cost to sell.

Convertible Preferred Stock

Philippine peso-denominated

The component of our convertible preferred stock that exhibits characteristics of a liability is recognized as a liability in the consolidated balance sheet, net of transaction costs. The corresponding dividends on those shares are charged as interest expense in the consolidated statement of income. On issuance of our convertible preferred stock, the fair value of the liability component is determined using a market rate for an equivalent non-convertible bond and this amount is carried as a long-term liability on the amortized cost basis until extinguished through conversion or redemption.

The remainder of the proceeds is allocated to the conversion option that is recognized and included in the equity section of the consolidated balance sheet, net of transaction costs. The carrying amount of the conversion option is not re-measured in subsequent years.

Transaction costs are apportioned between the liability and equity components of the convertible preferred stock based on the allocation of proceeds to the liability and equity components when the instruments are first recognized.

Foreign currency-denominated

We treat the Series VI and VII Convertible Preferred Stock as debt instruments with foreign currency-denominated embedded call options. The fair value of embedded call options as of issuance date was bifurcated and thereafter accounted for separately at fair value through profit or loss. The residual amount was assigned as a liability component and accreted to the redemption amount up to the call option date using the effective interest rate method.

Provisions

We recognize provisions when we have present obligations, legal or constructive, as a result of past events, and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where we expect some or all of a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the consolidated statement of income, net of any reimbursements. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as interest expense.

Retirement Benefits

Defined benefit pension plans

We have funded retirement plans, administered by our respective Fund's Trustees, covering permanent employees. Retirement costs are actuarially determined using the projected unit credit of accrued benefit valuation method. This method reflects services rendered by employees to the date of valuation and incorporates assumptions concerning employees' projected salaries. Retirement costs include current service cost plus amortization of past service cost, experience adjustments and changes in actuarial assumptions. Past service cost is recognized as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits vest immediately following the introduction of, or changes to, a pension plan, past service cost is recognized immediately. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses for each individual plan at the end of the previous reporting period exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains and losses are recognized over the expected average remaining working lives of the employees participating in the plan.

The defined benefit asset or liability comprises the present value of the defined benefit obligation less past service cost not yet recognized and less the fair value of plan assets out of which the obligations are to be settled directly. The value of any asset is restricted to the sum of any past service cost not yet recognized and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

Defined contribution plans

Smart and I-Contacts record expenses for defined contribution plans for their contribution when the employee renders service to Smart and I-Contacts, respectively, essentially coinciding with their cash contributions to the plans.

Share-Based Payment Transactions

Certain of our employees (including directors) receive remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares ("equity-settled transactions").

Equity-settled transactions

The cost of equity-settled transactions with employees is measured by reference to the fair value of the stock options at the date at which they are granted. Fair value is determined using an option-pricing model, further details of which are set forth in *Note 23 – Share-based Payments and Employee Benefits*. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of PLDT ("market conditions").

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("vesting date"). The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the number of awards that will ultimately vest, in our opinion, at that date, based on the best available estimate.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance and/or service conditions are satisfied.

Where the terms of an equity-settled awards are modified and the modification increases the fair value of the equity instruments granted, as measured immediately before and after the modification, the entity shall include the incremental fair value granted in the measurement of the amount recognized for services received as consideration for the equity instruments granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognized for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognized over the remainder of the original vesting period. If the modification occurs after vesting date, the incremental fair value granted is recognized immediately, or over the vesting period if the employee is required to complete an additional period of service before becoming unconditionally entitled to those modified equity instruments.

Where an equity-settled award is cancelled with payment, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were modifications of the original award, as described in the previous paragraph.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share. See *Note 7 – Earnings Per Common Share*.

Cash-settled transactions

Our Long-Term Incentive Plan, or LTIP, grants share appreciation rights, or SARs, to our eligible key executives and advisors. Under the LTIP, we recognize the services we receive from our eligible key executives and advisors, and our liability to pay for those services, as the eligible key executives and advisors render services during the vesting period. We measure our liability, initially and at each reporting date until settled, at the fair value of the SARs, by applying an option valuation model, taking into account the terms and conditions on which the SARs were granted, and the extent to which the eligible key executives and advisors have rendered service to date. We recognize any changes in fair value at each reporting date until settled, in the consolidated statement of income for the year.

Leases

The determination of whether an arrangement contains a lease is based on the substance of the arrangement at the inception date of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset.

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. All other leases are classified as operating leases.

A finance lease gives rise to a depreciation expense for the asset, as well as an interest expense for each year. Finance charges are charged directly to current operations. The depreciation policy for leased assets is consistent with that for depreciable assets that are owned.

Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term, if there is no reasonable certainty that we will obtain ownership of the leased asset at the end of the lease term.

Revenue Recognition

Revenues for services are stated at amounts invoiced to customers, net of value-added tax, or VAT, or overseas communication tax, or OCT, where applicable. We provide wireless communication, fixed line communication, and ICT services. We provide such services to mobile, business, residential and payphone customers. Revenues represent the value of fixed consideration that have been received or are receivable. Revenues are recognized when there is evidence of an arrangement, collectibility is reasonably assured, and the delivery of the product or rendering of service has occurred. In certain circumstances, revenue is split into separately identifiable components and recognized when the related components are delivered in order to reflect the substance of the transactions. The value of components is determined using verifiable objective evidence. Under certain arrangements where the above criteria are met, but there is uncertainty regarding the outcome of the transaction for which service was rendered, revenue is recognized only to the extent of expenses incurred for rendering the service, and such amount is determined to be recoverable. We do not provide our customers with the right to a refund.

Service Revenues

Subscriptions

We provide telephone and data communication services under prepaid and postpaid payment arrangements. Installation and activation-related fees and the corresponding costs, not exceeding the activation revenue, are deferred and recognized over the expected average periods of customer relationship for fixed line and cellular services. Postpaid service arrangements include subscription fees, typically fixed monthly fees, which are recognized over the subscription period on a pro-rata basis.

Air time, traffic and value-added services

Prepaid service revenues collected in advance are deferred and recognized based on the earlier of actual usage or upon expiration of the usage period. Interconnection revenues for call termination, call transit, and network usage are recognized in the year the traffic occurs. Revenues related to local, long distance, network-to-network, roaming and international call connection services are recognized when the call is placed or connection is provided, net of amounts payable to other telecommunication carriers for terminating calls in their territories. Revenues related to products and value-added services are recognized upon delivery of the product or service.

Knowledge processing solutions

Revenue is recognized when it is probable that the economic benefits associated with the transactions will flow to us and the amount of revenue can be measured reliably. Advance customer receipts that have not been recognized as revenue are recorded as advances from customers and presented as a liability in the consolidated balance sheet. If the fee is not fixed or determinable, revenue is not recognized on those arrangements until the customer payment is received. For arrangements requiring specific customer acceptance, revenue recognition is deferred until the earlier of the end of the deemed acceptance period or until a written notice of acceptance is received from the customer. Revenue on services rendered to customers whose ability to pay is in doubt at the time of performance of services is also not recorded. Rather, revenue is recognized from these customers as payment is received.

Incentives

We record insignificant commission expenses based on the number of new subscriber connections initiated by certain dealers. All other cash incentives provided to dealers and customers are recorded as a reduction of revenue. Product-based incentives provided to dealers and customers as part of a transaction are accounted for as multiple element arrangements and recognized when earned.

Non-service Revenues

Handset and equipment sales

Sales of cellular handsets and communication equipment are recognized upon delivery to the customer.

Interest income

Interest income is recognized as it accrues on a time proportion basis taking into account the principal amount outstanding and the effective interest rate. The majority of interest income represents interest earned from cash and cash equivalents, short-term investments and investments in debt securities.

Income Taxes

Current income tax

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

Deferred income tax

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

Deferred income tax liabilities are recognized for all taxable temporary differences except: (1) when the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss and (2) with respect to taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is possible that the temporary differences will not reverse in the foreseeable future. Deferred income tax assets are recognized for all deductible temporary differences, carryforward benefit of unused tax credits from excess minimum corporate income tax, or MCIT, and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carryforward benefit of unused tax credits and unused tax losses can be utilized except: (1) when the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss and (2) with respect to deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax liabilities are not provided on non-taxable temporary differences associated with investments in domestic subsidiaries and associates. With respect to investments in other subsidiaries and associates, deferred income tax liabilities are recognized except when the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

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

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

Deferred income tax relating to items recognized directly in equity is included in the related equity account and not in the consolidated statement of income.

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

Investments and Other Financial Assets and Liabilities

Financial assets are categorized as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial investments, as appropriate. When financial assets are recognized initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. We determine the category of its financial assets on initial recognition and, where allowed and appropriate, re-evaluate this designation at each financial year-end.

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

Day 1 profit

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

Fair value

The fair value of investments that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's-length market transactions; reference to the current market value of another instrument which is substantially the same; discounted cash flow analysis or other valuation models.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held-for-trading and financial assets designated upon initial recognition as at fair value through profit or loss. Financial assets are classified as held-for-trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives, are also classified as held-for-trading unless they are designated as effective hedging instruments. Gains or losses on investments held-for-trading are recognized in profit or loss.

Financial assets may be designated at initial recognition as at fair value through profit or loss if any of the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets and liabilities or recognizing gains or losses on them on a different basis; or (ii) the assets and liabilities are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial assets and liabilities contain an embedded derivative that would need to be separately recorded. An embedded derivative is separated from the hybrid or combined contract if all the following conditions are met: (a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract; (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative and (c) the hybrid instrument is not recognized at fair value through profit or loss.

Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. We determine whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed and whether the change is significant relative to the previously expected cash flow on the contract.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, loans and receivables are carried at amortized cost using the effective interest method less any allowance for impairment. Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through the amortization process. Assets in this category are included in current assets, except for maturities greater than 12 months after the balance sheet date, which are classified as non-current assets.

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity when we have the positive intention and ability to hold to maturity. After initial measurement, held-to-maturity investments are measured at amortized cost using the effective interest rate method. Gains and losses are recognized in profit or loss when the investments are derecognized or impaired, as well as through the amortization process. Assets in this category are included under current assets, except for maturities greater than 12 months after the balance sheet date, which are classified as non-current assets.

Available-for-sale financial investments

Available-for-sale financial investments are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. They are purchased and held indefinitely, and may be sold in response to liquidity requirements or changes in market conditions. After initial measurement, available-for-sale financial investments are measured at fair value with unrealized gains or losses recognized directly in equity until the investment is derecognized or determined to be impaired at which time the cumulative gain or loss previously recorded in equity is recognized in profit or loss. They are included under non-current assets unless we intend to dispose of the investment within 12 months of the balance sheet date.

Impairment of Financial Assets

We assess at each balance sheet date whether a financial asset or group of financial assets is impaired.

Financial assets carried at amortized cost

For loans and receivables carried at amortized cost, we assess whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If we determine that no objective evidence of impairment exists for individually assessed financial asset, whether significant or not, we include the asset in a group of financial assets with similar credit risk characteristics and collectively assesses for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be recognized, are not included in a collective assessment for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred). The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan receivable has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate, adjusted for the original credit risk premium. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of loss is charged to the consolidated statement of income. Interest income continues to be recognized based on the original effective interest rate of the asset. Loans and receivables, together with the associated allowance accounts, are written-off when there is no realistic prospect of future recovery and all collateral has been realized. If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is reduced by adjusting the allowance account. If a future write-off is later recovered, any amount formerly charged is credited to the income account.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of such credit risk characteristics as industry, past-due or collectibility status and term.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period at which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist. Estimates of changes in future cash flows reflect, and are directionally consistent with changes in related observable data from period to period (such changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by management to reduce any differences between loss estimates and actual loss experience.

Available-for-sale financial investments

In case of equity investments classified as available-for-sale financial investments, an objective evidence of impairment would include a significant or prolonged decline in the fair value of the investments below its cost.

Where there is evidence of impairment, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the consolidated statement of income, is removed from equity and recognized in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income. Increases in fair value after impairment are recognized directly in equity.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset and is recorded as part of "Interest income" account in the consolidated statement of income. If, in subsequent year, the fair value of a debt instrument increased and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

Financial Liabilities

Interest-bearing loans and borrowings

All loans and borrowings are initially recognized at fair value less directly attributable transaction costs. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortized cost using the effective interest rate method.

Gains and losses are recognized in profit or loss when the liabilities are derecognized as well as through the amortization process.

Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include financial liabilities held-for-trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

Financial liabilities are classified as held-for-trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives are also classified as held-for-trading unless they are designated as effective hedging instruments.

Gains or losses on liabilities held-for-trading and those designated at fair value through profit or loss are recognized in profit or loss.

Derecognition of Financial Assets and Liabilities

Financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognized when: (1) the rights to receive cash flows from the asset have expired; (2) we retain the right to receive cash flows from the asset, but have assumed an obligation to pay them in full without material delay to a third party under a "pass through" arrangement; or (3) we have transferred our right to receive cash flows from the asset and either (a) have transferred substantially all the risks and rewards of the asset, or (b) have neither transferred nor retained substantially all the risks and rewards of the asset, but have transferred control of the asset.

Where we have transferred our right to receive cash flows from an asset and have neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of our continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that we could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of our continuing involvement is the amount of the transferred asset that we may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of our continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

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

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

Offsetting financial instruments

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

Derivative Financial Instruments and Hedging

We use derivative financial instruments, such as long-term currency swaps, foreign currency options, forward currency contracts and interest rate swaps, to hedge our risks associated with interest rate and foreign currency fluctuations. Such derivative financial instruments are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in fair value on derivatives during the year that do not qualify for hedge accounting are taken directly to the losses or gains on derivative financial instruments account in the consolidated statement of income.

The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of long-term currency swaps, foreign currency options and interest rate swap contracts is determined using applicable valuation techniques. See *Note 26 – Financial Assets and Liabilities*.

For the purpose of hedge accounting, hedges are classified as: (1) fair value hedges when hedging the exposure to changes in the fair value of a recognized financial asset or liability or an unrecognized firm commitment (except for foreign-currency risk); (2) cash flow hedges when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized financial asset or liability or a highly probable forecast transaction or the foreign-currency risk in an unrecognized firm commitment; or (3) hedges of a net investment in a foreign operation.

At the inception of a hedge relationship, we formally designate and document the hedge relationship to which we wish to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how we will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an on-going basis to determine that they actually have been highly effective throughout the financial reporting periods for which they are designated. For situation when that hedged item is a forecast transaction, we assess whether transaction is highly probable and prevent an exposure to variations in cash flows that could ultimately affect the consolidated statement of income.

Hedges which meet the strict criteria for hedge accounting are accounted for as follows:

Fair value hedges

The change in the fair value of a hedging derivative is recognized in the consolidated statement of income. The change in the fair value of the hedged item attributable to the risk being hedged is recorded as part of the carrying value of the hedged item and is also recognized in the consolidated statement of income.

The fair value for financial instruments traded in active markets at the balance sheet date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and asking prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. For all other financial instruments not listed in an active market, the fair value is determined by using an appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models, and other relevant valuation models.

When an unrecognized firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognized as financial asset or liability with a corresponding gain or loss recognized in the consolidated statement of income. The changes in the fair value of the hedging instrument are also recognized in the consolidated statement of income.

Cash flow hedges

The effective portion of the gain or loss on the hedging instrument is recognized directly in equity, while any ineffective portion is recognized immediately in the consolidated statement of income.

Amounts taken to equity are transferred to the consolidated statement of income when the hedged transaction affects the consolidated statement of income, such as when the hedged financial income or financial expense is recognized or when a forecast sale occurs. Where the hedged item is the cost of a non-financial asset or non-financial liability, the amounts taken to equity are transferred to the initial carrying amount of the non-financial asset or liability.

If the forecast transaction or firm commitment is no longer expected to occur, amounts previously recognized in equity are transferred to the consolidated statement of income. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, amounts previously recognized in equity remain in equity until the forecast transaction or firm commitment occurs.

Hedges of a net investment

Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment, are accounted for in a way similar to cash flow hedges. Gains or losses on the hedging instrument relating to the effective portion of the hedge are recognized directly in equity while any gains or losses relating to the ineffective portion are recognized in the consolidated statement of income. On disposal of the foreign operation, the cumulative value of any such gains or losses recognized directly in equity is transferred to the consolidated statement of income.

New Accounting Standards Subsequent to 2007

Set forth below are the new PFRS accounting standards and Philippine Interpretations that will become effective subsequent to December 31, 2007:

- **PFRS 8, "Operating Segments".** This standard will become effective for financial years beginning on or after January 1, 2009 and will replace PAS 14. This standard requires an entity to report financial and descriptive information about our reportable segments. The requirements of this standard will be included in our consolidated financial statements for the fiscal year ending December 31, 2009.
- **PAS 23, "Borrowing Costs" – Revised.** This standard will become effective for financial years beginning on or after January 1, 2009. The revised standard eliminates the option of expensing all borrowing costs and requires borrowing costs to be capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of those assets.
- **PAS 1, "Presentation of Financial Statements" – Revised.** This standard will become effective for financial years beginning on or after January 1, 2009. PAS 1 has been revised to enhance the usefulness of information presented in the consolidated financial statements. The key changes are: (1) the statement of changes in equity includes only transactions with owners and all non-owner changes are presented in equity as a single line with details included in a separate statement. Owners are defined as "holders of instruments classified as equity"; (2) the introduction of a new statement of comprehensive income that combines all items of income and expense recognized in profit or loss together with "other comprehensive income". The revisions specify what is included in other comprehensive income, such as gains and losses on available-for-sale financial investments, actuarial gains and losses on defined benefit pension plans and changes in the asset revaluation reserve. Entities can choose to present all items in one statement, or to present two linked statements, a separate consolidated statement of income and a statement of comprehensive income; (3) amounts reclassified to profit or loss that were previously recognized in other comprehensive income (for example, previously unrealized gains on available-for-sale financial investments that are sold) must be separately disclosed, either in the statement of comprehensive income itself or in the notes; (4) entities must disclose the income tax relating to each component of other comprehensive income. This can be presented in the statement of comprehensive income itself or in the notes; (5) when an entity restates its financial statements or retrospectively applies a new accounting policy, a statement of financial position must be presented as at the beginning of the earliest comparative period; (6) dividends to equity holders can now be shown only in the statement of changes in equity or in the notes; and (7) the introduction of new terminology, replacing "balance sheet" with "statement of financial position" and "cash flow statement"

with “statement of cash flows”, although the titles are not obligatory. The requirements of this standard will be included in our consolidated financial statements for the fiscal year ending December 31, 2009.

- **Philippine Interpretation IFRIC 11, “PFRS 2, Group and Treasury Share Transactions”.** This standard is effective for annual periods beginning on or after March 31, 2007. This interpretation addresses issues relating to whether transactions should be accounted for as equity-settled or as cash-settled under PFRS 2 and issues concerning share-based payment arrangement involving entities within the same group. The requirements of this interpretation will be included in our consolidated financial statements for our fiscal year beginning January 1, 2008.
- **Philippine Interpretation IFRIC 12, “Service Concession Arrangements”.** This interpretation has become effective for financial years beginning on or after January 1, 2008. This interpretation applies to contractual arrangements whereby a private sector party participates in the development, financing, operation and maintenance of infrastructure for public sector services. This interpretation is not relevant to our current operations.
- **Philippine Interpretation IFRIC 13, “Customer Loyalty Programmes”.** This interpretation will become effective for financial years beginning on or after July 1, 2008. This interpretation requires that loyalty award credits granted to customers as part of a sales transaction are accounted for as a separate component of the sales transactions. The consideration received in the sales transactions is allocated between the loyalty award credits and the other components of the sale. The amount allocated to the loyalty award credits is determined by reference to their fair value and is deferred until the awards are redeemed or the liability is otherwise extinguished. If the cost of fulfilling the awards is expected to exceed the consideration received, the entity will have an onerous contract and a liability for the excess must be recognized.
- **Philippine Interpretation IFRIC 14, “PAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction”.** This interpretation has become effective for financial years beginning on or after January 1, 2008. Philippine Interpretation IFRIC 14 addresses how to assess the limit under PAS 19, “Employee Benefits”, on the amount of the pension scheme surplus that can be recognized as an asset in our consolidated balance sheet, in particular, when a minimum funding requirement exists. The specific issues addressed by the interpretation are: (1) a refund is available to the entity only if there is an unconditional right to the refund and such refund is measured as the amount of the surplus at the balance sheet date less any associated costs; (2) when there is an unconditional right to a refund and there is no minimum funding requirement, an entity determines the benefit available as the lower of the surplus in the plan and the present value of the future service cost to the entity; (3) when a minimum funding requirement exists, the benefit available is the present value of the estimated future service cost less the estimated minimum funding contribution required in respect of the future accrual of benefits in that year; and (4) if an entity has a minimum funding requirement to pay additional contributions, the entity must determine whether the contributions will be available as a refund or reduction in future contributions after they are paid into the plan. If not, a liability is recognized when the obligation arises. The requirements of this interpretation will be included in our consolidated financial statements for our financial year beginning January 1, 2008.

We expect that the adoption of the pronouncements listed above will have no significant impact on our consolidated financial statements in the period of our initial application, except that management is still evaluating the impact of Philippine Interpretations IFRIC 11 and 13 and PFRS 8.

3. Management's Use of Judgments, Estimates and Assumptions

The preparation of our consolidated financial statements in conformity with PFRS requires us to make judgments, estimates and assumptions that affect the reported amounts of our revenues, expenses, assets and liabilities and disclosure of contingent liabilities at the reporting date. Due to uncertainties inherent in these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amount of the assets or liabilities affected in the future.

Judgments

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

Determination of functional currency

The functional currencies of the entities under PLDT Group are the currency of the primary economic environment in which each entity operates. It is the currency that mainly influences the revenue and cost of rendering services.

Based on the economic substance of the underlying circumstances relevant to the PLDT Group, the functional and presentation currency of the PLDT Group (except for SCH, SGP, 3rd Brand, Mabuhay Satellite, PLDT Global, Digital Paradise Thailand and SPi and certain of its subsidiaries) is the Philippine peso. The functional and presentation currency of Mabuhay Satellite, PLDT Global, SPi and certain of its subsidiaries is the U.S. dollar; Thai baht for Digital Paradise Thailand and Singapore dollar for SCH, SGP and 3rd Brand.

Leases

We have various lease agreements as a lessee in respect of our certain equipment and properties. We evaluate whether significant risks and rewards of ownership of the leased properties are transferred to us or retained at the lessor based on PAS 17, “Leases”, which requires us to make judgments and estimates of transfer of risk and rewards of ownership of the leased properties. Total lease expense arising from operating leases amounted to Php2,762 million, Php2,257 million and Php2,086 million for the years ended December 31, 2007, 2006 and 2005, respectively. Total finance lease obligations as at December 31, 2007 and 2006 amounted to Php496 million and Php1,030 million, respectively. See Note 18 – Interest-bearing Financial Liabilities, Note 24 – Contractual Obligations and Commercial Commitments and Note 26 – Financial Assets and Liabilities.

Determination of fair values of financial assets and liabilities

We carry certain of our financial assets and liabilities at fair value, which requires extensive use of accounting estimates and judgments for the fair values of financial assets and liabilities. In addition, certain liabilities acquired through debt exchange and restructuring are required to be carried at fair value at the time of the debt exchange and restructuring. See Note 26 – Financial Assets and Liabilities. While significant components of fair value measurement were determined using verifiable objective evidence (i.e., foreign exchange rates, interest rates and volatility rates), the amount of changes in fair value would differ if we utilized a different valuation methodology. Any change in fair value of these financial assets and liabilities would directly affect our consolidated statement of income and consolidated statement of changes in equity.

Total fair values of financial assets and liabilities as at December 31, 2007 amounted to Php46,661 million and Php111,086 million, respectively, while the total fair values of financial assets and liabilities as at December 31, 2006 amounted to Php36,517 million and Php124,801 million, respectively. See *Note 26 – Financial Assets and Liabilities*.

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 *Note 25 – Provisions and Contingencies*.

Estimates and Assumptions

The key estimates and assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

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 at each financial year-end and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or 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 the factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of our property, plant and equipment would increase our recorded operating expenses and decrease our non-current assets.

We recognized additional depreciation charges of Php796 million, Php8,624 million and Php7,806 million for the years ended December 31, 2007, 2006 and 2005, respectively, due to a change in the estimated useful lives of certain of our network assets owing to continuing network upgrade and expansion. The acceleration of depreciation is expected to result in a reduction of future monthly depreciation charges amounting to Php10 million going forward.

Total carrying values of property, plant and equipment, net of accumulated depreciation and amortization amounted to Php159,414 million and Php164,190 million as at December 31, 2007 and 2006, respectively. See *Note 8 – Property, Plant and Equipment* and *Note 26 – Financial Assets and Liabilities*.

Investment properties

We have adopted the fair value approach in determining the carrying value of our investment properties. We opted to rely on independent appraisers in determining the fair values of our investment properties, and such fair values were determined based on recent prices of similar properties, with adjustments to reflect any changes in economic conditions since the date of those transactions. The amounts and timing of recorded changes in fair value for any period would differ if we made different judgments and estimates or utilized a different basis for determining fair value.

Total carrying values of our investment properties as at December 31, 2007 and 2006 amounted to Php577 million and Php587 million, respectively. See *Note 10 – Investment Properties* and *Note 26 – Financial Assets and Liabilities*.

Goodwill and intangible assets

Our consolidated financial statements and results of operations reflect acquired businesses after the completion of the respective acquisition. We account for the acquired businesses using the purchase method of accounting which requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair market values of the acquiree's identifiable assets and liabilities at the acquisition date. Any excess in the purchase price over the estimated fair market values of the net assets acquired is recorded as goodwill in the consolidated balance sheet. Our business acquisitions have resulted in goodwill and intangible assets, which are subject to annual impairment test and amortization, respectively. See *Note 11 – Goodwill and Intangible Assets*. Thus, the numerous judgments made in estimating the fair market value to be assigned to the acquiree's assets and liabilities can materially affect our results of operations.

Total carrying values of goodwill and intangible assets as at December 31, 2007 and 2006 amounted to Php11,721 million and Php12,214 million, respectively.

Realizability of deferred income tax assets

We review the carrying amounts of deferred income 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 income tax assets to be utilized. Our assessment on the recognition of deferred income tax assets on deductible temporary differences is based on the level and timing of forecasted taxable income of the subsequent reporting periods. This forecast is based on our past results and future expectations on revenues and expenses as well as future tax planning strategies. However, there is no assurance that we will generate sufficient taxable income to allow all or part of our deferred income tax assets to be utilized.

Based on the above assessment, we have not recognized certain of our deferred income tax assets as at December 31, 2007 and 2006 amounting to Php1,122 million and Php299 million, respectively. Total deferred income tax assets as at December 31, 2007 and 2006 amounted to Php13,757 million and Php19,884 million, respectively, while total deferred income tax liabilities as at December 31, 2007 and 2006 amounted to Php2,155 million and Php402 million, respectively. See *Note 6 – Income Tax*.

Estimating allowance for doubtful accounts

We estimate the allowance for doubtful accounts related to our trade receivables that are specifically identified as doubtful of collection. The level of allowance is evaluated by management on the basis of factors that affect the collectibility of the accounts. 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 credit status based on third party credit reports and known market factors, to record specific reserves for customers against amounts due in order to reduce our receivables to amounts that we expect to collect. These specific reserves are re-evaluated and adjusted as additional information received affect the amounts estimated.

In addition to specific allowance against individually significant receivables, we also assess a collective impairment allowance against credit exposures of our customers which were grouped based on common credit characteristic, which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when the receivables were originally granted to customers. This collective allowance is based on historical loss experience using various factors such as historical performance of the customers within the collective group, deterioration in the markets in which the customers operate, and identified structural weaknesses or deterioration in the cash flows of customers.

Impairment provision for receivable recognized in consolidated statements of income amounted to Php417 million, Php736 million and Php2,251 million for the years ended December 31, 2007, 2006 and 2005, respectively. Trade and other receivables, net of impairment, amounted to Php12,645 million and Php10,158 million as at December 31, 2007 and 2006, respectively. See *Note 5 – Income and Expenses*, *Note 14 – Trade and Other Receivables* and *Note 26 – Financial Assets and Liabilities*.

Estimation of 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 23 – Share-based Payments and Employee Benefits* and include, among other things, discount rates, expected returns on plan assets and rates of compensation increases. 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 exceed 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. Total pension benefit costs amounted to Php1,773 million, Php1,003 million and Php776 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Unrecognized net actuarial gain as at December 31, 2007 amounted to Php1,344 million and unrecognized net actuarial loss as at December 31, 2006 amounted to Php4,657 million. The accrued benefit costs as at December 31, 2007 and 2006 amounted to Php2,985 million and Php2,888 million, respectively. See *Note 23 – Share-based Payments and Employee Benefits*.

Share-based payment transactions

Our LTIP grants SARs to our eligible key executives and advisors. Under the LTIP, we recognize the services we receive from the eligible key executives and advisors, and our liability to pay for those services, as the eligible key executives and advisors render services during the vesting period. We measure our liability, initially and at each reporting date until settled, at the fair value of the SARs, by applying an option valuation model, taking into account the terms and conditions on which the SARs were granted, and the extent to which the eligible key executives and advisors have rendered service to date. We recognize any changes in fair value at each reporting date until settled, in the results of operations for the year. The estimates and assumptions are described in *Note 23 – Share-based Payments and Employee Benefits* and include, among other things, annual stock volatility, risk-free interest rate, dividends yield, the remaining life of options, and the fair value of common stock. While management believes that the estimates and assumptions used are reasonable and appropriate, significant differences in our actual experience or significant changes in the estimates and assumptions may materially affect the stock compensation costs charged to operations. The fair value of the LTIP recognized as an expense for the years ended December 31, 2007, 2006 and 2005 amounted to Php1,448 million, Php3,150 million and Php1,214 million, respectively. As at December 31, 2007 and 2006, outstanding LTIP liability amounted to Php1,494 million and Php5,030 million, respectively. See *Note 5 – Income and Expenses* and *Note 23 – Share-based Payments and Employee Benefits*.

Asset retirement obligations

Asset retirement obligations are recognized in the period in which they are incurred if a reasonable estimate of fair value can be made. This requires an estimation of the cost to restore/dismantle on a per square meter basis, depending on the location, and is based on the best estimate of the expenditure required to settle the obligation at the future restoration/dismantlement date, discounted at the balance sheet date using a pre-tax rate that reflects the current market assessment of the time value of money and, where appropriate, the risk specific to the liability. Total provision for asset retirement obligations amounted to Php952 million and Php831 million as at December 31, 2007 and 2006, respectively. See *Note 8 – Property, Plant and Equipment* and *Note 19 – Deferred Credits and Other Noncurrent Liabilities*.

Asset impairment

PFRS requires that an impairment review be performed when certain impairment indicators are present. In the case of goodwill, at a minimum, such asset is subject to an annual impairment test and more frequently whenever there is an indication that such asset may be impaired. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires us to make an estimate of the expected future cash flows from the cash-generating unit and to choose a suitable discount rate in order to calculate the present value of those cash flows.

Determining the fair values of property, plant and equipment, investments and intangible assets, which requires the determination of future cash flows expected to be generated from the continued use and ultimate disposition of such assets, requires us to make estimates and assumptions 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 estimations and assumptions. 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 PFRS. Total impairment charges for the years ended December 31, 2007, 2006 and 2005 amounted to Php1,317 million, Php2,766 million and Php2,756 million, respectively. See *Note 4 – Segment Information* and *Note 5 – Income and Expenses*.

The carrying values of our property, plant and equipment, investments in associates, goodwill and intangible assets, trade and other receivables and inventories and supplies are separately disclosed in *Notes 8, 9, 11, 14 and 15*, respectively.

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 are not material to our consolidated

financial statements. Differences between the amounts initially recognized and the actual settlements are taken up in the accounts upon reconciliation. However, there is no assurance that such use of estimates will not result in 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.

Under certain arrangements with our knowledge processing solutions services, if there is uncertainty regarding the outcome of the transaction for which service was rendered, revenue is recognized only to the extent of expenses incurred for rendering the service and such amount is determined to be recoverable.

Customer relationship

We recognize our revenues from installation and activation related fees and the corresponding costs over the expected average periods of customer relationship for fixed line and cellular services. We estimate the expected average period of customer relationship based on our most recent churn-rate analysis.

4. Segment Information

Operating segments are components of the PLDT Group that engage in business activities from which they may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of PLDT), whose operating results are regularly reviewed by the enterprise's chief operating decision-maker to make decisions about how resources are to be allocated to the segment and assess their performances, and for which discrete financial information are available. The accounting policies of the reportable segments are the same as those described in *Note 2 – Summary of Significant Accounting Policies and Practices*.

We have organized our business into three main segments:

- Wireless – wireless telecommunications services provided through our cellular service providers namely, Smart and Piltel, SBI, our wireless broadband provider, Wolfpac, our wireless content operator, and Mabuhay Satellite and ACeS Philippines, our wireless broadband satellite and other service operators;
- Fixed Line – fixed line telecommunications services primarily provided through PLDT. We also provide fixed line services through PLDT's subsidiaries ClarkTel, SubicTel, Maratel, Piltel, BCC, PLDT Global and SNMI, which together account for approximately 3% of our consolidated fixed line subscribers; and
- ICT – information and communications infrastructure and services for internet applications, internet protocol-based solutions and multimedia content delivery provided by ePLDT; customer interaction services (formerly referred to as call center services) provided under the umbrella brand name *ePLDT Ventus*, including Ventus, Parlance and Vocativ; knowledge processing solutions services (formerly referred to as business process outsourcing) provided through the SPi Group (consolidated since July 11, 2006); and internet access and online gaming services provided by ePLDT's subsidiaries Infocom, Digital Paradise, Digital Paradise Thailand, netGames, Airborne Access and Level Up!.

Transfer prices between business segments are set on terms similar to transactions with third parties. Segment revenue, segment expense and segment result include transfers between business segments. These transfers are eliminated upon consolidation.

Most of our revenues are derived from our operations within the Philippines.

The segment assets and liabilities, results of operations and cash flows of our reportable segments as at and for the years ended December 31, 2007, 2006 and 2005 are as follows:

	Wireless	Fixed Line	ICT	Inter-segment Transactions	Total
(in million pesos)					
As at and for the year ended December 31, 2007					
Income					
Service revenues	86,497	48,551	10,055	(9,627)	135,476
External party	86,065	39,836	9,575	–	135,476
Inter-segment transactions	432	8,715	480	(9,627)	–
Foreign exchange gains – net	2,649	465	(138)	–	2,976
Non-service revenues (Note 5)	2,054	281	267	(122)	2,480
External party	2,054	281	145	–	2,480
Inter-segment transactions	–	–	122	(122)	–
Interest income	1,186	296	21	–	1,503
Other income	973	2,190	594	(90)	3,667
External party	939	2,140	588	–	3,667
Inter-segment transactions	34	50	6	(90)	–
Segment income	93,359	51,783	10,799	(9,839)	146,102
Result					
Income (loss) before income tax	45,731	7,668	(211)	69	53,257
Provision for (benefit from) income tax (Notes 2 and 6)	15,001	2,395	(117)	–	17,279
Net income (loss) for the year	30,730	5,273	(94)	69	35,978

	Wireless	Fixed Line	ICT	Inter-segment Transactions	Total
(in million pesos)					
Assets and liabilities					
Segment assets	90,708	180,529	18,290	(63,126)	226,401
Deferred income tax assets (Notes 2, 6 and 26)	1,640	12,040	77	–	13,757
Total assets	92,348	192,569	18,367	(63,126)	240,158
Segment liabilities	50,573	78,323	5,697	(9,101)	125,492
Deferred income tax liabilities (Notes 2, 6 and 26)	1,660	–	495	–	2,155
Total liabilities	52,233	78,323	6,192	(9,101)	127,647
Cash flows					
Net cash provided by (used in):					
Operating activities	49,616	25,274	2,529	(1)	77,418
Investing activities	(19,915)	26,092	(2,687)	(34,809)	(31,319)
Financing activities	(34,635)	(45,385)	391	34,810	(44,819)
Other segment information					
Capital expenditures	14,259	9,886	679	–	24,824
Depreciation and amortization (Note 8)	12,202	15,477	934	–	28,613
Interest on loans and related items – net (Note 5)	1,393	4,288	33	–	5,714
Provisions	–	666	–	–	666
Asset impairment (Notes 3, 5, 8, 9 and 11)	563	43	711	–	1,317
As at and for the year ended December 31, 2006 (As restated – Note 2)					
Income					
Service revenues	78,383	49,176	6,337	(8,920)	124,976
External party	77,820	41,300	5,856	–	124,976
Inter-segment transactions	563	7,876	481	(8,920)	–
Non-service revenues (Note 5)	2,457	79	553	(122)	2,967
External party	2,457	79	431	–	2,967
Inter-segment transactions	–	–	122	(122)	–
Foreign exchange gains – net	1,722	354	(109)	–	1,967
Interest income	1,197	441	16	–	1,654
Other income	706	5,006	128	(100)	5,740
External party	671	4,943	126	–	5,740
Inter-segment transactions	35	63	2	(100)	–
Segment income	84,465	55,056	6,925	(9,142)	137,304
Result					
Income (loss) before income tax	36,854	5,726	(349)	–	42,231
Provision for (benefit from) income tax (Notes 2 and 6)	6,478	449	(37)	–	6,890
Net income (loss) for the year	30,376	5,277	(312)	–	35,341
Assets and liabilities					
Segment assets	86,905	184,095	17,431	(66,197)	222,234
Deferred income tax assets (Notes 2, 6 and 26)	4,991	14,834	59	–	19,884
Total assets	91,896	198,929	17,490	(66,197)	242,118
Segment liabilities	48,751	91,874	3,396	(6,372)	137,649
Deferred income tax liabilities (Notes 2, 6 and 26)	6	–	396	–	402
Total liabilities	48,757	91,874	3,792	(6,372)	138,051
Cash flows					
Net cash provided by (used in):					
Operating activities	37,285	30,425	1,501	–	69,211
Investing activities	(15,855)	7,051	(11,708)	(15,278)	(35,790)
Financing activities	(30,438)	(41,264)	10,524	15,278	(45,900)

	Wireless	Fixed Line	ICT	Inter-segment Transactions	Total
(in million pesos)					
Other segment information					
Capital expenditures	10,490	9,052	1,132	–	20,674
Depreciation and amortization (Note 8)	10,752	20,406	711	–	31,869
Interest on loans and related items – net (Note 5)	1,386	5,953	20	–	7,359
Provisions	–	38	–	–	38
Asset impairment (Notes 3, 5, 8, 9 and 11)	2,220	54	492	–	2,766
As at and for the year ended December 31, 2005 (As restated – Note 2)					
Income					
Service revenues	74,677	49,705	2,953	(6,231)	121,104
External party	73,945	44,398	2,761	–	121,104
Inter-segment transactions	732	5,307	192	(6,231)	–
Foreign exchange gains – net	3,047	1,889	(30)	–	4,906
Non-service revenues (Note 5)	3,036	41	351	(116)	3,312
External party	3,036	41	235	–	3,312
Inter-segment transactions	–	–	116	(116)	–
Interest income	1,135	385	15	–	1,535
Equity share in net income of associates	–	–	7	–	7
Other income	1,445	286	127	(195)	1,663
External party	1,417	119	127	–	1,663
Inter-segment transactions	28	167	–	(195)	–
Segment income	83,340	52,306	3,423	(6,542)	132,527
Result					
Income before income tax	38,464	135	58	–	38,657
Provision for (benefit from) income tax (Notes 2 and 6)	4,800	(657)	12	–	4,155
Net income for the year	33,664	792	46	–	34,502
Assets and liabilities					
Segment assets	97,643	185,140	4,355	(52,398)	234,740
Deferred income tax assets (Notes 2 and 26)	2,022	13,674	5	–	15,701
Total assets	99,665	198,814	4,360	(52,398)	250,441
Segment liabilities	57,527	125,343	3,598	(9,968)	176,500
Deferred income tax liabilities (Notes 2 and 26)	44	–	6	–	50
Total liabilities	57,571	125,343	3,604	(9,968)	176,550
Cash flows					
Net cash provided by (used in):					
Operating activities	46,257	29,395	1,024	45	76,721
Investing activities	(5,937)	20,052	(734)	(25,075)	(11,694)
Financing activities	(34,745)	(51,375)	(212)	25,030	(61,302)
Other segment information					
Capital expenditures	8,827	5,543	620	–	14,990
Depreciation and amortization (Note 8)	10,156	20,251	415	–	30,822
Interest on loans and related items – net (Note 5)	1,714	8,639	24	–	10,377
Provisions	–	196	–	–	196
Asset impairment (Notes 3, 5, 8, 9 and 11)	575	2,101	80	–	2,756

5. Income and Expenses

Non-service Revenues

	2007	2006	2005
		(in million pesos)	
Sale of computers, cellular handsets and cellular SIM-packs	2,335	2,536	3,077
Point-product sales	145	431	235
(Note 4)	2,480	2,967	3,312

Compensation and Employee Benefits

	2007	2006	2005
		(in million pesos)	
Salaries and other employee benefits	16,645	13,761	11,688
Pension (Notes 3 and 23)	1,773	1,003	776
Incentive plans (Notes 3 and 23)	1,448	3,150	1,214
Manpower rightsizing program, or MRP	604	445	458
	20,470	18,359	14,136

Over the past years, PLDT has been implementing its MRP in line with its continuing effort to reduce the cost base of its fixed line business. The total MRP cost charged to operations for the years ended December 31, 2007, 2006 and 2005 amounted to Php604 million, Php445 million and Php458 million, respectively. The decision to implement the MRP was anchored on the challenges being faced by the fixed line business as significant changes in technology, increasing competition, and shifting market preferences to cellular use have reshaped the future of the fixed line business. The MRP is being implemented in compliance with the Labor Code of the Philippines and all other relevant labor laws and regulations in the Philippines.

Professional and Other Contracted Services

	2007	2006	2005
		(in million pesos)	
Technical and consultancy fees (Note 22)	3,625	1,909	1,419
Contracted services	1,641	948	470
Legal and audit fees	203	219	508
Other services	119	73	67
	5,588	3,149	2,464

Cost of Sales

	2007	2006	2005
		(in million pesos)	
Cost of computers, cellular handsets and cellular SIM-packs sold	4,430	4,847	5,958
Cost of point-product sales	254	476	300
Cost of satellite air time and terminal units (Notes 22 and 24)	160	199	243
	4,844	5,522	6,501

Financing Costs – net

	2007	2006	2005
		(in million pesos)	
Interest on loans and related items (Notes 18 and 26)	6,256	7,908	10,881
Accretion on financial liabilities – net (Notes 2, 18 and 26)	1,161	3,314	2,882
Financing charges (Note 26)	196	51	202
Dividends on preferred stock subject to mandatory redemption (Notes 7 and 18)	17	130	251
Capitalized interest (Notes 2 and 8)	(542)	(549)	(504)
	7,088	10,854	13,712

Interest expense for short-term borrowings for the years ended December 31, 2007, 2006 and 2005 amounted to Php32 million, Php10 million and Php2 million, respectively.

Asset Impairment

	2007	2006	2005
		(in million pesos)	
Goodwill and intangible assets (Note 11)	1,244	50	–
Trade and other receivables (Notes 3 and 14)	417	736	2,251
Inventories and supplies (Note 15)	243	211	479
Reversal of impairment in investment in debt securities (Notes 9 and 13)	(616)	–	–
Property, plant and equipment (Note 8)	–	1,402	26
Notes receivable	–	346	–
Other assets	29	21	–
	1,317	2,766	2,756

6. Income Tax

The net components of deferred income tax assets (liabilities) recognized in the consolidated balance sheets are as follows:

	2007	2006
		(As restated – Note 2)
	(in million pesos)	
Net assets	13,757	19,884
Net liabilities	(2,155)	(402)

The components of the consolidated net deferred income tax assets and liabilities are as follows:

	2007	2006
		(As restated – Note 2)
	(in million pesos)	
Net assets:		
Net operating loss carryover, or NOLCO	6,055	4,983
Accumulated allowance for doubtful accounts	3,428	4,746
Derivative financial instruments	2,308	1,878
Unearned revenues	1,789	2,301
Pension and other employee benefits	1,096	2,568
Unamortized past service pension costs	985	871
Asset impairment	824	5,432
MCIT	645	982
Unrealized foreign exchange losses	544	2,632
Provisions for impaired assets	494	732
Accumulated write-down of inventories to net realizable values	224	321
Leases	160	304
Executive stock option plan	32	106
Intangible assets and fair value adjustments on assets acquired	2	(391)
Excess of fair value over cost of investment properties	(80)	(77)
Preferred stock subject to mandatory redemption	(100)	(109)
Capitalized taxes and duties – net of amortization	(376)	(446)
Capitalized foreign exchange differential	(783)	(988)
Undepreciated capitalized interest charges	(3,572)	(4,607)
Gain on debt exchange and debt restructuring transactions	–	(1,650)
Asset retirement obligation – net of undepreciated capitalized asset	–	191
Others	82	105
	13,757	19,884
Net liabilities:		
Unearned revenues	825	(1)
Provisions for impaired assets	348	–
Asset retirement obligation – net of undepreciated capitalized asset	332	–
Accumulated provision for doubtful accounts	304	–
Asset impairment	277	–
Pension and other employee benefits	217	–
Leases	42	–
Unamortized past service pension costs	7	–
Excess of fair value over cost of investment properties	(60)	(38)
Derivative financial instruments	(164)	–
Interest charges capitalized	(718)	–
Intangible assets and fair value adjustments on assets acquired	(736)	(357)
Gain on debt exchange and debt restructuring transactions	(1,228)	–
Unrealized foreign exchange gains	(1,613)	(6)
Others	12	–
	(2,155)	(402)

Provision for corporate income tax consists of:

	2007	2006	2005
		(As restated – Note 2)	
		(in million pesos)	
Current	10,773	10,035	8,583
Deferred	6,506	(3,145)	(4,428)
	17,279	6,890	4,155

The reconciliation between the provision for income tax at the applicable statutory tax rates and the actual provision for corporate income tax is as follows:

	2007	2006	2005
		(As restated – Note 2)	
		(in million pesos)	
Provision for corporate income tax at the applicable statutory tax rates	18,640	14,781	12,563
Tax effects of:			
Non-deductible expenses	333	751	204
Loss subject to lower tax rate	55	154	6
Equity share in net loss (income) of investees	3	18	(2)
Loss (income) not subject to tax	(420)	(2,375)	283
Income subject to final tax	(509)	(550)	(496)
Net movement in unrecognized deferred income tax assets	(823)	(5,889)	(8,403)
Actual provision for corporate income tax (Note 4)	17,279	6,890	4,155

Mabuhay Satellite and SubicTel are registered as Subic Bay Freeport Enterprises while ClarkTel is registered as a Clark Special Economic Zone Enterprise under Republic Act No. 7227, or R.A. 7227, otherwise known as the Bases Conversion and Development Act of 1992. As registrants, Mabuhay Satellite, SubicTel and ClarkTel are entitled to all the rights, privileges and benefits established thereunder including tax and duty-free importation of capital equipment and a special income tax rate of 5% of gross income, as defined in R.A. 7227.

On December 22, 2000, the Philippine Board of Investments, or BOI, approved ePLDT's registration as a new information technology, or IT, service firm in the field of services related to its internet data center on a pioneer status. As such, ePLDT enjoyed, among other incentives, a six-year income tax holiday, or ITH, starting January 2001 until January 2007.

On January 3, 2007, the BOI approved ePLDT's application for pioneer status for its new data center facility as a new IT service firm in the field of services related to Internet Data Center. ePLDT was granted a six-year ITH for its new data center facility from the earlier of January 2007 and the actual start of commercial operations. ePLDT started commercial operations of its new data center facility in February 2007.

On August 13, 2007, ePLDT received approval from the Philippine Economic Zone Authority, or PEZA, to declare the Vitro Data Center Building as a PEZA-registered IT Building EcoZone facility enabling prospective clients to apply for fiscal incentives should they qualify as a PEZA-registered entity. However, ePLDT as a developer and operator of Vitro Data Center Building is not entitled to PEZA incentives under R.A. No. 7916, or R.A. 7916, otherwise known as "The Special Economic Zone Act of 1995", as amended by Republic Act No. 8748, or R.A. 8748.

Parlance is registered with the BOI as a new IT export service firm in the field of customer interaction center on a pioneer status. Under this registration, Parlance is entitled to certain tax incentives, including an ITH for six years starting in June 2002. Parlance is required to comply with specific terms and conditions stated in its BOI registration.

Vocativ is registered with the PEZA as an Ecozone Export Enterprise to develop and operate a customer interaction services that serves overseas clients by providing customer relationship management services. As a registered enterprise, Vocativ is entitled to certain tax and non-tax incentives which include, among other things, tax and duty-free importations, exemption from local tax and an ITH for four years from start of commercial operations. After the ITH period, Vocativ is liable for a final tax, in lieu of all taxes, of 5% gross income less allowable deductions as defined under R.A. 7916. The 5% final tax must be paid and remitted in accordance with the amendments contained in R.A. 8748, as follows: (a) 3% to the National Government; and (b) 2% which will be directly remitted by the business establishments to the treasurer's office of the municipality or city where the enterprise is located.

On December 5, 2005, Vocativ received approval from PEZA for the adjustment of the start of its commercial operations, effectively extending the ITH to end of March 2006. On June 30, 2006, PEZA approved Vocativ's ITH extension for another year until April 2007. On September 3, 2007, PEZA again approved Vocativ's ITH extension for another year until March 2008.

Ventus and two of its customer interaction projects are registered with the BOI as a new IT export service firm in the field of customer interaction center on a pioneer status. Under their registrations, Ventus, Ventus Iloilo and Pasig customer interaction projects are entitled to certain tax incentives such as an ITH for six years starting March 2005 for Ventus and Ventus Iloilo customer interaction projects and August 2006 for Ventus Pasig customer interaction project. In relation to this, they are required to comply with specific terms and conditions stated in their BOI registration.

iPlus Intelligent Network, Inc., or iPlus, is a wholly-owned subsidiary of ePLDT and is registered with the BOI as a new IT service firm in the field of application service provider on a pioneer status. Under such registration, iPlus is entitled to a six-year ITH incentive from the actual start of commercial operations until January 1, 2009.

mySecureSign, Inc., or mSSI, is a wholly-owned subsidiary of ePLDT and is registered with the BOI as a new IT service firm in the field of services related to public key infrastructure on a pioneer status. Under such registration, mSSI enjoyed, among other incentives, a six-year ITH from August 1, 2001.

Digital Paradise is registered with the BOI as a new IT service firm in the field of community access on a non-pioneer status. Under the provisions of the registration, Digital Paradise's sales generated from its own community access activity and franchise fees are entitled to an ITH for a period of four years beginning December 2002. In December 2006, the BOI approved Digital Paradise's application for a status upgrade from non-pioneer to pioneer, accordingly extending the ITH period for another two years starting January 2007.

Level Up! was originally registered with the BOI as a new IT service firm in the field of application service provider on a non-pioneer status. Under such registration, Level Up! is entitled to certain tax incentives, which includes a four-year ITH from January 2003 and a tax credit for taxes on duties on materials used in export products for ten years starting January 2003. In April 2004, the BOI approved Level Up!'s request for upgrading its status from non-pioneer to pioneer in connection with its IT service activity in the field of application service provider for entertainment and educational project. Accordingly, the ITH period was extended from four years to six years to expire on January 2009.

In September 2006, PEZA approved SPI's application for registration as an ecozone information technology enterprise to provide IT enabled services with emphasis on the creation of electronic discovery, presentation of content in electronic information formats, data analysis, capture, abstracting and data processing, design, development and implementation of healthcare documentation solutions. As a registered enterprise, SPI is entitled to certain tax and non-tax incentives which include, among other things, tax and duty-free importations, exemption from local tax and an ITH for four years starting from June 2002. After the ITH period, SPI is liable for a final tax, in lieu of all taxes. The final tax is computed at 5% of gross income, in lieu of all taxes, less allowable deductions as defined under R.A. 7916 and will be paid and remitted in accordance with the amendments contained in R.A. 8748, as follows: (a) 3% to the National Government; and (b) 2% which will be directly remitted by the business establishments to the treasurer's office of the municipality or city where the enterprise is located.

Wolfpac is registered with the BOI as a new operator of service provider applications. Under the terms of its registration, it is entitled to certain tax and non-tax incentives which include, among other things, an ITH for four years starting February 2004.

On November 29, 2007, the BOI approved Wolfpac's application for a one year extension of ITH incentive on the basis that the capital equipment to labor ratio did not exceed US\$10 million as provided under Article 39 of Executive Order, or E.O. 226. The approved bonus is for the period from February 13, 2008 to February 12, 2009.

Smart Broadband, Inc., or SBI has three registered activities with the BOI on a pioneer status, namely: (i) a new operator of telecommunications systems (inter-exchange carrier for data services); (ii) new information technology service firm in the field of providing internet services; and (iii) a new operator of telecommunications facilities (nationwide broadband wireless access). Under the terms of these registrations, SBI is entitled to certain tax and non-tax incentives which include, among other things, an ITH for six years until February 2007, August 2007 and July 2011, respectively. After the ITH period, SBI is liable for a 30% regular corporate income tax or 2% MCIT, whichever is higher.

Income derived from non-registered activities with the BOI is subject to the regular corporate income tax rate enacted as at the balance sheet date.

Consolidated tax incentives that we availed for the years ended December 31, 2007, 2006 and 2005 amounted to Php766 million, Php142 million and Php235 million, respectively.

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; and
- 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 Php1 million.

Our deferred income tax assets have been recorded to the extent that such deferred income tax assets are expected to be utilized against sufficient future taxable profit. We had unrecognized deferred income tax assets of Php1,122 million and Php299 million largely pertaining to MCIT and asset impairments as at December 31, 2007 and 2006, respectively.

The breakdown of our consolidated unutilized NOLCO as at December 31, 2007 is as follows:

Year Incurred	Year Expiring	(in million pesos)
2005	2008	11,383
2006	2009	5,424
2007	2010	931
		17,738
Tax benefit from NOLCO		6,060
Unrecognized deferred income tax assets from NOLCO as at December 31, 2007		(5)
		6,055

The breakdown of our consolidated excess MCIT as at December 31, 2007 is as follows:

Year Incurred	Year Expiring	(in million pesos)
2005	2008	484
2006	2009	499
2007	2010	645
		1,628
Unrecognized deferred income tax assets from MCIT as at December 31, 2007		(983)
		645

7. Earnings Per Common Share

The following table presents information necessary to calculate the earnings per common share:

	2007		2006		2005	
	Basic	Diluted	Basic	Diluted	Basic	Diluted
	(As restated – Note 2)					
	(in million pesos)					
Consolidated net income attributable to equity holders of PLDT	36,004	36,004	35,138	35,138	34,135	34,135
Dividends on convertible preferred shares	(457)	(457)	(455)	(455)	(1,426)	(49)
Indicative share in net income in subsidiaries	-	-	-	-	7	7
Dividends on dilutive preferred stock subject to mandatory redemption charged to interest expense for the year	-	17	-	-	-	230
Accretion of preferred stock subject to mandatory redemption	-	131	-	-	-	1,233
Foreign exchange gains on preferred stock subject to mandatory redemption	-	(182)	-	-	-	(1,536)
Consolidated net income applicable to common shares	35,547	35,513	34,683	34,683	32,716	34,020
	(in thousands, except per share amounts)					
Outstanding common shares at beginning of year	188,435	188,435	180,789	180,789	170,214	170,214
Effect of issuance of common shares during the year	221	221	3,667	3,667	1,855	1,855
Average incremental number of shares under ESOP during the year	-	38	-	98	-	94
Common shares equivalent of convertible preferred shares deemed dilutive:						
Preferred Stock Series VI (Note 18)	-	680	-	-	-	4,399
Preferred Stock Series A to EE (Note 17)	-	-	-	-	-	2,617
Preferred Stock Series VII (Note 18)	-	-	-	-	-	3,842
Weighted average number of common shares for the year	188,656	189,374	184,456	184,554	172,069	183,021
Earnings per common share	Php188.42	Php187.53	Php188.03	Php187.93	Php190.13	Php185.88

Basic EPS is calculated by dividing the consolidated net income for the year attributable to common shareholders (consolidated net income adjusted for dividends on all series of preferred shares except for dividends on preferred stock subject to mandatory redemption) by the weighted average number of common shares outstanding during the year, after giving retroactive effect to any stock dividend declarations.

Diluted EPS is calculated in the same manner assuming that, at the beginning of the year or at the time of issuance during the year, all outstanding options are exercised and convertible preferred shares are converted to common shares, and appropriate adjustments to consolidated net income are effected for the related income and expenses on preferred shares. Outstanding stock options will have a dilutive effect only when the average market price of the underlying common share during the year exceeds the exercise price of the option.

Where the effect of the assumed conversion of the preferred shares and the exercise of all outstanding options have an anti-dilutive effect, basic and diluted EPS are stated at the same amount.

When required dividends declared on each series of convertible preferred shares divided by the number of equivalent common shares, assuming such convertible preferred shares are converted to common shares, decreases the basic EPS, then such convertible preferred shares are deemed dilutive. As such, the diluted EPS is calculated by dividing the consolidated net income attributable to common shareholders (consolidated net income, adding back any dividends and/or other charges recognized for the year related to the dilutive convertible preferred shares classified as liability, less dividends on non-dilutive preferred shares except for dividends on preferred stock subject to mandatory redemption) by the weighted average number of common shares including the common share equivalent arising from the conversion of the dilutive convertible preferred shares.

Series VI Convertible Preferred Stocks in 2007 and Series A to EE, VI and VII Convertible Preferred Stocks in 2005 were deemed dilutive based on a calculation of the required dividends on these preferred shares divided by the number of equivalent common shares assuming such preferred shares are converted into common shares, including the effect of shares under ESOP, and compared against the basic EPS. Since the amount of dividends on the Series A to EE and Series V Convertible Preferred Stocks in 2007 and Series A to EE, V and VI Convertible Preferred Stocks in 2006 over its equivalent number of common shares increased the basic EPS, these Convertible Preferred Stocks were anti-dilutive.

Dividends Declared For The Year Ended December 31, 2007

Class	Date			Amount	
	Approved	Record	Payable	Per Share	Total (in million pesos)
Preferred Stock Subject to Mandatory Redemption					
Series V	March 6, 2007	March 20, 2007	April 15, 2007	Php4.675	–
	June 12, 2007	June 28, 2007	July 15, 2007	4.675	–
	September 14, 2007	September 28, 2007	October 15, 2007	4.675	–
	December 1, 2007	December 21, 2007	January 15, 2008	4.675	–
Series VI	March 6, 2007	March 20, 2007	April 15, 2007	US\$0.09925	4
	June 12, 2007	June 28, 2007	July 15, 2007	0.09925	3
	September 14, 2007	September 28, 2007	October 15, 2007	0.09925	3
	December 1, 2007	December 21, 2007	January 15, 2008	0.09925	3
Charged to income					13
10% Cumulative Convertible Preferred Stock					
Series CC	January 30, 2007	February 28, 2007	March 30, 2007	Php1.00	17
Series DD	January 31, 2007	February 15, 2007	February 28, 2007	1.00	2
Series EE	March 27, 2007	April 26, 2007	May 31, 2007	1.00	–
Series A, I, R, W, AA and BB	July 10, 2007	August 1, 2007	August 31, 2007	1.00	129
Series B, F, Q, V and Z	August 7, 2007	September 3, 2007	September 28, 2007	1.00	91
Series E, K, O and U	September 14, 2007	October 4, 2007	October 31, 2007	1.00	44
Series C, D, J, T and X	September 14, 2007	October 14, 2007	November 27, 2007	1.00	57
Series G, N, P and S	November 6, 2007	December 6, 2007	December 28, 2007	1.00	27
Series H, L, M and Y	December 1, 2007	December 28, 2007	January 31, 2008	1.00	41
					408
Cumulative Non-Convertible Redeemable Preferred Stock					
Series IV*	January 30, 2007	February 23, 2007	March 15, 2007	Php–	12
	May 8, 2007	May 25, 2007	June 15, 2007	–	13
	July 10, 2007	August 9, 2007	September 15, 2007	–	12
	November 6, 2007	November 23, 2007	December 15, 2007	–	12
					49
Common Stock					
Regular Dividend	March 6, 2007	March 20, 2007	April 20, 2007	Php50.00	9,429
	August 7, 2007	August 24, 2007	September 24, 2007	60.00	11,322
Special Dividend	August 7, 2007	August 24, 2007	September 24, 2007	40.00	7,548
					28,299
Charged to retained earnings					28,756

* Dividends are declared based on total amount paid up.

Dividends Declared After December 31, 2007

Class	Date			Amount	
	Approved	Record	Payable	Per Share	Total (in million pesos)
Cumulative Non-Convertible Redeemable Preferred Stock					
Series IV*	January 29, 2008	February 22, 2008	March 15, 2008	Php–	12
10% Cumulative Convertible Preferred Stock					
Series CC	January 29, 2008	February 28, 2008	March 31, 2008	Php1.00	17
Series DD	January 29, 2008	February 15, 2008	February 29, 2008	1.00	2
					19
Convertible Preferred Stock					
Series V	March 4, 2008	March 20, 2008	April 15, 2008	Php4.675	–
Series VI	March 4, 2008	March 20, 2008	April 15, 2008	US\$0.09925	3
					3

Class	Date			Amount	
	Approved	Record	Payable	Per Share	Total (in million pesos)
Common Stock					
Regular Dividend	March 4, 2008	March 19, 2008	April 21, 2008	Php68.00	12,834
Special Dividend	March 4, 2008	March 19, 2008	April 21, 2008	56.00	10,570
					23,404
					23,438

* Dividends are declared based on total amount paid up.

8. Property, Plant and Equipment

This account consists of:

	Cable and wire facilities	Central office equipment	Cellular facilities	Buildings	Vehicles, furniture and other network equipment	Communications satellite	Information origination and termination equipment	Land and land improvements	Property under construction	Total
(in million pesos)										
At December 31, 2005										
Cost	107,781	82,353	61,043	19,727	27,923	10,560	7,918	2,438	11,794	331,537
Accumulated depreciation and amortization	(41,262)	(46,259)	(29,410)	(5,196)	(21,056)	(6,083)	(5,048)	(249)	-	(154,563)
Net book value	66,519	36,094	31,633	14,531	6,867	4,477	2,870	2,189	11,794	176,974
Year Ended December 31, 2006										
Net book value at beginning of year	66,519	36,094	31,633	14,531	6,867	4,477	2,870	2,189	11,794	176,974
Additions/Transfers – net	4,900	3,277	6,562	601	2,193	-	1,351	230	1,084	20,198
Disposals/Retirements	(38)	(158)	(103)	(71)	99	-	(2)	(4)	(223)	(500)
Translation differences charged directly to cumulative translation adjustments	-	(35)	-	(7)	(73)	(311)	-	-	-	(426)
Acquisition through business combination	-	(13)	-	273	903	-	1	20	31	1,215
Reclassifications	2	91	(99)	8	(2)	-	-	-	-	-
Impairment losses recognized during the year (Note 5)	-	(3)	-	(5)	(3)	(1,391)	-	-	-	(1,402)
Depreciation and amortization (Note 4)	(5,356)	(12,941)	(6,459)	(1,189)	(4,406)	(619)	(880)	(19)	-	(31,869)
Net book value at end of year (Note 3)	66,027	26,312	31,534	14,141	5,578	2,156	3,340	2,416	12,686	164,190
Year Ended December 31, 2007										
Net book value at beginning of year	66,027	26,312	31,534	14,141	5,578	2,156	3,340	2,416	12,686	164,190
Additions/Transfers – net	4,769	2,254	3,018	408	1,811	-	1,633	1	10,914	24,808
Disposals/Retirements	(183)	(55)	(75)	(11)	(45)	-	-	(41)	(31)	(441)
Translation differences charged directly to cumulative translation adjustments	-	5	-	(77)	(103)	(495)	-	(84)	-	(754)
Acquisition through business combination	-	99	-	18	146	-	(32)	-	(7)	224
Reclassifications	894	3	4,923	31	888	-	(1,709)	-	(5,030)	-
Depreciation and amortization (Note 4)	(8,449)	(6,063)	(7,530)	(1,138)	(3,426)	(556)	(1,448)	(3)	-	(28,613)
Net book value at end of year (Note 3)	63,058	22,555	31,870	13,372	4,849	1,105	1,784	2,289	18,532	159,414
At December 31, 2007										
Cost	117,081	86,841	70,045	20,695	32,572	8,454	8,191	2,561	18,532	364,972
Accumulated depreciation and amortization	(54,023)	(64,286)	(38,175)	(7,323)	(27,723)	(7,349)	(6,407)	(272)	-	(205,558)
Net book value (Note 3)	63,058	22,555	31,870	13,372	4,849	1,105	1,784	2,289	18,532	159,414

Substantially, all our telecommunications equipment is purchased from outside the Philippines. Our significant sources of financing for such purchases are foreign loans requiring repayment in currencies other than Philippine pesos, principally in U.S. dollars. See *Note 18 – Interest-bearing Financial Liabilities*. Interest, using an average capitalization rate of 10%, and net foreign exchange losses capitalized to property, plant and equipment qualified as borrowing costs for the years ended December 31, 2007, 2006 and 2005 were as follows:

	2007	2006	2005
		(in million pesos)	
Interest (Notes 2 and 5)	542	549	504
Foreign exchange gains – net	63	521	607

As at December 31, 2007, 2006 and 2005, the undepreciated capitalized net foreign exchange losses which qualified as borrowing costs amounted to Php2,533 million, Php3,117 million and Php4,276 million, respectively.

The consolidated useful lives of the assets are estimated as follows:

Buildings	25 years
Cable and wire facilities	10 – 25 years
Central office equipment	10 – 20 years
Communications satellite	15 years
Information origination and termination equipment	3 – 15 years
Land improvements	10 years
Vehicles, furniture and other network equipment	3 – 10 years
Cellular facilities	3 – 10 years

We recognized additional depreciation charges of Php796 million, Php8,624 million and Php7,806 million for the years ended December 31, 2007, 2006 and 2005, respectively, due to a change in the estimated useful lives of certain of our network assets owing to continuing network upgrade and expansion. The acceleration of depreciation is expected to result in a reduction of future monthly depreciation charge amounting to Php10 million going forward.

SBI's Acquisition of Cluster 3 Assets from Cruz Telephone Company, Inc., or Cruztelco

On February 1, 2008, SBI completed the acquisition of the Cluster 3 assets from Cruztelco at a price of Php371 million. Cruztelco is a Local Exchange Carrier operator offering fixed line services in three geographical clusters, namely: (i) Cluster 1 covering certain areas in Visayas and Luzon; (ii) Cluster 2 North Western Mindanao, and (iii) Cluster 3 North Eastern Mindanao.

The fair value of the Cluster 3 assets, determined provisionally, was assessed to be equal to its book value allocated as follows: (a) equipment at Php318 million; (b) land at Php31 million; and (c) buildings and improvements at Php22 million.

SBI intends to engage an independent appraiser to establish the fair values of the acquired assets.

Asset Impairment Review

As at December 31, 2006, management determined that due to Mabuhay Satellite's difficulty in generating cash flows with the satellite nearing its end-of-life and other events affecting its business, Mabuhay Satellite's Agila II transponder was considered impaired. This impairment review was based on the net present value of future cash flows from the continued use of this asset group using the discount factor of 10% as applied on cash flow projection from 2008 until 2010. An impairment loss of Php1,391 million was charged to the carrying value of this satellite as at December 31, 2006 and included in the accumulated depreciation and amortization account in the consolidated balance sheet as at December 31, 2006. In 2007, we performed an impairment update review on Mabuhay Satellite's Agila II and no additional impairment was recognized.

Property, plant and equipment include the following amounts for capitalized leases as at December 31, 2007 and 2006:

	2007			2006		
	Central office equipment	Vehicles, furniture and other network equipment	Total (in million pesos)	Central office equipment	Vehicles, furniture and other network equipment	Total
Cost	354	1,190	1,544	354	1,183	1,537
Less accumulated depreciation	333	1,109	1,442	310	950	1,260
	21	81	102	44	233	277

The following table summarizes all changes to the liabilities on asset retirement obligations as at December 31, 2007 and 2006:

	2007	2006
	(in million pesos)	
Asset retirement obligations at beginning of year	831	752
Accretion expenses	81	87
Additional liability recognized during the year	48	45
Settlement of obligations	(8)	(53)
Asset retirement obligations at end of year (Notes 3 and 19)	952	831

9. Investments in Associates and Joint Ventures

This account consists of:

	2007	2006
	(in million pesos)	
ACeS International Limited	1,896	1,896
Mabuhay Space Holdings Limited	791	937
Blue Ocean Wireless	724	–
Philweb Corporation	712	712
BayanTrade Dotcom, Inc.	97	97
ePDS, Inc.	6	6
	4,226	3,648
Less accumulated impairment losses and equity share in net losses of associates	2,875	3,012
	1,351	636

Movements in the accumulated equity share in net losses of associates are as follows:

	2007	2006
	(in million pesos)	
Balance at beginning of year	82	134
Equity in net losses (gains) of associates for the year	11	(52)
Balance at end of year	93	82

Movements in the accumulated impairment losses are as follows:

	2007	2006
	(in million pesos)	
Balance at beginning of year	2,930	2,725
Translation adjustments	(148)	(77)
Impairment losses for the year	–	282
Balance at end of year	2,782	2,930

Investment of ACeS Philippines in ACeS International Limited, or AIL

As at December 31, 2007, ACeS Philippines had a 36.99% investment in AIL, a company incorporated under the laws of Bermuda. AIL owns the Garuda I Satellite and the related system control equipment in Batam, Indonesia.

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 National Service Providers', or NSPs, inability to generate the amount of revenues originally expected as the growth in subscriber numbers has been significantly lower than budgeted. These factors raised substantial doubt about AIL's ability to continue as a going concern. On this basis, we recognized a full impairment provision in respect of our investment in AIL in 2003.

See Note 22 – Related Party Transactions and Note 24 – Contractual Obligations and Commercial Commitments for further details as to the contractual relationships in respect of AIL.

Investment of Mabuhay Satellite in Mabuhay Space Holdings Limited, or MSHL

In 1996, Mabuhay Satellite entered into a Joint Venture Agreement, or JVA, with Space Systems/Loral Inc., or SS/L, to form MSHL for the purpose of providing high-power Ku-Band satellite transmission services using the payload which was added by SS/L to the Agila II Satellite. Under the terms of the JVA, SS/L is required to convey title to the additional payload service to MSHL in consideration for SS/L's 35% equity interest in MSHL, and Mabuhay Satellite is required to pay SS/L in the amount of US\$19 million for a 65% equity interest in MSHL.

In 2000, SS/L filed a Notice of Default and Termination against Mabuhay Satellite arising from the latter's alleged failure to amicably resolve its unpaid obligation to SS/L under the JVA. In 2002, the arbitration panel handed down its decision and provided for payment by Mabuhay Satellite to SS/L of the principal amount of US\$10 million plus accrued interest at 9% per annum. On June 30, 2003, Mabuhay Satellite and SS/L concluded a US\$15 million settlement agreement under which Mabuhay Satellite leased two transponders under a transponder agreement on a life-term basis to SS/L and offset the lease charges due from SS/L and its receivables from Loral Skynet Network Services, Inc. (formerly known as the Loral Cyberstar, Inc.), among other things, for a full and final settlement of the arbitration decision. The agreement was subsequently approved by Mabuhay Satellite's creditors in March 2004.

In accordance with the settlement agreement, Mabuhay Satellite and SS/L are required to proceed to dissolve the joint venture under a separate agreement, for which each of the parties will receive title over a number of transponders owned by the joint venture in proportion to their respective interests. On the basis of the joint venture dissolution, we recognized full impairment provision in respect of our investment in MSHL in 2004.

Investment of Smart in Blue Ocean Wireless, or BOW

On August 3, 2007, Smart (through its subsidiary, SCH) acquired a 30% equity interest in BOW, a Dublin-based company delivering GSM communication capability for the merchant maritime sector. The total acquisition cost amounted to US\$16 million, or Php724 million, of which US\$13 million, or Php601 million, was paid in cash and US\$3 million, or Php123 million, worth of equipment and services was delivered by Smart in accordance with the subscription agreement. BOW provides GSM network on the seas through Altobridge, a patented GSM technology that will complement Smart's prepaid wireless satellite phone service, *SmartLink*.

Investment of ePLDT in Philweb Corporation, or Philweb

In May 2006, ePLDT subscribed to newly issued common shares of Philweb, an internet-based online gaming company, equivalent to 20% of the total outstanding capital stock of Philweb at a price of Php0.020 per share or an aggregate amount of Php503 million. Of the total subscription price, Php428 million was paid by ePLDT on the closing date. The portion of the unpaid subscription price amounting to Php25 million will be paid by ePLDT at the same time as the Philweb majority stockholders pay the remaining unpaid portion of the subscription pursuant to a general call on subscription to be made by Philweb's board of directors. The unpaid balance of Php50 million will be paid upon the lapse of certain post-closing price adjustment periods. The unpaid subscription of Php75 million was recorded as part of accrued expenses and other current liabilities in the consolidated balance sheet.

In October 2006, ePLDT acquired an additional 8,037,692,308 shares of Philweb at a price of Php0.026 per share or an aggregate amount of Php209 million. This represents an additional 6.2% of the outstanding shares of Philweb, raising ePLDT's total equity stake to 26.87% and 25.5% as at December 31, 2007 and 2006, respectively.

Philweb is primarily engaged in internet-based online gaming, through its appointment as Principal Technology Service Provider under the Marketing Consultancy Agreement for Internet Sports Betting and Internet Casino with the Philippine Amusement and Gaming Corporation, or PAGCOR. As at the end of December 2007, Philweb offers Internet Sports Betting in over 200 PAGCOR Internet Sports Betting Stations and over 70 Internet Casino Stations nationwide. As at December 31, 2007 and 2006, the market value of ePLDT's investments in Philweb amounted to Php1,492 million and Php1,028 million, respectively.

Investment of ePLDT in BayanTrade Dotcom, Inc., or BayanTrade

BayanTrade was incorporated and registered with the Philippine SEC on August 8, 2000 to provide: (a) a business-to-business electronic purchasing market place to link buyers and suppliers of goods and services over the internet; (b) electronic catalogue purchasing facilities over the internet to buyers and suppliers; (c) link-up with similar horizontal markets and vertical markets across the Asia-Pacific Region and the world; and (d) facilitating services incidental to the business. BayanTrade is an e-procurement joint venture established together with six of the Philippines' leading conglomerates. ePLDT's initial shareholding in BayanTrade was 20.5%, which was subsequently diluted to 19.17% in August 2004 due to an equity call to which ePLDT did not subscribe. The dilution did not affect the degree of our representation on the board of directors of BayanTrade and significant influence was therefore retained.

In September 2005, ePLDT received 4,794,615 bonus warrants from BayanTrade which entitles ePLDT to purchase 2,794,615 common shares at a price of Php0.50 per share at any time on or before August 31, 2010.

Investment of ePLDT in ePDS, Inc., or ePDS

ePLDT entered into a joint venture agreement with DataPost Pte Ltd., or DataPost, a subsidiary of Singapore Post, or Spring, and G3 Worldwide ASPAC pursuant to which the parties formed ePDS, a bills printing company that performs laser printing and enveloping services for statements, bills and invoices, and other value-added services for companies in the Philippines. ePLDT has a 50% equity interest in ePDS, while DataPost has a 30% equity interest. Spring, the largest international mail services provider, owns the remaining 20% equity interest. ePDS has an initial paid-up capital of Php11 million.

Summarized Financial Information of Equity Investees and Joint Ventures

The following table presents the summarized financial information of our investments in associates and joint ventures in conformity with PFRS for equity investees for which we have significant influence as at December 31, 2007 and 2006 and for the years ended December 31, 2007, 2006 and 2005.

	2007	2006
	(in million pesos)	
Noncurrent assets	1,383	1,333
Current assets	1,084	1,122
Capital deficiency	(8,340)	(9,618)
Noncurrent liabilities	10,162	10,029
Current liabilities	645	2,044

	2007	2006	2005
	(in million pesos)		
Revenues	863	1,194	774
Revenues less cost of revenues	746	654	615
Expenses	578	1,066	472
Net income (loss)	168	(412)	471

10. Investment Properties

	2007	2006
	(in million pesos)	
Balance at beginning of year	587	701
Net gains (losses) from fair value adjustments	3	(2)
Disposals	(13)	(112)
Balance at end of year (Notes 3 and 26)	577	587

Investment properties are stated at fair values, which have been determined based on the latest valuations performed by Asian Appraisal Company, Inc., an independent firm of appraisers, which is an industry specialist in valuing these types of investment properties. The valuation undertaken was based on an open market value, supported by a market evidence in which assets could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's-length transaction at the dates of valuation. None of our investment properties are being leased to third parties that earn rental income.

11. Goodwill and Intangible Assets

Movements in goodwill and intangible assets are as follows:

	2007			2006		
	Goodwill	Intangible assets	Total	Goodwill	Intangible assets	Total
Cost:	(in million pesos)					
Balance at beginning of year	10,137	3,456	13,593	1,942	1,991	3,933
Additions during the year	2,231	607	2,838	8,498	1,540	10,038
Translation adjustments	(1,489)	(242)	(1,731)	(303)	(75)	(378)
Balance at end of year	10,879	3,821	14,700	10,137	3,456	13,593
Accumulated amortization and impairment:						
Balance at beginning of year	438	941	1,379	438	446	884
Amortization during the year	-	390	390	-	450	450
Impairment during the year (Note 5)	1,191	53	1,244	-	50	50
Translation adjustments	-	(34)	(34)	-	(5)	(5)
Balance at end of year	1,629	1,350	2,979	438	941	1,379
Net balance (Notes 3 and 26)	9,250	2,471	11,721	9,699	2,515	12,214

2006 Acquisitions

ePLDT's Acquisition of Level Up!

On February 16, 2006, ePLDT entered into a sale and purchase agreement to acquire a 60% equity interest of Level Up!, a leading publisher of online games in the Philippines, for a total cash consideration of US\$7 million, or Php383 million. The transaction was completed on April 30, 2006. In August 2006, the shareholders agreement and share purchase agreement between ePLDT and Level Up! were amended to reflect the removal of earn-out and price adjustment provisions thereby fixing the acquisition for 60% equity interest of Level Up! at the aforementioned original purchase price of US\$7 million, or Php383 million. As at April 30, 2006, the net cash outflow related to the acquisition was Php350 million, representing cash payments of Php383 million, net of cash acquired from Level Up! of Php35 million. Total cash payments include a purchase price consideration of Php381 million and incidental cost of Php2 million.

The purchase price consideration has been allocated to the assets and liabilities on the basis of fair values at the date of acquisition. The fair values of the identifiable acquired assets and liabilities of Level Up! as at April 30, 2006 and the corresponding carrying amounts immediately before the acquisition are as follows:

	Previous Carrying Value	Fair Value Recognized on Acquisition
	(in million pesos)	
Assets:		
Property, plant and equipment	129	129
Goodwill	-	597
Intangible assets	84	185
Prepayments and advances and refundable deposits – net of current portion	7	7
Cash and cash equivalents	35	35
Trade and other receivables	8	8
Inventories and supplies	1	1
Current portion of prepayments and advances and refundable deposits	20	20
	284	982
Liabilities:		
Deferred income tax liabilities	-	60
Finance lease	49	49
Accounts payable	21	21
Accrued expenses and other current liabilities	104	104
Due to related parties	110	110
	284	344
Minority interest	-	255
Net assets acquired	-	383

Intangible assets, as determined by American Appraisal China, Limited, an independent appraiser, pertaining to Level Up!'s game license agreements for certain of its services amounted to Php185 million with an estimated remaining useful life of 5.67 years. Level Up! was accounted for in our consolidated financial statements using the purchase method of accounting, which resulted in goodwill amounting to Php597 million in 2006. Goodwill pertains to the assembled workforce and other unidentified intangible assets that did not qualify as intangible assets under IAS 38, "Intangible Assets". As at December 31, 2006, ePLDT provided impairment in value of its intangible assets in Level Up! amounting to Php50 million, representing a write-down of such intangible assets to recoverable amounts using the value in use approach. The impairment was a result of projected decline on revenues related to certain license agreements. Value in use was based on the discounted cash flow projections using the most recent financial forecast approved by our management.

Our consolidated revenues would have been increased by Php140 million while our consolidated net income would have been decreased by Php6 million for the year ended December 31, 2006 if the acquisition of Level Up! had actually taken place on January 1, 2006. Total net loss of Level Up! included in our 2006 consolidated statement of income from the time of acquisition until December 31, 2006 amounted to Php34 million.

ePLDT's Acquisition of SPi

On July 11, 2006, ePLDT acquired a 100% equity interest in SPi and its direct and indirect Philippine and offshore subsidiaries for a total cash consideration of US\$136 million. As part of the transaction, ePLDT also assumed a US\$7 million debt owed by SPi to the seller at face value. In addition, ePLDT advanced US\$16 million to SPi in order for SPi to fully pay its debt owed to DBS Bank Singapore. As at December 31, 2006, the net cash outflow related to the acquisition was Php7,028 million, representing cash payments of Php7,114 million, net of cash acquired from SPi of Php86 million. The total cash payments include a purchase price consideration of Php7,024 million and incidental cost of Php90 million.

The purchase price consideration has been allocated to the assets and liabilities on the basis of fair values at the date of acquisition. The fair values of the identifiable acquired assets and liabilities of SPi as at the time of the acquisition and the corresponding carrying amounts immediately before the acquisition are as follows:

	Previous Carrying Value		Fair Value Recognized on Acquisition	
	In U.S. Dollar	In Php ⁽¹⁾	In U.S. Dollar	In Php ⁽¹⁾
	(in millions)			
Assets:				
Property, plant and equipment	16	862	19	1,019
Goodwill	72	3,830	130	6,906
Intangible assets	-	-	18	972
Prepayments and advances and refundable deposits – net of current portion	1	51	1	51
Cash and cash equivalents	2	86	2	86
Trade and other receivables	36	1,915	36	1,915
Current portion of prepayments and advances and refundable deposits	2	96	2	96
	129	6,840	208	11,045
Liabilities:				
Deferred income tax liabilities	1	38	7	395
Deferred credits and other noncurrent liabilities	3	182	3	182
Accounts payable	54	2,942	54	2,942
Accrued expenses and other current liabilities	8	412	8	412
	66	3,574	72	3,931
Net assets acquired	63	3,266	136	7,114

⁽¹⁾ Converted to Philippine Peso using the exchange rate at the time of purchase of Php53.11 to US\$1.00.

Intangible assets, as determined by American Appraisal China, Limited, an independent appraiser, amounted to Php972 million relating to SPi's customer relationships and self-developed software with estimated remaining useful lives of seven and four years, respectively.

SPi was accounted for in the consolidated financial statements using the purchase method of accounting, which resulted in goodwill amounting to Php6,906 million. Goodwill pertains to the assembled workforce of SPi and other unidentified intangible assets that did not qualify as intangible assets under PAS 38.

Our consolidated revenues would have been increased by Php1,724 million while our consolidated net income would have been decreased by Php295 million for the year ended December 31, 2006 if the acquisition of SPi and its direct and indirect Philippine offshore subsidiaries had actually taken place on January 1, 2006. The total consolidated net income of SPi and its direct and indirect Philippine offshore subsidiaries included in our 2006 consolidated statement of income from the time of acquisition until December 31, 2006 amounted to Php68 million.

ePLDT's Acquisition of CyMed

On August 11, 2006, ePLDT, through its direct subsidiary SPi, acquired 100% equity interest of CyMed for an aggregate purchase price of US\$37 million, inclusive of certain debt obligations. As at August 15, 2006, the net cash outflow related for this acquisition was Php1,774 million, representing cash payments of Php1,831 million, net of cash acquired from CyMed of Php57 million. The total cash payments include a purchase price consideration of Php1,716 million, working capital amounts and other net debt adjustments totaling Php102 million and incidental cost of Php13 million.

The purchase price consideration has been allocated to the assets and liabilities on the basis of fair values at the date of acquisition. The fair values of the identifiable acquired assets and liabilities of CyMed as at the time of the acquisition and the corresponding carrying amounts immediately before the acquisition are as follows:

	Previous Carrying Value		Fair Value Recognized on Acquisition	
	In U.S. Dollar	In Php ⁽¹⁾	In U.S. Dollar	In Php ⁽¹⁾
	(in millions)			
Assets:				
Property, plant and equipment	1	39	1	39
Goodwill	2	108	25	1,223
Intangible assets	–	–	7	336
Deferred income tax assets	1	30	1	30
Cash and cash equivalents	1	57	1	57
Trade and other receivables	3	148	3	148
Notes receivable	2	108	2	108
Current portion of advances and refundable deposits	1	20	1	20
	11	510	41	1,961
Liabilities:				
Interest-bearing financial liabilities – net of current portion	2	72	2	72
Accounts payable and other current liabilities	2	58	2	58
	4	130	4	130
Net assets acquired	7	380	37	1,831

⁽¹⁾ Converted to Philippine Peso using the exchange rate at the time of purchase of Php49.03 to US\$1.00.

CyMed was accounted for in the consolidated financial statements using the purchase method of accounting, which resulted in goodwill amounting to Php1,223 million. Goodwill pertains to assembled workforce of CyMed and other unidentified intangible assets that did not qualify as intangible assets under PAS 38.

Intangible assets pertaining to CyMed's customer relationship was determined at Php336 million with an estimated useful life of five years. Intangible assets were valued by American Appraisal China, Limited, an independent appraiser.

Our consolidated revenues would have been increased by Php681 million while our consolidated net income would have been decreased by Php40 million for the year ended December 31, 2006 if the acquisition of CyMed had actually taken place on January 1, 2006. The total net loss of CyMed included in our 2006 consolidated statement of income from the time of acquisition until December 31, 2006 amounted to Php40 million.

2007 Acquisitions

SPI's Acquisition of Springfield Service Corporation, or Springfield

On April 12, 2007, SPI acquired, through a wholly-owned U.S. subsidiary, a 100% equity interest in Springfield for an aggregate purchase price of US\$35 million, or Php1,664 million, plus possible future earn-out payments with an aggregate fair value at acquisition date of US\$18 million, or Php855 million. As at date of acquisition, the net cash outflow related to acquisition was US\$35 million, or Php1,664 million, representing cash payments of US\$34 million, or Php1,616 million, net of cash acquired from Springfield of US\$1 million, or Php48 million, and incidental cost amounted to US\$1.3 million, or Php63 million. The total purchase price consideration including the fair value of possible future earn-out payments at acquisition date amounted to US\$53 million, or Php2,520 million, inclusive of other net debt adjustments totaling US\$8 million, or Php380 million. As at December 31, 2007, the revised fair value of possible future earn-out payments, as revised after effecting adjustments on forecasted earn-out and accretion, amounted to US\$25 million, or Php1,048 million. See Note 19 – *Deferred Credits and Other Noncurrent Liabilities* and Note 21 – *Accrued Expenses and Other Current Liabilities*.

The purchase price consideration has been allocated to the assets and liabilities on the basis of fair values at the date of acquisition. The fair values of the identifiable acquired assets and liabilities of Springfield as at the time of the acquisition and the corresponding carrying amounts immediately before the acquisition are as follows:

	Previous Carrying Value		Fair Value Recognized on Acquisition	
	In U.S. Dollar	In Php ⁽¹⁾	In U.S. Dollar	In Php ⁽¹⁾
	(in millions)			
Assets:				
Property, plant and equipment	3	143	3	143
Goodwill	–	–	45	2,139
Intangible assets	7	333	8	380
Cash and cash equivalents	1	48	1	48
Trade and other receivables	3	143	3	143
	14	667	60	2,853
Liabilities:				
Deferred income tax liabilities	1	48	4	190
Noncurrent liabilities	–	–	1	48
Accounts payable and other current liabilities	10	475	2	95
	11	523	7	333
Net assets acquired	3	144	53	2,520

⁽¹⁾ Converted to Philippine Peso using the exchange rate at the time of purchase of Php47.536 to US\$1.00.

Springfield was accounted for in our consolidated financial statements using the purchase price method of accounting, which resulted in goodwill amounting to Php2,139 million. Goodwill pertains to the assembled workforce of Springfield and other unidentified intangible assets that did not qualify as intangible assets under PAS 38.

Intangible assets pertaining to Springfield customer relationship was determined at Php380 million with an estimated useful life of seven years. Intangible assets was valued by American Appraisal China, Limited, an independent appraiser based on multiple excess earnings approach using a discount rate of 15%.

Our consolidated revenues would have been increased by Php333 million while our consolidated net income would have been decreased by Php11 million for the year ended December 31, 2007 if the acquisition of Springfield had actually taken place on January 1, 2007. The total net income of Springfield included in our 2007 consolidated statement of income from the time of acquisition until December 31, 2007 amounted to Php164 million.

Smart's Investment in 3rd Brand

In 2007, Smart also recognized intangible assets for technology and license costs in 3rd Brand amounting to US\$4 million, or Php172 million. Said technology and license costs were estimated to have an estimated useful life of 10 years.

Smart's Supply Agreement with THISS Technologies Pte. Ltd., or THISS

In 2007, Smart recognized an intangible assets for technology and license costs incurred in connection with SCH's GSM connectivity service for the commercial shipping sector. Smart (through SCH) engaged the services of THISS as developer and supplier for this service. As at December 31, 2007, US\$1 million, or Php41 million, has been recognized as intangible assets for this project.

Other Intangible Assets

Other intangible assets consist of:

	Estimated Useful Lives	Remaining Useful Lives	2007			2006		
			Gross		Net	Gross		Net
			Carrying Amount	Accumulated Amortization		Carrying Amount	Accumulated Amortization	
						(in million pesos)		
Customer list	1 – 10 years	4 – 6 years	1,486	384	1,102	1,332	195	1,137
Spectrum	15 years	12 years	1,205	268	937	1,205	187	1,018
Technology application	4 – 10 years	2 – 10 years	812	516	296	601	471	130
Licenses	5 – 17 years	4 – 15 years	318	182	136	318	88	230
			3,821	1,350	2,471	3,456	941	2,515

The future amortization of other intangible assets as at December 31, 2007 is as follows:

Year	(in million pesos)
2008	382
2009	378
2010	347
2011	317
2012 and onwards	1,047
Balance at end of year	2,471

Impairment Testing of Goodwill

Goodwill from Acquisition of SBI

The test for recoverability of goodwill recognized in connection with the acquisition of SBI was applied to our wireless asset group, representing the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities.

Although revenue streams may be segregated between Smart and SBI through subscribers availing themselves of their respective cellular and wireless broadband services, the cost items and cash flows are difficult to carve out, largely due to the significant portion of shared and common-used networks/platforms. In the case of SBI, it provides broadband wireless access to its subscribers using Smart's cellular base stations, fiber optic and IP backbone. With the common use of wireless assets of Smart in providing wireless services, the lowest asset group for SBI for which cash flows could be clearly identified from other groups of assets is Smart's wireless business segment.

Our wireless business segment is our largest revenue and cash flow contributor. As such, there is no impairment of our wireless business segment. As at December 31, 2007, the recoverable amount of this segment is determined on the basis of value in use calculations using cash flow projections based on the financial budgets approved by the board of directors, covering a 5-year period from 2008 to 2012. The pre-tax discount rate applied to cash flow projections is 8.4% and cash flows beyond the 5-year period are determined using a 2.5% growth rate that is the same as the long-term average growth rate for the telecommunications industry.

Goodwill from Acquisition of SPi and its Subsidiary, CyMed

The goodwill acquired through the SPi and CyMed transactions was allocated for impairment testing to each of the cash-generating units of those businesses, namely medical transcription, litigation and publishing. The recoverable amount of goodwill was determined using the value in use approach. Value in use was based on the cash flow projections of the most recent financial budgets/forecasts approved by the board of directors, which management believes are reasonable and are management's best estimate of the ranges of economic conditions that will exist over the remaining useful life of the asset. The discount rate applied was 15% which was based on the weighted cost of capital adjusted for the difference in currency and specific risks associated with the assets or business of a cash-generating unit.

We recognized an impairment loss of Php908 million in 2007 pertaining to the medical transcription business of SPi, since the carrying amount of the individual assets, pertaining to the medical transcription business, exceeded the recoverable amount in 2007.

Goodwill from Acquisition of Level Up!

Goodwill acquired from our acquisition of a 60% equity interest in Level Up! was tested for impairment where the recoverable amount was determined using the value in use approach. Value in use was based on the cash flow projections on the most recent financial budgets/forecasts approved by the board of directors. The discount rate applied was 22% which was based on the weighted cost of capital. We recognized an impairment loss of Php254 million pertaining to the goodwill of ePLDT's acquisition of Level Up! in 2007.

Goodwill from Acquisition of Digital Paradise

Goodwill acquired from the acquisition of Digital Paradise was tested for impairment based on the recoverable amount of the long lived assets where recoverable amount was determined based on the cash flow projections on the most recent financial budgets/forecasts approved by the board of directors. The discount rate applied was 22% which was based on the weighted cost of capital. We impaired goodwill acquired from ePLDT's acquisition of Digital Paradise amounting to Php29 million in 2007.

12. Cash and Cash Equivalents

This account consists of:

	2007	2006
	(in million pesos)	
Cash on hand and in banks (Note 26)	3,944	3,416
Temporary cash investments (Note 26)	13,503	13,454
	17,447	16,870

Cash in banks earns interest at prevailing bank deposit rates. Temporary cash investments are made for varying periods of up to three months depending on our immediate cash requirements, and earn interest at the prevailing short-term deposit rates. Due to the short-term nature of such transactions, the carrying value approximates the fair value of our temporary cash investments.

13. Investment in Debt Securities

Investment of ePLDT in Stradcom International Holdings, Inc., or SIHI

ePLDT has a 22.5% equity interest in convertible securities of SIHI, the parent company of Stradcom Corporation, or Stradcom, which has an existing concession agreement with the Philippine Government for the modernization of the Philippine Land Transportation Office, including the computerization of driver's license issuance, vehicle registration and traffic adjudication systems. SIHI has been incurring losses from the start of operations due to Stradcom's continuous losses and recurring excess of current liabilities over current assets. On this basis, we recognized an impairment provision in respect of our total investment in SIHI of Php616 million in 2004.

In 2007, Stradcom entered into a Lenders' Agreement for the issuance of Asset-Backed Bonds amounting to Php1.6 billion. The proceeds were used to payoff all of Stradcom's debts, trade payables and capital expenditures for upgrade in its new inter-connectivity business, which is expected to contribute significantly to Stradcom's operating results in future years.

On December 10, 2007, ePLDT and SIHI agreed to extend the redemption date of the convertible securities of SIHI owned by ePLDT to January 31, 2008 and fixed the redemption price at Php1,170 million as at December 31, 2007 (original maturity date) plus an additional amount of Php256,760 per day from December 31, 2007 until actual redemption of such shares. The redemption date was further extended to February 28, 2008, on which date SIHI paid Php1,187 million in final redemption amount.

As at December 31, 2007, with the foregoing development with Stradcom, the provision for impairment from investment in SIHI amounting to Php616 million was reversed to profit or loss. See *Note 5 – Income and Expenses*. Cumulative dividends and interest recognized in the consolidated statement of income amounted to Php499 million in 2007. As at December 31, 2007, the balance of investment in SIHI amounted to Php1,115 million. Investment in SIHI as at December 31, 2006 was carried at nil value.

Movements in the accumulated impairment losses are as follows:

	2007	2006
	(in million pesos)	
Balance at beginning of year	616	616
Reversal of impairment provision for the year	(616)	-
Balance at end of year	-	616

14. Trade and Other Receivables

This account consists of receivables from:

	2007	2006
	(in million pesos)	
Retail subscribers (Note 26)	8,179	7,874
Corporate subscribers (Notes 22 and 26)	7,915	8,160
Foreign administrations (Note 26)	5,371	6,342
Domestic carriers (Note 26)	1,884	1,965
Dealers, agents and others (Notes 22 and 26)	2,151	2,587
	25,500	26,928
Less allowance for doubtful accounts	12,855	16,770
	12,645	10,158

Movements in the allowance for doubtful accounts are as follows:

	Total	Retail Subscribers	Corporate Subscribers	Foreign Administrations	Domestic Carriers	Dealers, Agents and Others
	(in million pesos)					
December 31, 2007						
Balance at beginning of year	16,770	5,847	6,418	2,506	504	1,495
Provisions for the year (Notes 3 and 5)	417	226	151	–	–	40
Translation adjustments	(91)	–	(91)	–	–	–
Reversals/reclassifications	(889)	213	(603)	(175)	(123)	(201)
Write-offs	(3,352)	(1,968)	–	(1,284)	–	(100)
Balance at end of year	12,855	4,318	5,875	1,047	381	1,234
Individual impairment	12,115	3,944	5,509	1,047	381	1,234
Collective impairment	740	374	366	–	–	–
	12,855	4,318	5,875	1,047	381	1,234
Gross amount of receivables, individually impaired, before deducting any individually assessed impairment allowance	12,168	3,951	5,555	1,047	381	1,234
December 31, 2006						
Balance at beginning of year	18,525	7,657	6,196	2,497	780	1,395
Provisions for the year (Notes 3 and 5)	736	273	324	25	–	114
Business combination	71	–	71	–	–	–
Translation adjustments	(24)	–	(24)	–	–	–
Reversals/reclassifications	(654)	(317)	(45)	(16)	(276)	–
Write-offs	(1,884)	(1,766)	(104)	–	–	(14)
Balance at end of year	16,770	5,847	6,418	2,506	504	1,495
Individual impairment	15,828	5,180	6,143	2,506	504	1,495
Collective impairment	942	667	275	–	–	–
	16,770	5,847	6,418	2,506	504	1,495
Gross amount of receivables, individually impaired, before deducting any individually assessed impairment allowance	15,895	5,190	6,200	2,506	504	1,495

Receivables from carriers represent receivables arising from interconnection agreements with other telecommunication carriers. The aforementioned amount of receivable is shown net of related payable to the same telecommunications carriers because a legal right of offset exists.

On October 10, 2002, PLDT entered into a Receivables Purchase Deed, or RPD, with a foreign financial institution, or the Purchaser, under which PLDT agreed (1) to sell its receivables from certain eligible foreign carriers up to September 30, 2007 for an advance payment of US\$50 million and (2) to service, administer and collect the receivables on behalf of the Purchaser. Under the RPD, the Purchaser has no recourse against PLDT should an eligible carrier fail or refuse to settle the assigned/purchased receivables, except when PLDT commits a breach of its representations and warranties under the RPD. The RPD expired on December 4, 2007.

Sale of receivables under the RPD amounted to US\$4 million, or Php167 million, and US\$6 million, or Php272 million, for the years ended December 31, 2007 and 2006, respectively. Loss on sale of receivables under the RPD included in other expenses account amounted to US\$0.1 million, or Php6 million, US\$0.5 million, or Php27 million, and US\$1 million, or Php75 million for the years ended December 31, 2007, 2006 and 2005, respectively.

15. Inventories and Supplies

This account consists of:

	2007	2006
	(in million pesos)	
Terminal and cellular phone units:		
At net realizable value	554	556
At cost	808	719
Spare parts and supplies:		
At net realizable value	502	513
At cost	1,385	1,397
Others:		
At net realizable value	111	161
At cost	112	161
At lower of cost or net realizable value (Note 26)	1,167	1,230

16. Prepayments

This account consists of:

	2007	2006
	(in million pesos)	
Prepaid taxes (Notes 6 and 25)	3,995	4,844
Prepaid fees and licenses (Notes 5 and 25)	236	75
Prepaid insurance (Note 22)	184	189
Prepaid rent (Note 24)	61	128
Other prepayments	173	967
	4,649	6,203
Less current portion of prepayments	2,368	4,018
Net of noncurrent portion of prepayments	2,281	2,185

Prepaid taxes include creditable withholding taxes, input VAT and real property taxes.

17. Equity

The movement of PLDT's capital accounts for the years ended December 31, 2005, 2006 and 2007 are as follows:

	Preferred Stock – Php10 par value per share				Common Stock – Php5 par value per share		
	Series A to HH	III	IV	Total Preferred Stock	No. of Shares	Amount	
	No. of Shares				Amount		
					(in millions)		
Authorized				823	Php8,230	234	Php1,170
Outstanding							
Balance at January 1, 2005	409	5	36	450	Php4,497	170	Php851
Conversion	(2)	(5)	–	(7)	(67)	10	51
Issuance	–	–	–	–	3	1	2
Balance at December 31, 2005	407	–	36	443	Php4,433	181	Php904
Balance at January 1, 2006	407	–	36	443	Php4,433	181	Php904
Conversion	(1)	–	–	(1)	(11)	7	38
Issuance	–	–	–	–	2	–	–
Balance at December 31, 2006	406	–	36	442	Php4,424	188	Php942
Balance at January 1, 2007	406	–	36	442	Php4,424	188	Php942
Conversion	(1)	–	–	(1)	(8)	–	1
Issuance	–	–	–	–	1	–	–
Balance at December 31, 2007	405	–	36	441	Php4,417	188	Php943

Preferred Stock

The preferred stock is non-voting, except as specifically provided by law, and is preferred as to liquidation.

The Series A to EE 10% Cumulative Convertible Preferred Stocks earn cumulative dividends at an annual rate of 10%. After the lapse of one year from the last day of the year of issuance of a particular series of 10% Cumulative Convertible Preferred Stock, any holder of such series may convert all or any of the shares of 10% Cumulative Convertible Preferred Stock held by him into fully paid and non-assessable shares of Common Stock of PLDT, at a conversion price equivalent to 10% below the average of the high and low daily sales price of a share of Common Stock on the PSE, or if there have been no such sales on the PSE on any day, the average of the bid and the asked prices of a share of Common Stock of PLDT at the end of such day on such Exchange, in each such case averaged over a period of 30 consecutive trading days prior to the conversion date, but in no case shall the conversion price be less than the price set by the board of directors which, as at December 31, 2007, was Php5.00 per share. The number of shares of Common Stock issuable at any time upon conversion of one share of the subscriber investment plan, or SIP, or the 10% Cumulative Convertible Preferred Stock is determined by dividing Php10.00 by the then applicable conversion price.

In case the shares of common stock at anytime outstanding are subdivided into a greater or consolidated into a lesser number of shares, then the minimum conversion price per share of common stock will be proportionately decreased or increased, as the case may be, and in the case of a stock dividend, such price will be proportionately decreased, provided, however, that in every case the minimum conversion price shall not be less than the par value per share of common stock. In the event the relevant effective date for any such subdivision or consolidation of shares or stock dividend occurs during the period of 30 trading days preceding the presentation of any shares of 10% Cumulative Convertible Preferred Stock for conversion, a similar adjustment will be made in the sales prices applicable to the trading days prior to such effective date utilized in calculating the conversion price of the shares presented for conversion.

In case of any other reclassification or change of outstanding shares of common stock, or in case of any consolidation or merger of PLDT with or into another corporation, the board of directors shall make such provisions, if any, for adjustment of the minimum conversion price and the sales price utilized in calculating the conversion price as the board of directors, in its sole discretion, shall deem appropriate.

At PLDT's option, the Series A to EE 10% Cumulative Convertible Preferred Stocks are redeemable at par value plus accrued dividends five years after the year of issuance.

On January 30, 2007, the board of directors designated 150,000 shares of serial Preferred Stock as Series HH 10% Cumulative Convertible Preferred Stock for issuance from January 1, 2007 up to December 31, 2009.

The issuance of SIP Series FF, GG and HH is an exempt transaction under Section 10.2 of the Securities Regulation Code, as confirmed by the Philippine SEC on April 2, 2007.

The Series IV Cumulative Non-Convertible Redeemable Preferred Stock earns cumulative dividends at an annual rate of 13.5% based on the paid-up subscription price. It is redeemable at the option of PLDT at any time one year after subscription and at the actual amount paid for such stock, plus accrued dividends.

The provisions of certain subscription agreements involving preferred stock have an effect on the ability of PLDT to, without written consent, sell certain assets and pay cash dividends unless all dividends for all past quarterly dividend periods have been paid, and provision has been made for the currently payable dividends.

Common Stock

On January 29, 2008, our board of directors approved a share buyback program of up to two million shares of PLDT's Common Stock, representing approximately 1.1% of PLDT's total outstanding shares of Common Stock. The share buyback program reflects PLDT's commitment to capital management as an important element in enhancing shareholder value. This also reinforces initiatives that PLDT has already undertaken such as the declaration of special dividends in addition to the regular dividend pay out of 70% on common shares, after having determined that PLDT has the capacity to pay additional returns to shareholders. The share buyback program contemplates that PLDT will reacquire shares on an opportunistic basis, direct from the open market through the trading facilities of the PSE and NYSE.

As at March 14, 2008, we have not acquired any shares based on the share buyback program.

18. Interest-bearing Financial Liabilities

This account consists of the following:

	2007	2006
	(in million pesos)	
Long-term portion of interest-bearing financial liabilities – net of current portion:		
Long-term debt (Note 26)	53,372	63,769
Obligations under finance lease (Notes 8 and 26)	15	106
Preferred stock subject to mandatory redemption (Note 26)	–	1,369
	53,387	65,244
Current portion of interest-bearing financial liabilities:		
Notes payable	493	201
Long-term debt maturing within one year (Note 26)	6,775	16,184
Obligations under finance lease maturing within one year (Notes 8 and 26)	481	924
Preferred stock subject to mandatory redemption (Note 26)	1,015	–
	8,764	17,309

Unamortized debt discount, representing debt issuance costs and any difference between the fair value of consideration given or received on initial recognition, included in the financial liabilities are as follows:

	2007	2006
	(in million pesos)	
Long-term debt	4,472	5,953
Obligations under finance lease (Notes 8 and 26)	444	540
Preferred stock subject to mandatory redemption	56	260
Total unamortized debt discount at end of year	4,972	6,753

The following table describes all changes to unamortized debt discount as at December 31, 2007 and 2006.

	2007	2006
	(in million pesos)	
Unamortized debt discount at beginning of year	6,753	13,347
Additions during the year	59	48
Settlements and conversions during the year	(96)	(2,733)
Revaluations during the year	(678)	(595)
Accretion during the year charged to interest expense	(1,066)	(3,314)
Total unamortized debt discount at end of year	4,972	6,753

Long-term Debt

Long-term debt consists of:

Description	Interest Rates	2007		2006	
		(in millions)			
<i>U.S. Dollar Debt:</i>					
Export Credit Agencies-Supported Loans: Kreditanstalt für Wiederaufbau, or KfW	5.65% - 7.58% and US\$ LIBOR + 0.55% - 2.5% in 2007 and 2006	US\$130	Php5,365	US\$201	Php9,877
Finnvera, Plc, or Finnvera	US\$ LIBOR + 0.05% in 2007 and 7.53% - 7.75% and US\$ LIBOR + 0.05% in 2006	49	2,048	69	3,381
Nippon Export and Investment Insurance of Japan, or NEXI	US\$ LIBOR + 1% in 2007 and 2006	-	-	25	1,215
Others	6.60% and US\$ LIBOR + 0.15% - 0.65% and GOVCO's cost + 0.20% in 2007 and 5.83% - 6.6% and US\$ LIBOR + 0.15% - 1.60% and GOVCO's Cost + 0.20% in 2006	1	47	10	508
		180	7,460	305	14,981
Fixed Rate Notes	7.85% - 11.375% in 2007 and 2006	676	28,016	835	40,971
Term Loans:					
Debt Exchange Facility	2.25% and US\$ LIBOR + 1% in 2007 and 2006	187	7,742	176	8,615
GSM Network Expansion Facilities	4.49% - 4.70% and US\$ LIBOR + 0.75% - 0.815% in 2007 and 4.49% - 4.70% and US\$ LIBOR + 0.815% - 3.25% in 2006	194	8,024	194	9,509
Others	US\$ LIBOR + 0.40% and 6% - 10% in 2007 and US\$ LIBOR + 0.40% - 3.625% and 1.75% - 10% in 2006	4	153	10	487
Satellite Acquisition Loans	5.66% and US\$ LIBOR + 1.75% - 2.75% in 2007 and 2006	28	1,145	42	2,083
		US\$1,269	Php52,540	US\$1,562	Php76,646

Description	Interest Rates	2007	2006
(in millions)			
<i>Philippine Peso Debt:</i>			
Peso Fixed Rate Corporate Notes	5.625% - 15% in 2007 and 15% - 15.816% in 2006	Php4,967	Php808
Term Loans:			
Secured Term Loans	7.09%, MART1 + 5.70% and 90-day PHILBOR + 3% in 2007 and 7.09% - 15% and 90-day PHILBOR + 3% in 2006	6	11
Unsecured Term Loans	6.125% and MART1 + 0.75% in 2007 and MART1 + 0.75% in 2006	2,634	2,488
Total long-term debt		60,147	79,953
Less portion maturing within one year (Note 26)		6,775	16,184
Noncurrent portion of long-term debt (Note 26)		Php53,372	Php63,769

Note: Amounts presented are net of unamortized debt discount and debt issuance costs.

The scheduled maturities of our outstanding consolidated long-term debt at nominal values as at December 31, 2007 are as follows:

Year	U.S. Dollar Loans		Php Loans	Total
	In U.S. Dollar	In Php	In Php	In Php
(in millions)				
2008	152	6,315	558	6,873
2009	274	11,353	570	11,923
2010	82	3,391	568	3,959
2011	26	1,075	568	1,643
2012 and onwards	841	34,837	5,384	40,221
	1,375	56,971	7,648	64,619

U.S. Dollar Debt:

Export Credit Agencies-Supported Loans

In order to obtain imported components for our network infrastructure in connection with our expansion and service improvement programs, we obtained loans extended and/or guaranteed by various export credit agencies. These financings account for a significant portion of our indebtedness.

Kreditanstalt für Wiederaufbau, or KfW

KfW, a German state-owned development bank, is PLDT's largest single creditor. As at December 31, 2007, we owed an aggregate principal amount of US\$130 million, or Php5,365 million, to KfW, as follows:

- US\$95 million provided under various export credit agency-backed facilities, of which US\$14 million was in connection with our expansion and service improvement programs, and US\$81 million in connection with the US\$149 million refinancing facility discussed below; and
- US\$35 million provided for the 15% downpayment portion and credit facilities without guarantee/insurance cover from the export credit agencies, of which US\$22 million was in connection with the US\$149 million refinancing facility discussed in the following paragraphs.

On January 25, 2002, PLDT signed two loan agreements with KfW, which provided PLDT with a US\$149 million facility to refinance in part the repayment installments under its existing loans from KfW due from January 2002 to December 2004. The facility is composed of a nine-year loan, inclusive of a three-year disbursement period and a two-year grace period during which no principal is payable. It partly enjoys the guarantee of HERMES, the export credit agency of the Federal Republic of Germany. We have drawn US\$140 million, or Php5,796 million, under this facility as at December 31, 2007. PLDT waived further disbursements under this refinancing facility effective September 1, 2004. Thus, the undrawn portion of US\$9 million was cancelled.

Of the amounts outstanding under these KfW loans, US\$55 million will mature in 2008, US\$44 million will mature in 2009 and US\$31 million will mature in 2010. Principal amortizations on these loans are generally payable in equal semi-annual installments.

Finnvera, Plc, or Finnvera

As at December 31, 2007, a principal amount of US\$50 million (US\$49 million, net of unamortized debt discount of US\$1 million), or Php2,070 million (Php2,048 million, net of unamortized debt discount of Php22 million) of Smart's debt was provided by various banks under an export credit agency-backed facility in connection with Smart's GSM expansion program. This facility is covered by a guarantee from Finnvera, the Finnish Export Credit Agency, for 100% of political and commercial risk for the refinancing facility of GSM Phases 5A and 5B.

A US\$100 million refinancing facility was obtained on February 11, 2005 in relation to Smart's GSM Phases 5A and 5B loans which were prepaid on March 1, 2005 with outstanding balances of US\$60 million and US\$41 million, respectively, at the time of prepayment. This refinancing facility is payable semi-annually over five years starting September 1, 2005 with final repayment due in March 2010. The principal benefit of refinancing the Phase 5 loan was the savings from a lower interest margin on the refinancing facility.

Of the amount outstanding under the remaining Finnvera guaranteed loan, US\$20 million will mature in 2008, US\$20 million will mature in 2009 and US\$10 million will mature in 2010. Principal amortization on this loan is payable in equal semi-annual installments.

Nippon Export and Investment Insurance of Japan, or NEXI

On November 28, 2002, Smart signed a US\$100 million term loan facility supported by NEXI, of which US\$60 million was drawn on November 28, 2003 and US\$40 million on April 5, 2004. This loan is payable semi-annually over four years in eight equal installments starting May 28, 2004 with final repayment due in November 2007. The outstanding balance was fully paid in the amount of US\$25 million on May 25, 2007.

Other Export Credit Agency Supported Loans

PLDT has also obtained loans extended and/or guaranteed by other export credit agencies, including the Export-Import Bank of the United States, and the respective export credit agencies of France and Italy, in the aggregate outstanding principal amount of US\$1 million, or Php47 million, as at December 31, 2007. The outstanding balance under this loan will mature on various dates from April 1, 2008 to September 15, 2008. Smart, likewise, obtained loans guaranteed by the export credit agencies of Calyon (SACE) Hypo (GIEK). The outstanding balance was fully paid in the amounts of US\$0.5 million and US\$0.7 million on May 30, 2007 and October 1, 2007, respectively.

Fixed Rate Notes

PLDT has the following non-amortizing fixed rate notes outstanding as at December 31, 2007 and 2006:

Principal Amount	Interest Rate	Maturity Date	2007		2006	
			(in millions)			
US\$300,000,000	8.350%	March 6, 2017	US\$296	Php12,273	US\$296	Php14,523
US\$250,000,000	11.375%	May 15, 2012	245	10,136	244	11,963
US\$135,886,000	10.500%	April 15, 2009	135	5,607	166	8,148
US\$ 19,310,000	10.625%	May 15, 2007	-	-	19	941
US\$110,068,000	7.850%	March 6, 2007	-	-	110	5,396
			US\$676	Php28,016	US\$835	Php40,971

Consent Solicitation for the US\$175 Million 10.5% Notes due 2009, or 2009 Notes, US\$250 Million 11.375% Notes due 2012, or 2012 Notes, and US\$300 Million 8.35% Notes due 2017, or 2017 Notes

In 2007, we conducted a consent solicitation of holders of our 11.375% Notes due 2012, 10.5% Notes due 2009 and 8.35% Notes due 2017, or the Notes, in respect of amendments to the terms of the Notes that allow PLDT greater flexibility to make certain restricted payments, pay dividends or make distributions, while reducing PLDT's permitted leverage ratios pursuant to the terms of the Notes. These amendments to the terms of the Notes became effective on December 3, 2007, the date on which PLDT made the applicable consent payments, after holders of more than 51% of the aggregate principal amount of the Notes gave their consents for these amendments to the terms of the Notes prior to the expiration of the consent solicitation period and after the execution of relevant amendments to the indentures governing the Notes on November 21, 2007.

Term Loans

US\$283 Million Term Loan Facility, or Debt Exchange Facility

On July 2, 2004, Smart acquired from Piltel's creditors approximately US\$289 million, or 69.4%, in the aggregate of Piltel's outstanding restructured debt at that time, in exchange for Smart debt and a cash payment by Smart. In particular, Smart paid an amount in cash of US\$1.5 million, or Php84 million and issued new debt of US\$283.2 million, or Php15,854 million, at fair value of Php8,390 million, net of debt discount amounting to Php7,464 million.

The breakdown of the total outstanding amount of Smart debt issued to participating Piltel creditors is as follows:

- 2007 Facility in the amount of US\$0.2 million which was payable in full in December 2007;
- 2008 Facility in the amount of US\$2.9 million will be payable in full in December 2008; and
- 2014 Facility in the amount of US\$280.1 million will be payable in full in June 2014.

As at December 31, 2007, outstanding balance of the 2008 Facility and the 2014 Facility amounted to US\$283 million (US\$187 million, net of unamortized debt discount of US\$96 million), or Php11,721 million (Php7,742 million, net of unamortized debt discount of Php3,979 million). The 2007 Facility was fully paid in the amount of US\$0.2 million on December 28, 2007.

Interest for the 2008 Facility and the 2014 Facility is payable every quarter at a floating rate of three months US\$ LIBOR plus 1.00% for the 2008 Facility, and a fixed rate of 2.25% per annum for the 2014 Facility. Furthermore, a portion of the 2014 Facility amounting to US\$144 million has a variable yield option whereby the creditors have an option to elect for an early repayment at a discount in December 2008 at 57.5% of the relevant debt amount.

GSM Network Expansion Facilities

On September 13, 2004, Smart signed a US\$104 million 5-year term loan facility to finance the related Phase 7 GSM equipment and services. The facility was awarded to ABN AMRO Bank, Banque National de Paribas, Calyon, DBS Bank and Sumitomo Mitsui Banking Corporation as the Lead Arrangers with Finnish Export Credit, Plc as the Lender. The full amount of the facility was drawn on November 22, 2004 at a fixed rate of 4.49%, of which US\$42 million, or Php1,723 million, remained outstanding as at December 31, 2007. The loan is payable over five years in ten equal semi-annual payments starting May 2005 with final repayment in November 2009.

On August 8, 2005, Smart signed a US\$30 million commercial facility with NIB to partly finance the related Phase 8 GSM equipment and services contracts. The facility is a 5-year term loan payable semi-annually in ten equal installments commencing six months from the first drawdown date at a floating interest rate of US\$ LIBOR plus 0.815% margin per annum. The facility was drawn in full on July 11, 2006 for the full amount of US\$30 million at a floating interest rate of 6.21% (5.40% US\$ LIBOR plus 0.815% per annum margin). The first installment payment commenced on January 11, 2007 with final repayment on July 11, 2011. The amount of US\$24 million, or Php994 million, remained outstanding as at December 31, 2007.

On August 10, 2005, Smart signed a loan facility for its GSM Phase 8 financing in the amount of US\$70 million. The facility was awarded to the Bank of Tokyo Mitsubishi Ltd., Mizuho Corporate Bank Ltd., Standard Chartered Bank and Sumitomo Mitsui Banking Corporation as the Lead Arrangers, with FEC as the Lender. Smart opted to utilize only a total of US\$67 million which was drawn on February 15, 2006 and March 13, 2006 for US\$10 million and US\$57 million, respectively. The undrawn balance of US\$3 million was cancelled. The facility is a 5-year term loan payable in 10 equal semi-annual installments with final repayment on September 1, 2010. Interest is payable semi-annually at a fixed rate of 4.515% per annum. As at December 31, 2007, US\$44 million, or Php1,816 million, remained outstanding.

On July 31, 2006, Smart signed a U.S. Dollar term loan facility for US\$44.2 million to partly finance the related Phase 9 GSM equipment and services contracts. The Lender is FEC with ABN AMRO Bank N.V., Standard Chartered Bank, Sumitomo Mitsui Banking Corporation and Mizuho Corporate Bank Ltd. as the Lead Arrangers. The facility is a 5-year term loan payable in 10 equal semi-annual installments commencing six months from the drawdown date at a commercial interest reference rate, or CIRR, fixed rate of 4.05% per annum plus 0.65% margin. The facility was drawn on November 10, 2006 for the full amount of US\$44.2 million. The first installment commenced on January 16, 2007 with final repayment on July 15, 2011. As at December 31, 2007, US\$35 million, or Php1,464 million, remained outstanding.

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. The facility is a 5-year loan payable in 18 equal and consecutive quarterly installments commencing on the third quarter from the date of the first drawdown. Interest rate is floating at three-month US\$ LIBOR plus 0.75% per annum margin. The facility was drawn on October 10, 2007 for the full amount of US\$50 million. The first installment will commence on July 10, 2008 with final repayment on October 10, 2012. As at December 31, 2007, US\$50 million, or Php2,071 million, remained outstanding.

As at December 31, 2007, the aggregate outstanding balance of these loans amounted to US\$195 million (US\$194 million, net of unamortized debt discount of US\$1 million), or Php8,068 million (Php8,024 million, net of unamortized debt discount of Php44 million).

Other Term Loans

On July 1, 2004, CyMed availed itself of a 5-year interest-bearing advance from an officer of CyMed to fund its operating expenses, including salaries and other incidental expenses. The outstanding balance of this loan as at December 31, 2007 amounted to US\$1 million, or Php26 million, which is payable quarterly until July 31, 2009.

On October 10, 2007, Smart signed a US\$50 million 5-year term loan facility to finance the related Phase 10 GSM equipment and service contracts. The facility was awarded to Norddeutsche Landesbank Girozentrale Singapore Branch (Nord/LB) as the original lender with Standard Chartered Bank (Hong Kong) Ltd. as the facility agent. The full amount of the facility was drawn on March 10, 2008. The loan is payable over five years in ten equal semi-annual payments.

Satellite Acquisition Loans

Mabuhay Satellite had a credit agreement with the Export-Import Bank of the United States, or Ex-Im Bank, to finance a portion of the cost of purchasing the Agila II Satellite. In 2004, Ex-Im Bank approved, in principle, the re-profiling of Mabuhay Satellite's US\$42 million debt with them by extending the maturity of the loan by 1½ years to July 15, 2007 and reducing the interest rate by 1% to 5.6%. The revised repayment terms have been approved by the majority of the local creditor banks. On the extended maturity date, the outstanding balance was fully paid in the amount of US\$5 million, or Php236 million.

Mabuhay Satellite has an existing Omnibus Agreement with a syndicate of local banks, or the Banks, which includes issuance of irrevocable standby Letters of Credit in favor of Ex-Im Bank, as security under the above credit agreement and a term loan to Mabuhay Satellite which term loan will mature on various dates from 2007 to 2009. The irrevocable standby Letters of Credit have been cancelled after the above described full payment of the Ex-Im Bank loan. As at December 31, 2007, the outstanding amount under the term loan was US\$28 million, or Php1,145 million.

Mabuhay Satellite has constituted in favor of the Banks: (a) a first mortgage on its leasehold rights under a lease agreement entered into with the Subic Bay Metropolitan Authority and the components of the satellite system; (b) an assignment of its rights under its purchase contract for the satellite system; (c) an assignment of its rights under the transponder lease contracts to be entered into with its shareholders and other parties and the revenues therefrom; and (d) an assignment of the applicable proceeds of insurance to be taken on the satellite system.

In 2006, the Banks have approved Mabuhay's request to extend the maturity of the loan under the Omnibus Agreement by two years to October 20, 2009, with a 1% increase in the margin on the deferred amount.

Philippine Peso Debt:

Peso Fixed Rate Corporate Notes

Php2,770 Million Peso Fixed Rate Corporate Notes

In connection with PLDT's service improvement and expansion programs, PLDT has entered into two loan agreements, pursuant to each of which PLDT issued fixed rate corporate notes in three tranches.

Under the first loan agreement, PLDT borrowed an aggregate amount of Php1,500 million, of which Php230 million was repaid on November 11, 2002, Php500 million was repaid on November 9, 2004 and Php770 million was repaid on November 9, 2006.

Under the second loan agreement, PLDT borrowed an aggregate amount of Php1,270 million, of which Php360 million was repaid on June 9, 2003, Php100 million was repaid on June 9, 2005 and Php810 million was repaid on June 12, 2007.

Php5 Billion Peso Fixed Rate Corporate Notes

On February 15, 2007, Smart issued Php5 billion unsecured fixed rate corporate notes, comprised of Series A notes amounting to Php3.8 billion and Series B notes amounting to Php1.2 billion with five and ten year terms, respectively. Series A notes were priced at 5.625%, while Series B notes were priced at 6.500%. Funds raised from the issuance of these notes have been used primarily for Smart's capital expenditures for network improvement and expansion. The amount of Php5 billion remained outstanding as at December 31, 2007.

Term Loans

Secured Term Loans

Php100 Million Term Loan Facility

On March 15, 2004, ePLDT entered into a three-year term loan facility with Asia United Bank amounting to Php100 million for the payment of its outstanding short-term bank loan facility and for other working capital requirements. This loan was fully paid on March 31, 2007.

Unsecured Term Loans

Php2,500 Million Term Loan Facility

On August 14, 2006, Smart signed a Philippine 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 is a five-year loan payable in 18 equal consecutive quarterly installments commencing on the third quarter from the date of the first drawdown. Interest rate is floating at three-month MART plus 0.75% per annum margin. The facility was drawn on December 11, 2006 for the full amount of Php2,500 million at a floating interest rate of 6.02% (5.27% three-month MART1 plus 0.75% per annum margin). The first installment commenced on September 11, 2007 with final repayment on December 9, 2011. The outstanding balance of this loan as at December 31, 2007 amounted to Php2,222 million (Php2,214 million, net of unamortized debt discount of Php8 million).

Php400 Million and Php20 Million Refinancing Loans

On May 22, 2007, PLDT signed loan agreements with The Philippine American Life and General Insurance Company for Php400 million and The Philam Bond Fund, Inc. for Php20 million to refinance their respective participations in the Ten-Year Note under the Php1,270 million Peso Fixed Rate Corporate Notes which were repaid on June 12, 2007. Interest is payable quarterly. Both refinancing loans will mature on June 12, 2014.

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 complied with all of our maintenance financial ratios as required under our loan covenants and other debt instruments.

The principal factors that can negatively affect our ability to comply with these financial ratios and other financial tests are depreciation of the Philippine peso relative to the U.S. dollar, poor operating performance of PLDT and its 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 expense. Interest expense 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 88% of PLDT's total consolidated debts are 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.

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.

Further, certain of PLDT's debt instruments contain provisions wherein PLDT may be required to repurchase or prepay certain indebtedness in case of change in control of PLDT.

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 consolidated debt to consolidated equity ratio of not more than 1.5:1.0, a consolidated debt to consolidated EBITDA ratio of not more than 3:1 and a debt service coverage ratio of not less than 1.5:1.0. As at December 31, 2007, 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; and (c) the occurrence of any material adverse change in circumstances that the lender reasonably believes materially impairs Smart's ability to perform its obligations or impair guarantors' ability to perform their obligations under its loan agreements.

The Omnibus Agreement of Mabuhay Satellite imposes several negative covenants which, 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.

As at December 31, 2007, we are in compliance with all of our debt covenants.

Obligations Under Finance Lease

The future minimum payments for finance leases as at December 31, 2007 are as follows:

Year	(in million pesos)
2008	925
2009	15
Total minimum lease payments (Note 24)	940
Less amount representing interest	444
Present value of net minimum lease payments (Note 3)	496
Less obligations under finance lease maturing within one year (Notes 8 and 26)	481
Long-term portion of obligations under finance lease (Notes 8 and 26)	15

Municipal Telephone Projects

In 1993, PLDT entered into two (2) lease agreements (the "Financial Lease Agreements, or FLAs") with the Philippine Department of Transportation and Communications, or DOTC, covering telecommunications facilities in the provinces of Bohol and Batangas established under the Municipal Telephone Act. Under these FLAs, PLDT was granted the exclusive right to provide telecommunications management services, to expand telecommunications services, and to promote the use of the DOTC-contracted facilities in certain covered areas for a period of 15 years. Title to the telecommunications facilities/properties shall be transferred to PLDT upon expiration of the lease term. As at December 31, 2007, PLDT's aggregate remaining obligation under this agreement was approximately Php393 million. In case of cancellation, PLDT is liable to pay Php100 million under each of the two contracts as liquidated damages.

On June 1, 2004, PLDT served the DOTC a notice of termination of the FLA in respect of the telecommunications system in Bohol which state of deterioration, obsolescence and disrepair has made it impossible for PLDT to continue managing, operating, and maintaining the system. Since 2002, PLDT has been advising the DOTC of the need to review the viability of the Bohol telecommunications system as PLDT had infused more than Php200 million for upgrades and maintenance to keep the system operable. Further, the enactment of Public Telecommunications Policy Act, or R.A. No. 7925, which negated the DOTC's warranty to grant PLDT the exclusive right to provide telecommunication services in the areas stipulated, prevented PLDT from achieving its originally projected profitability, thereby rendering it impossible for PLDT to continue fulfilling its obligations under the FLA.

Although several discussions have been held since 2002, no mutually acceptable agreement has been reached between the parties. On June 30, 2004, DOTC advised PLDT that the request for termination of the FLA for Bohol telecommunications system has been referred to the Department of Justice, or DOJ, as government agencies such as the DOTC are required to refer all interpretation of contracts and agreements to the DOJ Secretary as attorney-general of the national government. On May 5, 2005, PLDT received a letter from the DOTC stating that PLDT is in default for failure to remit to DOTC the quarterly installments under the FLA.

Due to the failure of the parties to amicably settle their dispute, the dispute was referred to arbitration. On October 11, 2007, the arbitral committee issued a final award which held that the FLA relating to Bohol was validly terminated effective July 1, 2004. In spite of the valid pre-termination of the FLA, however, the arbitral committee decreed that there remained particular payments due from PLDT to DOTC, particularly on the lease rentals that have accrued as of the date of termination of the FLA, and the net present value of the facilities. Moreover, the arbitral committee decreed that payment by PLDT of the net present value of the facilities and the transfer fee will result in the transfer of ownership of the facilities to PLDT. Hence, under the final award, the arbitral committee awarded in favor of DOTC a total amount of Php293 million, which amount PLDT has fully paid on various dates between September 26, 2007 and January 8, 2008. The arbitral committee's final award was confirmed by the Regional Trial Court (Branch 121) of Mandaluyong City in an Order dated November 20, 2007.

As at December 31, 2007, the telecommunications system in Bohol, including PLDT's additional capital expenditure relating to the telecommunications system has been fully depreciated, while the net book value of corresponding finance lease obligation amounted to Php277 million.

Piltel entered into an agreement for the financial lease of the Palawan Telecommunications System of the Municipal Telephone Public Office with the DOTC on September 3, 1994. The Municipal Telephone Public Office Contract is a 30-year contract for Piltel to lease facilities for public call office stations in the Palawan area, with revenues going to Piltel. In consideration, Piltel pays the DOTC an escalating annual lease fee. The total lease payment for 30 years is Php483 million. As at December 31, 2007, Piltel's aggregate remaining obligation under this agreement was approximately Php43 million.

Other Long-term Finance Lease Obligations

The PLDT Group has various long-term lease contracts for a period of three years covering various office equipment. In particular, PLDT, Smart and ePLDT have finance lease obligations in the aggregate amount of Php504 million as at December 31, 2007 in respect of office equipment.

Under the terms of certain loan agreements and other debt instruments, PLDT may not create, incur, assume or permit or suffer to exist any mortgage, pledge, lien or other encumbrance or security interest over the whole or any part of its assets or revenues or suffer to exist any obligation as lessee for the rental or hire of real or personal property in connection with any sale and leaseback transaction.

Preferred Stock Subject to Mandatory Redemption

The movements of PLDT's preferred stock subject to mandatory redemption for 2007 and 2006 are as follows:

	2007			2006			
	Series V	Series VI	Total	Series V	Series VI	Series VII	Total
	(in million pesos)						
Balance at beginning of year	61	1,308	1,369	272	6,321	5,381	11,974
Accretion	10	131	141	13	481	282	776
Conversion	(22)	(291)	(313)	(224)	(5,253)	(5,543)	(11,020)
Revaluation	-	(182)	(182)	-	(241)	(120)	(361)
Balance at end of year (Notes 24 and 26)	49	966	1,015	61	1,308	-	1,369

PLDT had issued 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 discussed below, as at December 31, 2006, all shares of Series VII Convertible Preferred Stock had been converted. 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 Convertible Preferred Stock is convertible at any time at the option of the holder into one share of PLDT's common stock. Shares of Series V and VI Convertible Preferred Stock which are outstanding on June 4, 2008, the seventh anniversary of the issue date thereof, will be mandatorily converted into shares of PLDT's common stock on the date immediately following such anniversary date. Under a put option exercisable for 30 days following the mandatory conversion, holders of shares of PLDT's common stock received on mandatory conversion of the shares of Series V and VI Convertible Preferred Stock, will be able to require PLDT to purchase such shares of PLDT's common stock for Php1,700 per share and US\$36.132 per share, respectively.

The shares of Series V Convertible Preferred Stock was designated as a compound instrument consisting of liability and equity components. The fair value of the shares of Series V Convertible Preferred Stock was determined on the issue date, of which the fair value of the liability component as at date of issuance is recorded as "Preferred Stock Subject to Mandatory Redemption" and is included under the "Interest-bearing Financial Liabilities" account in the consolidated balance sheets. The residual amount was assigned as the equity component.

The cost of each foreign currency component of the shares of Series VI and VII Convertible Preferred Stock was designated as a debt instrument with embedded call options. The fair value of the shares of Series VI and VII Convertible Preferred Stock was determined on the issue date, of which the fair value of embedded call options was bifurcated and accounted for separately. See *Note 2 – Summary of Significant Accounting Policies and Practices* and *Note 26 – Financial Assets and Liabilities*. The residual amount was assigned as a liability component and recorded as "Preferred Stock Subject to Mandatory Redemption" and is included under the "Interest-bearing Financial Liabilities" account in the consolidated balance sheets.

The difference between the amount designated as liability components of the shares of Series V, VI and VII Convertible Preferred Stock at issue date and the aggregate redemption value is accreted over the period up to the put option date using the effective interest rate method. Accretions added to "Preferred Stock Subject to Mandatory Redemption" and charged to interest for the years ended December 31, 2007 and 2006 amounted to Php141 million and Php776 million, respectively.

Preferred Stock Subject to Mandatory Redemption amounted to Php1,015 million and Php1,369 million as at December 31, 2007 and 2006, respectively, after revaluation of the shares of Series VI and VII Convertible Preferred Stock to the exchange rates at balance sheet dates and after giving effect to the above accretions, conversions and additional issuances. As at December 31, 2007 and 2006, 11,147,451 shares and 10,937,309 shares, respectively, of the shares of Series V, VI and VII Convertible Preferred Stock had been voluntarily converted into PLDT common shares. On August 18, 2006, all of the remaining 3,842,000 shares of the Series VII Convertible Preferred Stock had been voluntarily converted into shares of PLDT's common stock. As at December 31, 2007, 30,790 shares of the Series V and 680,303 shares of the Series VI Convertible Preferred Stock remained outstanding. On March 4, 2008, PLDT issued a notice to the effect that all shares of the Series V and VI Convertible Preferred Stock originally issued on June 4, 2001 and outstanding as at June 4, 2008 will be mandatorily converted on June 5, 2008 to shares of PLDT's common stock. The aggregate redemption value of the outstanding shares of the Series V and VI Convertible Preferred Stock amounted to Php1,070 million and Php1,629 million as at December 31, 2007 and 2006, respectively. See *Note 24 – Contractual Obligations and Commercial Commitments*.

The corresponding dividends on these shares charged as interest expense amounted to Php17 million and Php130 million for the years ended December 31, 2007 and 2006, respectively. See *Note 5 – Income and Expenses*.

Notes Payable

In 2006, SPi obtained unsecured dollar-denominated short-term notes payable from various local commercial banks amounting to US\$4.09 million. In 2007, additional short-term unsecured dollar-denominated notes payable were obtained from various banks totaling US\$4.8 million. Interest on the notes range from 6.9% to 7.5% of the outstanding balance per annum and the notes are payable within 90 to 360 days from the availment date. The outstanding balance of US\$10 million, or Php416 million, as at December 31, 2007 will mature on various dates from January 31, 2008 to December 8, 2008.

In 2006, CyMed obtained two-year interest-bearing notes payable amounting to US\$3.4 million from its previous shareholders. Interest on the notes payable is 6.2% per annum. The outstanding balance of US\$2 million, or Php67 million, as at December 31, 2007 will mature in August 2008.

On June 1, 2007, SPi America LLC obtained short-term interest-bearing notes payable amounting to US\$0.5 million, or Php22 million, in payment for software license. The loan is payable within one year in four equal quarterly payments of principal and interest which commenced on September 1, 2007. Interest on the loan is 5% per annum. The outstanding balance of US\$0.02 million, or Php10 million, as at December 31, 2007 will mature on various dates from March 1, 2008 to June 1, 2008.

19. Deferred Credits and Other Noncurrent Liabilities

This account consists of:

	2007	2006
		(As restated – Note 2)
	(in million pesos)	
Accrual of capital expenditures under long-term financing	7,554	5,646
Liabilities on asset retirement obligations (Notes 3 and 8)	952	831
Future earn-out payments – net (Notes 2 and 11)	782	–
Unearned revenues (Note 21)	290	507
Prepayments received under a receivables purchase facility (Note 14)	–	205
Others	54	836
	9,632	8,025

Accrual of capital expenditures under long-term financing represent expenditures related to the expansion and upgrade of our network facilities which are not expected to be settled within one year and refinanced by long-term debt.

20. Accounts Payable

This account consists of:

	2007	2006
	(in million pesos)	
Suppliers and contractors (Notes 24 and 26)	8,672	5,428
Carriers (Note 26)	1,843	1,593
Taxes (Note 25)	1,648	1,286
Related parties (Note 22)	29	133
Others	61	194
	12,253	8,634

21. Accrued Expenses and Other Current Liabilities

This account consists of:

	2007	2006
	(As restated – Note 2)	
	(in million pesos)	
Accrued utilities and related expenses (Note 22)	10,823	8,078
Unearned revenues (Note 2)	3,769	3,511
Accrued employee benefits (Note 23)	2,837	7,474
Accrued interests and other related costs (Notes 18 and 22)	1,234	1,768
Accrued taxes and related expenses (Notes 24 and 25)	977	756
Current portion of future earn-out payments (Notes 2 and 11)	266	–
Payable in installment purchase of equity investment (Note 11)	123	–
Others	1,645	1,026
	21,674	22,613

Unearned revenues represent advance payments for leased lines, installation fees, monthly service fees and unused and/or unexpired portion of prepaid loads.

22. Related Party Transactions

a. Air Time Purchase Agreement between PLDT and AIL and Related Agreements

Under the Founder NSP Air Time Purchase Agreement, or ATPA, entered into with AIL in March 1997, which was amended in December 1998 (as amended, the “Original ATPA”), 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 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.

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 "Banks Terms Sheet"), with a majority of the banks, as the basis for negotiations between the parties thereto with a view to enter into an agreement to further amend the Amended Credit Agreement with AIL's bank creditors. Under the Banks Terms 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 Terms 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 Banks 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 LMGH Holdings (ACeS), Inc., or LMGH, 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 million, or the Transferred AIL Note, together with related security interests pursuant to a 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 equity holdings in AIL increased from 20% in 2006 to 36.99% as at the date of this report.

Total fees under the Amended ATPA amounted to Php160 million and Php199 million for the years ended December 31, 2007 and 2006, respectively. The Amended ATPA did no longer qualify as an onerous contract under the provision of *PAS 10, "Events After the Balance Sheet Date"*, since the cost of meeting the obligations under the Amended ATPA is below or within the estimated benefits that PLDT is expected to receive by it. Net provisions for onerous contract amounting to US\$72 million, or Php3,529 million, were reversed on December 31, 2006, excluding the amount paid or to be paid in relation to the Amended ATPA. As a result, as at December 31, 2007 and 2006, outstanding obligations of PLDT under the Amended ATPA amounted to Php93 million and Php24 million, respectively.

b. Transactions with Major Stockholders, Directors and Officers

Material transactions to which PLDT or any of its subsidiaries is a party, in which a director, key officer or owner of more than 10% of the outstanding common stock of PLDT, or any member of the immediate family of a director, key officer or owner of more than 10% of the outstanding common stock of PLDT had a direct or indirect material interest, as at December 31, 2007 and 2006 and for the three years ended December 31, 2007, 2006 and 2005 are as follows:

1. Cooperation Agreement with First Pacific and certain affiliates, or the FP Parties, NTT Communications and NTT DoCoMo

In connection with the transfer by NTT Communications of approximately 12.6 million shares of PLDT's common stock to NTT DoCoMo pursuant to a Stock Sale and Purchase Agreement dated January 31, 2006 between NTT Communications and NTT DoCoMo, the FP Parties, NTT Communications and NTT 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 NTT DoCoMo, including:

- certain contractual veto rights over a number of major decisions or transactions; and
- rights relating to the representation on the board of directors of PLDT and Smart, respectively, and any committees thereof.

Moreover, key provisions of the Cooperation Agreement pertain to, among other things:

- *Restriction on Ownership of Shares of PLDT by NTT Communications and NTT DoCoMo.* Each of NTT Communications and NTT 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, NTT 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 NTT 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 NTT DoCoMo agreed in principle to collaborate with each other on the business development, roll-out and use of a wireless-code division multiple access 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 NTT DoCoMo.

- *Additional Rights of NTT DoCoMo.* Pursuant to amendments effected by the Cooperation Agreement to the Strategic Agreement and the Shareholders Agreement, upon NTT Communications and NTT DoCoMo and their respective subsidiaries owning in the aggregate 20% or more of PLDT's shares of common stock and for as long as they continue to own in the aggregate at least 17.5% of PLDT's shares of common stock then outstanding, NTT DoCoMo has additional rights under the Strategic Agreement and Shareholders Agreement, including that:

1. NTT DoCoMo is entitled to nominate one additional NTT DoCoMo nominee to the board of directors of each PLDT Smart;
2. PLDT must consult NTT DoCoMo no later than 30 days prior to the first submission to the board of PLDT or certain of its committees of any proposal of investment in an entity that would primarily engage in a business that would be in direct competition or substantially the same business opportunities, customer base, products or services with business carried on by NTT DoCoMo, or which NTT DoCoMo has announced publicly an intention to carry on;
3. PLDT must procure that Smart does not cease to carry on its business, dispose of all of its assets, issue common shares, merge or consolidate, or effect winding up or liquidation without PLDT first consulting with NTT DoCoMo no later than 30 days prior to the first submission to the board of PLDT or Smart, or certain of its committees; and
4. PLDT must first consult with NTT DoCoMo no later than 30 days prior to the first submission to the board of PLDT or certain of its committees for the approval of any transfer by any member of the PLDT Group of Smart common capital stock to any person who is not a member of the PLDT Group.

As at February 29, 2008, NTT Communications and NTT DoCoMo together beneficially owned 20.86% of the outstanding shares of PLDT's common stock.

- *Change in Control.* Each of NTT Communications, NTT 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, NTT 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 NTT DoCoMo in good faith whether such person should be considered a Hostile Transferee.
- *Termination.* If NTT Communications, NTT 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.

2. *Integrated i-mode Services Package Agreement between NTT DoCoMo and Smart*

An Integrated i-mode Services Package Agreement was entered into by Smart and NTT DoCoMo on February 15, 2006, under which NTT 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 NTT 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. Smart has no outstanding obligation under this agreement as at December 31, 2007. Outstanding obligation under this agreement amounted to Php53 million as at December 31, 2006. Total royalty fees charged to operations under this agreement amounted to Php88 million and Php53 million as at December 31, 2007 and 2006, respectively.

3. *Advisory Services Agreement between NTT DoCoMo and PLDT*

An Advisory Services Agreement was entered into by NTT DoCoMo and PLDT on June 5, 2006, in accordance with the Cooperation Agreement dated January 31, 2006. Pursuant to the Advisory Services Agreement, NTT DoCoMo will provide the services of certain key personnel in connection with certain aspects of the business of PLDT and Smart. Also, said agreement governs the terms and conditions of the appointments of such key personnel and the corresponding fees related thereto. Total fees under this agreement amounted to Php73 million and Php44 million for the years ended December 31, 2007 and 2006, respectively. Outstanding liability under this agreement amounted to Php12 million and Php32 million as at December 31, 2007 and 2006, respectively.

4. *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 Php104 million, Php184 million and Php256 million for the years ended December 31, 2007, 2006 and 2005, respectively. As at December 31, 2007 and 2006, outstanding obligations of PLDT under these agreements amounted to Php16 million and Php18 million, respectively.

5. *Agreements 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. ALBV provides technical support services and assistance in the operations and maintenance of Smart's cellular business. The agreement, which is effective until February 23, 2008 and is subject to renewal upon mutual agreement of the parties, provides for payment of technical service fees equivalent to 1% of the consolidated net revenues of Smart. Total service fees charged to operations under this agreement amounted to Php656 million, Php591 million and Php567 million for the years ended December 31, 2007, 2006 and 2005, respectively. As at December 31, 2007, Smart had advanced the payment of service fees to ALBV amounting to Php87 million. Smart's outstanding liability to ALBV amounted to Php128 million as at December 31, 2006.
6. *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 directly paid to Malayan. Total insurance expenses under these agreements amounted to Php339 million, Php360 million and Php468 million for the years ended December 31, 2007, 2006 and 2005, respectively. Two directors of PLDT have direct/indirect interests in or serve as a director/officer of Gotuaco and Malayan, respectively.

Compensation of Key Management Personnel of the PLDT Group

PLDT Group's compensation of key management personnel by benefit type follows:

	2007	2006	2005
		(in million pesos)	
Short-term employee benefits	781	698	591
Share-based payments (Note 23)	299	978	372
Post-employment benefits	58	30	29
	1,138	1,706	992

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 finance 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.

23. Share-based Payments and Employee Benefits

Executive Stock Option Plan, or ESOP

On April 27, 1999 and December 10, 1999, the board of directors and stockholders, respectively, approved the establishment of an ESOP and the amendment of the Seventh Article of the Articles of Incorporation of PLDT denying the pre-emptive right of holders of common stock to subscribe for any issue of up to 1,289,745 common stock pursuant to the ESOP. The ESOP covers management executives, which include officers with rank of Vice President up to the President, executives with the rank of Manager up to Assistant Vice President, and advisors/consultants engaged by PLDT. The ESOP seeks to motivate option holders to achieve PLDT's goals, reward option holders for the creation of shareholder value, align the option holders' interests with those of the stockholders of PLDT, and retain the option holders to serve the long-term interests of PLDT. The ESOP is administered by the Executive Compensation Committee of the board of directors. About 1.3 million shares of common stock of PLDT had been reserved as underlying option shares under the ESOP in 1999.

Movements in the number of stock options outstanding under the ESOP are as follows:

	2007	2006
Balance at beginning of year	119,034	197,500
Exercised shares*	(92,276)	(78,466)
Balance at end of year	26,758	119,034

* Based on the date of payment of exercised shares.

Under ESOP, option grants were made for a total of 1,541,360 shares of PLDT's common stock, all of which were made to executives of PLDT and 206,942 shares of which were made to "key officers". All outstanding stock options became fully vested in December 2004. As at December 31, 2007, a total of 843,092 shares were acquired by certain officers and executives who exercised their options, at an exercise price of Php814 per share and 671,510 share option grants were cancelled due to resignation of PLDT executives.

The fair value of the ESOP was estimated at the date of grant using an option pricing model, which considered annual stock volatility, risk-free interest rate, expected life of the option, exercise price of Php814 per share, and a weighted average price of Php870 per share and Php315 per share for the 1999 and 2002 grants, respectively, as at valuation date. Total fair value of shares granted amounted to Php359 million as at December 31, 2007. No fair value of share options were recognized as an expense for the years ended December 31, 2007, 2006 and 2005.

LTIP

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 was 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 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 and chose to join the New LTIP. The early vesting of the Original LTIP in 2006 resulted in additional LTIP costs of Php1,339 million in 2006. 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 total number of SARs outstanding under the Original LTIP as at December 31, 2007 was 17,445 which is expected to be paid in May 2008. The total number of SARs awarded under the New LTIP as at December 31, 2007 was 4,319,585, which will be paid in 2010.

The fair value of the Original LTIP was estimated using an option pricing model, which considered annual stock volatility, risk-free interest rates, dividends yield, the remaining life of options and the share price capped at Php2,300 as at December 31, 2006 for the Original LTIP and share price of Php3,175 as at December 31, 2007 for the New LTIP. Incentive cost per share as at December 31, 2007 for the existing Original LTIP and for the New LTIP amounted to Php1,500 and Php1,039, respectively, while incentive cost per share as at December 31, 2006 for the existing Original LTIP amounted to Php1,350. The fair value of the LTIP recognized as an expense for the years ended December 31, 2007, 2006 and 2005 amounted to Php1,448 million, Php3,150 million and Php1,214 million, respectively. As at December 31, 2007 and 2006, outstanding LTIP liability amounted to Php1,494 million and Php5,030 million, respectively. See *Note 3 – Management's Use of Judgments, Estimates and Assumptions* and *Note 5 – Income and Expenses*.

Pension

Defined Benefit Pension Plans

We have defined benefit pension plans, covering substantially our permanent and regular employees, excluding those of Smart and its subsidiary, I-Contacts, which require contributions to be made to separate administrative funds.

Our actuarial valuation is done on an annual basis. Based on the latest actuarial valuation, the actual present value of accrued liabilities, net pension cost and average assumptions used in developing the valuation are as follows:

	2007	2006	2005
		(in million pesos)	
Change in benefit obligation:			
Benefit obligation at beginning of year	13,314	7,652	6,924
Current service cost	777	479	453
Interest cost	996	895	689
Curtailment	427	-	-
Benefits paid from assets	(566)	(594)	(495)
Actuarial losses (gains) on obligation	(4,788)	4,826	81
Liabilities of newly acquired subsidiaries	-	56	-
Benefit obligation at end of year	10,160	13,314	7,652
Change in plan assets:			
Fair value of plan assets at beginning of year	5,768	5,154	4,449
Actuarial gains on plan assets	1,157	343	92
Actual contribution	1,515	320	633
Expected return on plan assets	644	541	475
Actual benefits paid	(565)	(590)	(495)
Fair value of plan assets at end of year	8,519	5,768	5,154
Unfunded status	1,641	7,546	2,498
Unrecognized net actuarial gain (loss) (Note 3)	1,344	(4,657)	(162)
Unrealized net transition obligation	-	(1)	(61)
Accrued benefit cost (Note 3)	2,985	2,888	2,275
Components of net periodic benefit cost:			
Interest cost	996	895	689
Current service cost	777	479	453
Curtailment loss	416	-	-
Net actuarial loss recognized for the year	89	-	-
Expected return on plan assets	(644)	(541)	(475)
Amortizations of unrecognized net transition obligation	1	58	59
Net periodic benefit cost	1,635	891	726

Actual return on plan assets amounted to Php1,801 million, Php884 million and Php568 million for the years ended December 31, 2007, 2006 and 2005, respectively.

The weighted average assumptions used to determine pension benefits as at December 31, 2007, 2006 and 2005 are as follows:

	2007	2006	2005
Average remaining working years of covered employee	21	22	23
Expected rate of return on plan assets	10%	10%	10%
Discount rate	8%	8%	12%
Rate of increase in compensation	7%	9%	9%

We have adopted mortality rates in accordance with the 1983 Group Annuity Mortality Table developed by the U.S. Society of Actuaries, which provides separate rates for males and females.

As at December 31, 2007 and 2006, the assets of the beneficial trust fund established for PLDT's defined pension plan include investments in shares of stocks of PLDT and Piltel with total fair values aggregating Php2,651 million and Php2,185 million, respectively, which represent about 31% and 35%, respectively, of such beneficial trust fund's net assets available for plan benefits.

The Board of Trustees of the beneficial trust fund uses an investment approach of mixed equity and fixed income investments to maximize the long-term expected return of plan assets. The investment portfolio has been structured to achieve the objective of regular income with capital growth and out-performance of benchmarks. A majority of the investment portfolio consists of fixed income debt securities and various equity securities, while the remaining portion consists of multi-currency investments.

The allocation of the fair value of the beneficial trust fund's assets for the PLDT's defined pension plan as at December 31, 2007, 2006 and 2005 follows:

	2007	2006	2005
Investments in equity securities	60%	52%	44%
Investments in debt and fixed income securities	21%	23%	28%
Investments in real estate	8%	10%	13%
Investments in mutual funds	6%	8%	7%
Investments in temporary placements	5%	7%	8%
	100%	100%	100%

Based on the latest actuarial valuation report, the recommended cash contributions of PLDT to its pension plan in 2008 amounts to approximately Php311 million.

Defined Contribution Plan

Smart and I-Contacts contributions to the plan are made based on the employee's years of tenure and range from 5% to 10% of the employee's monthly salary. Additionally, an employee has an option to make a personal contribution to the fund, at an amount not exceeding 10% of his monthly salary. The employer then provides an additional contribution to the fund ranging from 10% to 50% of the employee's contribution based on the latter's years of tenure. Although the plan has a defined contribution format, Smart and I-Contacts regularly monitor compliance with R.A. 7641, otherwise known as "The Retirement Pay Law". As at December 31, 2007 and 2006, Smart and I-Contacts were in compliance with the requirements of R.A. 7641.

The plan's investment portfolio seeks to achieve regular income and long-term capital growth and consistent performance over its own portfolio benchmark. In order to attain this objective, the trustee's mandate is to invest in a diversified portfolio of bonds and equities, both domestic and international. The portfolio mix is kept at 60% to 90% for debt and fixed income securities while 10% to 40% is allotted to equity securities.

The allocation of the fair value of plan assets for Smart as at December 31, 2007, 2006 and 2005 follows:

	2007	2006	2005
Investments in debt and fixed income securities	57%	68%	76%
Investments in equity securities	35%	29%	23%
Others	8%	3%	1%
	100%	100%	100%

Total cash contributions to pension plan for the year ended December 31, 2007, 2006 and 2005 amounted to Php143 million, Php114 million and Php44 million, respectively, of which Php5 million, Php3 million and Php3 million, respectively, are contributions to defined contribution plans for key management personnel.

Smart and I-Contacts currently expects to make approximately Php143 million of cash contributions to its pension plan in 2008.

Pension Benefit Cost

Total pension benefit cost follows:

	2007	2006	2005
		(in million pesos)	
Expense recognized for defined benefit plans	1,635	891	726
Expense recognized for defined contribution plans	138	112	50
Total (Notes 3 and 5)	1,773	1,003	776

24. Contractual Obligations and Commercial Commitments

Contractual Obligations

The following table discloses our consolidated contractual undiscounted obligations outstanding as at December 31, 2007 and 2006:

	Payments Due by Period				
	Total	Less than 1 year	1–3 years	3–5 Years	More than 5 years
	(in million pesos)				
December 31, 2007					
<i>Long-term debt⁽¹⁾:</i>					
Principal	86,334	11,441	22,662	21,218	31,013
Interest	64,619	6,872	15,883	16,267	25,597
<i>Lease obligations:</i>	21,715	4,569	6,779	4,951	5,416
Operating lease	6,554	2,992	1,515	1,040	1,007
Finance lease	5,614	2,067	1,500	1,040	1,007
<i>Unconditional purchase obligations⁽²⁾</i>	940	925	15	–	–
<i>Other obligations:</i>	776	113	41	249	373
Mandatory conversion and purchase of shares	49,488	28,023	10,835	4,294	6,336
Derivative financial liabilities ⁽³⁾ :	1,070	1,070	–	–	–
Long-term currency swaps	11,638	8	2,938	4,240	4,452
Long-term foreign currency options	11,170	–	2,527	4,191	4,452
Interest rate swap	318	–	318	–	–
Forward foreign exchange contracts	142	–	93	49	–
Various trade and other obligations:	8	8	–	–	–
Suppliers and contractors	36,780	26,945	7,897	54	1,884
Utilities and related expenses	16,371	8,816	7,555	–	–
Employee benefits	10,532	10,453	75	4	–
Customers' deposits	2,778	2,778	–	–	–
Carriers	2,201	–	267	50	1,884
Dividends	2,187	2,187	–	–	–
Others	1,071	1,071	–	–	–
Total contractual obligations	1,640	1,640	–	–	–
	143,152	42,569	35,053	26,801	38,729
December 31, 2006					
<i>Long-term debt⁽¹⁾:</i>					
Principal	117,375	22,343	32,550	13,068	49,414
Interest	85,906	16,323	22,749	6,120	40,714
<i>Lease obligations:</i>	31,469	6,020	9,801	6,948	8,700
Operating lease	6,866	3,311	1,530	1,016	1,009
Finance lease	5,296	1,837	1,435	1,015	1,009
<i>Unconditional purchase obligations⁽²⁾</i>	1,570	1,474	95	1	–
<i>Other obligations:</i>	834	25	49	172	588
Mandatory conversion and purchase of shares (Notes 18 and 26)	42,564	22,166	12,222	2,362	5,814
Derivative financial liabilities ⁽³⁾ :	1,629	–	1,629	–	–
Long-term currency swaps	10,718	–	4,381	2,284	4,053
Long-term foreign currency options	9,296	–	3,134	2,144	4,018
Interest rate swap	943	–	943	–	–
Forward foreign exchange contracts	377	–	202	140	35
Various trade and other obligations:	102	–	102	–	–
Suppliers and contractors	30,217	22,166	6,212	78	1,761
Utilities and related expenses	11,455	5,809	5,646	–	–
Employee benefits	9,696	9,495	200	1	–
Customers' deposit	2,416	2,416	–	–	–
Carriers	2,205	1	366	77	1,761
Dividends	2,407	2,407	–	–	–
Others	774	774	–	–	–
Total contractual obligations	1,264	1,264	–	–	–
	167,639	47,845	46,351	16,618	56,825

(1) Before deducting unamortized debt discount and debt issuance costs.

(2) Based on the Amended ATPA with AIL.

(3) Gross liabilities before any offsetting application.

Long-term Debt

See *Note 18 – Interest-bearing Financial Liabilities* for a detailed discussion of our long-term debt.

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 10 to 25 years expiring at various dates. As at December 31, 2007 and 2006, PLDT's aggregate remaining obligation under these contracts amounted to approximately Php3 million and Php6 million, respectively.

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, PLDT may purchase maintenance services for a fee of 15% of the current published license fee. As at December 31, 2007 and 2006, PLDT's aggregate remaining obligation under this agreement was approximately Php15 million and Php10 million, respectively.

Other Operating Lease Obligations. The PLDT Group has various lease contracts for periods ranging from one to ten years covering certain offices, warehouses, cell sites telecommunication equipment locations and various office equipment amounting to Php5,596 million and Php5,280 million as at December 31, 2007 and 2006, respectively.

Finance Lease Obligations

See *Note 18 – Interest-bearing Financial Liabilities* for the detailed discussion of our long-term finance lease obligations.

Unconditional Purchase Obligations

See *Note 22 – Related Party Transactions* for a detailed discussion of PLDT's obligation under the Original ATPA and the Amended ATPA.

As at December 31, 2007 and 2006, PLDT's aggregate remaining minimum obligation under the Amended ATPA was approximately Php776 million and Php834 million, respectively.

Other Obligations

Mandatory Conversion and Purchase of Shares. As discussed in *Note 18 – Interest-bearing Financial Liabilities*, 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, 2007, 2,690,650 shares of the Series V Convertible Preferred Stock, 4,614,801 shares of the Series VI Convertible Preferred Stock and all of the remaining 3,842,000 shares of the Series VII Convertible Preferred Stock had been voluntarily converted into shares of PLDT's common stock and 30,790 shares of the Series V Convertible Preferred Stock and 680,303 shares of the Series VI Convertible Preferred Stock remained outstanding.

Each share of Series V and VI Convertible Preferred Stock is convertible at any time at the option of the holder into one share of PLDT's common stock. Shares of Series V and VI Convertible Preferred Stock which are outstanding on June 4, 2008, the seventh anniversary of the issue date thereof, will be mandatorily converted into shares of PLDT's common stock on the date immediately following such anniversary date. Under a put option exercisable for 30 days following the mandatory conversion, holders of shares of PLDT's common stock received on mandatory conversion of the shares of Series V and VI Convertible Preferred Stock will be able to require PLDT to purchase such shares of PLDT's common stock for Php1,700 per share and US\$36.132 per share, respectively.

The aggregate value of the put options based on outstanding shares as at December 31, 2007 was Php1,070 million assuming all of the outstanding shares of the Series V and VI Convertible Preferred Stock were mandatorily converted on June 5, 2008 and all shares of PLDT's common stock issued upon such conversion were put to PLDT at that time in accordance with the terms of the put option. The market value of the underlying shares of PLDT's common stock was Php2,256 million, based on the market price of PLDT common shares of Php3,175 per share as at December 31, 2007. On March 4, 2008, PLDT issued a notice to the effect that all of the shares of Series V and VI Convertible Preferred Stock originally issued on June 4, 2001 and outstanding as at June 4, 2008 will be mandatorily converted on June 5, 2008 to shares of PLDT's common stock. As a result of such mandatory conversion, holders of shares of PLDT's common stock received on mandatory conversion of the shares of Series V and VI Convertible Preferred Stock will be able to exercise the above described put option in accordance with its terms.

Derivative Financial Liabilities. See *Note 26 – Financial Assets and Liabilities* for the detailed discussion of our derivative financial liabilities.

Various trade and other obligations. PLDT Group has various obligations to suppliers for the acquisition of phone and network equipment, contractors for services rendered on various projects, foreign administrations and domestic carriers for the access charges, shareholders for unpaid dividends distributions, employees for benefits related obligations, and various business and operational related agreements. As at December 31, 2007 and 2006, total obligations under these various agreements amounted to approximately Php36,780 million and Php30,217 million, respectively.

Commercial Commitments

As at December 31, 2007, our outstanding commercial commitments, in the form of letters of credit, amounted to Php3,782 million. These commitments will expire within one year.

25. Provisions and Contingencies

NTC Supervision and Regulation Fees, or SRF

Since 1994, following the rejection of PLDT's formal protest against the assessments by the NTC of SRF, PLDT and the NTC had been involved in legal proceedings before the Court of Appeals and the Supreme Court. The principal issue in these proceedings was the basis for the computation of the SRF. PLDT's position, which was upheld by the Court of Appeals, but, as set forth below, rejected by the Supreme Court, was that the SRF should be computed based only on the par value of the subscribed or paid up capital of PLDT, excluding stock dividends, premium or capital in excess of par. The Supreme Court, in its decision dated July 28, 1999, ordered the NTC to make a recomputation of the SRF based on PLDT's capital stock subscribed and paid. Subsequently, in February 2000, the NTC issued an assessment letter for the balance of the SRF, but in calculating said fees, the NTC used as a basis not only capital stock subscribed or paid but also the stock dividends. PLDT questioned the inclusion of the stock dividends in the calculation of the SRF and sought to restrain the NTC from enforcing/implementing its assessment until the resolution of the said issue. Prior to the resolution of the issue mentioned above, PLDT paid the SRF due in 2000 together with the balance due from the recalculation of the SRF and had been paying the SRF due in September of each year thereafter, excluding the portion that was based on stock dividends.

As at December 31, 2007, PLDT has paid, since 1994, a total amount of Php2,541 million in SRF, of which Php2,251 million was paid under protest.

The Supreme Court, in a resolution promulgated on December 4, 2007, upheld the NTC assessment of SRF based on outstanding capital stock of PLDT, including stock dividends. PLDT intends to comply with the Supreme Court Resolution and is now in the process of paying the outstanding principal amount relating to stock dividend amounts in the amount of Php455 million to the NTC.

Local Business and Franchise Tax Assessments

As discussed below, PLDT currently expects that going forward, PLDT will pay local franchise taxes on an annual basis based on the gross receipts received or collected for services rendered within the jurisdiction of the respective taxing authority. For this reason, we have made the appropriate provisions in our consolidated financial statements as at December 31, 2007.

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 the Public Telecommunications Policy Act, or 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. However, on March 25, 2003, in a ruling relating to a tax assessment by the City of Davao, the Supreme Court decided that PLDT was not exempt from the local franchise tax.

Although PLDT believes that it is not liable to pay local franchise and business taxes, PLDT has entered into compromise settlements with several LGUs, including the City of Makati, in order to maintain and preserve its good standing and relationship with these LGUs. Under these compromise settlements, which have mostly been approved by the relevant courts, as at December 31, 2007, PLDT has paid a total amount of Php694 million for local franchise tax covering prior periods up to the end of 2006.

PLDT had no longer contested assessments of LGUs for franchise taxes based on gross receipts received or collected for services within their respective territorial jurisdiction as at December 31, 2007.

However, PLDT 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 Php6.2 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. In addition, PLDT is contesting the imposition of franchise tax by the Province of Cagayan based on gross receipts derived from outside its territorial jurisdiction in the amount of Php3 million for the years 1999 to 2006.

While Smart had received and paid under protest the local franchise tax assessment issued by the City of Makati totaling approximately Php312 million, the Regional Trial Court, or RTC, of Makati declared Smart exempt from payment of local franchise tax to the City of Makati and on June 9, 2005, the Court of Appeals dismissed the appeal filed by the City of Makati.

Also, Smart had received local franchise tax assessments issued by the City of Iloilo amounting to approximately Php1 million. 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. To date, Smart has not received any notice that the said decision had been appealed by the City of Iloilo.

26. Financial Assets and Liabilities

Our principal financial liabilities, other than derivatives, comprise of bank loans and overdrafts, convertible preferred stock, finance leases, trade and non-trade payables. The main purpose of these financial liabilities is to finance our operations. We have various financial assets such as trade and non-trade receivables and cash and short-term deposits, which arise directly from our operations. We also enter into derivative transactions, primarily principal only currency swap agreements, currency options, interest rate swaps and forward foreign exchange contracts to manage the currency and interest rate risks arising from our operations and sources of financing. Our accounting policies in relation to derivatives are set out in *Note 2 – Summary of Significant Accounting Policies and Practices*.

The following table sets forth our financial assets and financial liabilities as at December 31, 2007 and 2006.

	Loans and receivables	Held-to-maturity investments	Held-for-trading	Derivatives used for hedging	Available-for-sale financial investments	Liabilities carried at amortized cost	Total financial assets and liabilities	Non-financial assets and liabilities	Total
(in million pesos)									
Assets as at December 31, 2007									
<i>Noncurrent:</i>									
Property, plant and equipment – net	-	-	-	-	-	-	-	159,414	159,414
Investments in associates	-	-	-	-	-	-	-	1,351	1,351
Investments-available-for-sale	-	-	-	-	143	-	143	-	143
Investment in debt securities	-	273	-	-	-	-	273	-	273
Investment properties	-	-	-	-	-	-	-	577	577
Goodwill and intangible assets	-	-	-	-	-	-	-	11,721	11,721
Deferred income tax assets	-	-	-	-	-	-	-	13,757	13,757
Derivative financial assets	-	-	58	1	-	-	59	-	59
Prepayments – net of current portion	-	-	-	-	-	-	-	2,281	2,281
Advances and refundable deposits – net of current portion	734	-	-	-	-	-	734	296	1,030
<i>Current:</i>									
Cash and cash equivalents	17,447	-	-	-	-	-	17,447	-	17,447
Short-term investments	11,366	-	2,049	-	-	-	13,415	-	13,415
Investment in debt securities	1,115	-	-	-	-	-	1,115	-	1,115
Trade and other receivables	12,645	-	-	-	-	-	12,645	-	12,645
Inventories and supplies	-	-	-	-	-	-	-	1,167	1,167
Derivative financial assets	-	-	227	670	-	-	897	-	897
Current portion of prepayments	-	-	-	-	-	-	-	2,368	2,368
Current portion of advances and refundable deposits	-	-	-	-	-	-	-	498	498
Total assets	43,307	273	2,334	671	143	-	46,728	193,430	240,158
Liabilities as at December 31, 2007									
<i>Noncurrent:</i>									
Interest bearing financial liabilities – net of current portion	-	-	-	-	-	53,387	53,387	-	53,387
Deferred income tax liabilities	-	-	-	-	-	-	-	2,155	2,155
Derivative financial liabilities	-	-	530	7,211	-	-	7,741	-	7,741
Pension and other employee benefits	-	-	-	-	-	-	-	4,540	4,540
Customers' deposits	-	-	-	-	-	2,201	2,201	-	2,201
Deferred credits and other noncurrent liabilities	-	-	-	-	-	7,608	7,608	2,024	9,632
<i>Current:</i>									
Accounts payable	-	-	-	-	-	10,605	10,605	1,648	12,253
Accrued expenses and other current liabilities	-	-	-	-	-	16,570	16,570	5,104	21,674
Derivative financial liabilities	-	-	237	5	-	-	242	-	242
Provisions for assessments	-	-	-	-	-	-	-	1,112	1,112
Current portion of interest-bearing financial liabilities	-	-	-	-	-	8,764	8,764	-	8,764
Dividends payable	-	-	-	-	-	1,071	1,071	-	1,071
Income tax payable	-	-	-	-	-	-	-	2,875	2,875
Total liabilities	-	-	767	7,216	-	100,206	108,189	19,458	127,647
Net assets and liabilities	43,307	273	1,567	(6,545)	143	(100,206)	(61,461)	173,972	112,511
Assets as at December 31, 2006									
<i>Noncurrent:</i>									
Property, plant and equipment – net	-	-	-	-	-	-	-	164,190	164,190
Investments in associates	-	-	-	-	-	-	-	636	636
Investments-available-for-sale	-	-	-	-	116	-	116	-	116
Investment properties	-	-	-	-	-	-	-	587	587
Goodwill and intangible assets	-	-	-	-	-	-	-	12,214	12,214
Deferred income tax assets	-	-	-	-	-	-	-	19,884	19,884
Derivative financial assets	-	-	139	295	-	-	434	-	434
Prepayments – net of current portion	-	-	-	-	-	-	-	2,185	2,185
Advances and refundable deposits – net of current portion	646	-	-	-	-	-	646	420	1,066
<i>Current:</i>									
Cash and cash equivalents	16,870	-	-	-	-	-	16,870	-	16,870
Short-term investments	5,520	-	2,807	-	-	-	8,327	-	8,327
Trade and other receivables	10,158	-	-	-	-	-	10,158	-	10,158
Inventories and supplies	-	-	-	-	-	-	-	1,230	1,230
Derivative financial assets	-	-	47	-	-	-	47	-	47
Current portion of prepayments	-	-	-	-	-	-	-	4,018	4,018
Current portion of advances and refundable deposits	1	-	-	-	-	-	1	155	156
Total assets	33,195	-	2,993	295	116	-	36,599	205,519	242,118

	Loans and receivables	Held-to-maturity investments	Held-for-trading	Derivatives used for hedging	Available-for-sale financial investments	Liabilities carried at amortized cost	Total financial assets and liabilities	Non-financial assets and liabilities	Total
(in million pesos)									
Liabilities as at December 31, 2006									
Noncurrent:									
Interest bearing financial liabilities – net of current portion	-	-	-	-	-	65,244	65,244	-	65,244
Deferred income tax liabilities	-	-	-	-	-	-	-	402	402
Derivative financial liabilities	-	-	1,680	5,192	-	-	6,872	-	6,872
Pension and other employee benefits	-	-	-	-	-	-	-	2,982	2,982
Customers' deposits	-	-	-	-	-	2,204	2,204	-	2,204
Deferred credits and other noncurrent liabilities	-	-	-	-	-	6,483	6,483	1,542	8,025
Current:									
Accounts payable	-	-	-	-	-	7,348	7,348	1,286	8,634
Accrued expenses and other current liabilities	-	-	-	-	-	13,288	13,288	9,325	22,613
Derivative financial liabilities	-	-	108	-	-	-	108	-	108
Provisions for assessments	-	-	-	-	-	-	-	446	446
Current portion of interest-bearing financial liabilities	-	-	-	-	-	17,309	17,309	-	17,309
Dividends payable	-	-	-	-	-	774	774	-	774
Income tax payable	-	-	-	-	-	-	-	2,438	2,438
Total liabilities	-	-	1,788	5,192	-	112,650	119,630	18,421	138,051
Net assets and liabilities	33,195	-	1,205	(4,897)	116	(112,650)	(83,031)	187,098	104,067

The following table sets forth the carrying values and estimated fair values of our financial assets and liabilities recognized as at December 31, 2007 and 2006.

	Carrying Value		Fair Value	
	2007	2006	2007	2006
(in million pesos)				
Noncurrent Financial Assets				
Investments-available-for-sale:				
Listed equity securities	77	55	77	55
Unlisted equity securities	66	61	66	61
Investment in debt securities	273	-	283	-
Derivative financial assets:				
Long-term foreign currency options	58	296	58	296
Long-term currency options	1	138	1	138
Advances and refundable deposits – net of current portion	734	646	657	564
Total noncurrent financial assets	1,209	1,196	1,142	1,114
Current Financial Assets				
Cash and cash equivalents:				
Cash on hand and in banks	3,944	3,416	3,944	3,416
Temporary cash investments	13,503	13,454	13,503	13,454
Short-term investments	13,415	8,327	13,415	8,327
Investment in debt securities	1,115	-	1,115	-
Trade and other receivables:				
Foreign administrations	4,324	3,836	4,324	3,836
Retail subscribers	3,861	2,027	3,861	2,027
Corporate subscribers	2,040	1,742	2,040	1,742
Domestic carriers	1,503	1,461	1,503	1,461
Dealers, agents and others	917	1,092	917	1,092
Derivative financial assets:				
Forward foreign exchange contracts	863	3	863	3
Bifurcated embedded derivatives	34	44	34	44
Current portion of advances and refundable deposits	-	1	-	1
Total current financial assets	45,519	35,403	45,519	35,403
Total Financial Assets	46,728	36,599	46,661	36,517

	Carrying Value		Fair Value	
	2007	2006	2007	2006
	(in million pesos)			
Noncurrent Financial Liabilities				
Interest-bearing financial liabilities:				
Long-term debt - net of current portion	53,372	63,769	58,044	70,420
Obligations under finance lease	15	106	15	106
Preferred stock subject to mandatory redemption	-	1,369	-	1,528
Derivative financial liabilities:				
Long-term currency swap	7,211	5,192	7,211	5,192
Long-term foreign currency options	390	1,043	390	1,043
Interest rate swap	140	413	140	413
Bifurcated equity call options	-	224	-	224
Customers' deposits	2,201	2,204	1,481	1,439
Deferred credits and other noncurrent liabilities	7,608	6,483	6,553	5,609
Total noncurrent financial liabilities	70,937	80,803	73,834	85,974
Current Financial Liabilities				
Accounts payable:				
Suppliers and contractors	8,493	5,562	8,493	5,562
Carriers	1,843	1,593	1,843	1,593
Others	269	193	269	193
Accrued expenses and other current liabilities:				
Utilities and related expenses	10,780	8,078	10,780	8,078
Employee benefits	2,795	2,416	2,795	2,416
Interest and other related costs	1,234	1,768	1,234	1,768
Others	1,761	1,026	1,761	1,026
Derivative financial liabilities:				
Bifurcated equity call options	231	-	231	-
Forward foreign exchange contracts	7	92	7	92
Interest rate swap	4	10	4	10
Long-term currency options	-	6	-	6
Interest-bearing financial liabilities:				
Notes payable	493	201	493	201
Current portion of long-term debt	6,775	16,184	6,775	16,184
Obligations under finance lease	481	924	481	924
Preferred stock subject to mandatory redemption	1,015	-	1,015	-
Dividends payable	1,071	774	1,071	774
Total current financial liabilities	37,252	38,827	37,252	38,827
Total Financial Liabilities	108,189	119,630	111,086	124,801

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

Long-term financial assets and liabilities: Fair value is based on the following:

Type	Fair Value Assumptions
Noncurrent portion of advances and refundable deposits	Estimated fair value is based on the discounted values of future cash flows using the applicable zero coupon rates plus credit spread.
Fixed rate loans: U.S. dollar notes/convertible debt Other loans in all other currencies	Quoted market price. Estimated fair value is based on the discounted value of future cash flows using the applicable CIRR and Philippine Dealing System Treasury Fixing rates for similar types of loans.
Variable rate loans	The carrying value approximates fair value because of recent and regular repricing based on market conditions.
Customers' deposits and deferred credits and other noncurrent liabilities	Estimated fair value is based on the discounted values of future cash flows using the applicable zero coupon rates plus credit spread.

Preferred stock subject to mandatory redemption: The fair values were determined using a discounted cash flow model.

Derivative Financial Instruments:

Foreign currency options: The fair values were computed using an option pricing model using market volatility rates of the U.S. dollar and Philippine peso exchange rate as at valuation date.

Forward foreign exchange contracts, bifurcated foreign currency forwards, foreign currency and interest rate swaps: The fair values were computed as the present value of estimated future cash flows using market U.S. dollar and Philippine peso interest rates as at valuation date.

Bifurcated equity call options: The fair values were computed using an option pricing model using market volatility rates of the PLDT share price as at valuation date.

Investments-available-for sale: Fair values were determined using quoted prices.

Due to the short-term nature of the transactions, the fair value of cash and cash equivalents, short-term investments, investment in debt securities, trade and other receivables, current portion of advances and refundable deposits, accounts payable, accrued expenses and other current liabilities, current portion of interest-bearing financial liabilities, and dividends payable approximate the carrying values as at the balance sheet date.

Derivative Financial Instruments

Our derivative financial instruments are accounted for as either cash flow hedges or transactions not designated as hedges. Cash flow hedges refer to those transactions that hedge our exposure to variability in cash flows attributable to a particular risk associated with a recognized financial asset or liability and exposures arising from forecast transactions. Changes in the fair value of these instruments representing effective hedges are recognized as cumulative translation adjustments in equity until the hedged item is recognized in earnings. For transactions that are not designated as hedges, any gains or losses arising from the changes in fair value are recognized directly to income for the period.

The table below sets out the information about our derivative financial instruments as at December 31, 2007 and 2006:

	Maturity	2007		2006	
		Notional	Mark-to-market Gains (Losses)	Notional	Mark-to-market Gains (Losses)
(in millions)					
PLDT					
Cash flow hedges:					
Long-term currency swaps	2017	US\$300	(Php3,714)	US\$300	(Php2,716)
	2012	250	(3,496)	250	(2,475)
Long-term foreign currency options	2009	136	(389)	167	(747)
Forward foreign exchange contracts	2008	134	296	–	–
Transactions not designated as hedges:					
Long-term foreign currency options	2009	136 ⁽¹⁾	58	167 ⁽¹⁾	138
Forward foreign exchange contracts	2008	16	20	202	(90)
Interest rate swap	2012	31	(144)	63	(423)
Bifurcated equity call options	2008	1 share	(231)	1 share	(224)
Short-term currency options	2007	–	–	7	(6)
			(7,600)		(6,543)
Smart					
Cash flow hedges:					
Forward foreign exchange contracts	2008	171	265	–	–
Transactions not designated as hedges:					
Forward foreign exchange contracts					
On loan proceeds	2008	50	100	–	–
On gross U.S. dollar revenues	2008	55	70	–	–
Bifurcated embedded derivatives	2008	5	34	15	44
			469		44
ePLDT					
Cash flow hedges:					
Forward foreign exchange contracts	2008	36	104	–	–
Net liabilities			(Php7,027)		(Php6,499)

⁽¹⁾ Non-hedged portion of 2009 long-term foreign currency options based on the same notional amount as the hedged portion.

	2007	2006
	(in million pesos)	
Presented as:		
Noncurrent assets	59	434
Current assets	897	47
Noncurrent liabilities	(7,741)	(6,872)
Current liabilities	(242)	(108)
Net liabilities	(7,027)	(6,499)

Analysis of losses (gains) on derivative financial instruments for the years ended December 31, 2007, 2006 and 2005 are as follows:

	2007	2006	2005
	(in million pesos)		
Net mark-to-market losses at end of year	(7,027)	(6,499)	(3,284)
Net mark-to-market losses at beginning of year	(6,499)	(3,284)	(2,953)
Net change	(528)	(3,215)	(331)
Net losses charged to cumulative translation adjustments	1,234	6,452	1,014
Settlements, accretion and conversion	(622)	(3,642)	(1,311)
Ineffective portion recognized in the profit or loss for the cash flow hedge	(3)	-	-
Net gains (losses) on derivative financial instruments (Note 5)	81	(405)	(628)

PLDT

Long-term Currency Swaps

PLDT entered into long-term principal only currency swap agreements with various foreign counterparties to hedge the currency risk on its fixed rate notes maturing in 2012 and 2017. As at December 31, 2007 and 2006, these long-term currency swaps have an aggregate notional amount of US\$550 million. Under the swaps, PLDT effectively exchanges the principal of its U.S. dollar-denominated fixed rate notes into Philippine peso-denominated loan exposures at agreed swap exchange rates. The agreed swap exchange rates are reset to the lowest U.S. dollar/Philippine peso spot exchange rate during the term of the swaps, subject to a minimum exchange rate. In March and April 2004, PLDT entered into amendments to keep the lowest reset exchange rate and unwind the downward resettable feature of US\$550 million of its long-term principal only currency swap agreements in order to lower the running hedging cost of the swaps. As at December 31, 2007 and 2006, the outstanding swap contracts have an agreed average swap exchange rate of Php50.76.

In order to manage hedge costs, these swaps included a credit-linkage feature with PLDT as the reference entity. The specified credit events include bankruptcy, failure to pay, obligation acceleration, moratorium/repudiation, and restructuring of PLDT bonds or all or substantially all of PLDT's obligations. Upon the occurrence of any of these credit events, subject to agreed threshold amounts where applicable, the obligations to both PLDT and its counterparty under the swap contracts terminate without further settlements to either party, including any mark-to-market value of the swaps. As at December 31, 2007 and 2006, US\$686 million and US\$717 million, respectively, of PLDT's long-term currency swaps/options have been structured to include credit-linkage with PLDT as the reference entity. The semi-annual fixed or floating swap cost payments that PLDT is required to make to its counterparties averaged about 3.93% and 5.18% per annum as at December 31, 2007 and 2006, respectively. As cash flow hedges, any movements in the fair value of these financial instruments will be taken as cumulative translation adjustments under equity in our consolidated balance sheets. There is no ineffective portion in the fair value of these financial instruments recognized in the consolidated statement of income.

Long-term Foreign Currency Options

To manage hedging costs, the currency swap agreement relating to the 2009 fixed rate notes with a notional amount of US\$175 million has been structured to include currency option contracts. If the Philippine peso to U.S. dollar spot exchange rate on maturity date settles beyond Php90.00 to US\$1.00, PLDT will have the option to purchase U.S. dollar at an exchange rate of Php52.50 to US\$1.00 plus the excess above the agreed threshold rate. On the other hand, if on maturity, the Philippine peso to U.S. dollar spot exchange rate is lower than the exchange rate of Php52.50 to US\$1.00, PLDT will have to purchase at the prevailing Philippine peso to U.S. dollar spot exchange rate. In July 2004, PLDT and its counterparty, agreed to re-document and re-classify the transaction into long-term currency option contracts. The net semi-annual floating hedge cost payments that PLDT is required to pay under these transactions was approximately 4.34% and 6.17% per annum as at December 31, 2007 and 2006, respectively.

The option currency contract relating to PLDT's option to purchase U.S. dollar at Php52.50 to US\$1.00 or prevailing spot exchange rate at maturity, whichever is lower, qualifies as a cash flow hedge. The option currency contract relating to the counterparty's option to purchase foreign currency from PLDT at Php90.00 to US\$1.00 is not designated as a hedge. Please refer to discussion below (under transactions not designated as hedges). Both option contracts have been structured to include credit-linkage with PLDT as the reference entity similar to the long-term currency swaps.

In December 2006, the currency option agreement was partially terminated, thereby reducing the outstanding currency options notional amount to US\$167 million. The total amounts settled for the unwinding was Php40 million.

In January 2007, the currency option agreement was again partially terminated, thereby further reducing the outstanding currency options notional amount to US\$136 million. The total amounts settled for the unwinding was Php177 million.

Due to the amounts of PLDT's foreign currency hedging requirements and the large interest differential between the Philippine peso and the U.S. dollar, the costs to book long-term hedges can be significant. In order to manage such hedging costs, PLDT utilizes structures that include currency option contracts, and fixed-to-floating coupon-only swaps that may not qualify for hedge accounting.

Concurrent with the above swap agreement relating to the 2009 fixed rate notes, PLDT sold a currency option contract with the same notional amount of US\$175 million with the same maturity that gives the counterparty a right to purchase foreign currency at Php90.00 to US\$1.00. Together with the long-term currency option contract classified under cash flow hedges, PLDT has the obligation to purchase U.S. dollars at an exchange rate of Php52.50 to US\$1.00 plus the excess above the agreed threshold rate. In exchange for this condition, the overall net hedging cost for the transaction is reduced.

In December 2006, the currency option agreement was partially terminated, thereby reducing the notional amount to US\$167 million. Since changes in fair value have already been recognized as profit or loss in prior periods, the corresponding proceeds from the partial termination of the currency option contract amounted to Php7 million.

In January 2007, the currency option agreement was again partially terminated, thereby further reducing the outstanding notional amount to US\$136 million. The proceeds from this transaction amounted to Php33 million.

Forward Foreign Exchange Contracts

In 2007, PLDT entered into short-term U.S. dollar forward foreign exchange sale contracts to hedge a portion of monthly dollar revenues maturing monthly in 2008. As at December 31, 2007, outstanding forward foreign exchange contracts not accounted for under hedge accounting amounted to US\$16 million with an average exchange rate of Php43.19.

PLDT entered into short-term U.S. dollar forward foreign exchange purchase contracts to hedge short-term foreign currency obligations. There were no outstanding forward foreign exchange contracts as at December 31, 2007. As at December 31, 2006, outstanding forward foreign exchange contracts amounted to US\$202 million with an average exchange rate of Php49.50.

Interest Rate Swap

A portion of PLDT's currency swap agreements to hedge its 2017 fixed rate notes carry fixed rate swap cost payments. To effectively lower the running cost of such swap agreements, in April 2003, PLDT entered into an agreement to swap the coupon on US\$125 million of its 2012 fixed rate notes into a floating rate Japanese yen amount. Under this agreement, PLDT is entitled to receive a fixed coupon rate of 11.375%, provided the Japanese yen to U.S. dollar exchange rate stays above JP¥99.90 to US\$1.00. Below this level, a reduced fixed coupon rate of 3% will be due to PLDT. In order to mitigate the risk of the Japanese yen strengthening below the agreed threshold, in December 2003, PLDT entered into an overlay swap transaction to effectively lower the portion of the coupon indexed to the U.S. dollar to Japanese yen rate to 3% such that the fixed coupon rate due to PLDT when the Japanese yen strengthens below the agreed threshold will be 8.375%. Both swap agreements include a credit-linkage feature with PLDT as the reference entity.

In March 2006, the interest rate and overlay swap agreements were partially terminated to effectively lower the outstanding interest rate swap notional amount to US\$63 million. Since changes in fair values have already been recognized as profit or loss in prior periods, the corresponding liability settled by PLDT amounted to Php804 million.

In April 2007, the interest and overlay swap agreements were again partially terminated where outstanding notional amount was lowered to US\$31 million. The total amounts settled for the unwinding is Php276 million.

Bifurcated Equity Call Options

Pursuant to Piltel's debt restructuring plan, PLDT issued its shares of Series VI and VII Convertible Preferred Stock. See *Note 18 – Interest-bearing Financial Liabilities*. Each share of Series VI and VII Convertible Preferred Stock is convertible at any time at the option of the holder into one share of PLDT's common stock. On the date immediately following the seventh anniversary of the issue date of the Series VI Convertible Preferred Stock and on the eighth anniversary of the issue date of the Series VII Convertible Preferred Stock, the remaining outstanding shares under these series will be mandatorily converted into shares of PLDT's common stock. For 30 days thereafter, the holders of these mandatorily converted shares of PLDT's common stock have the option to sell such shares of PLDT's common stock back to PLDT for US\$36.132 per share and JP¥4,071.89 per share for Series VI and VII, respectively. On August 18, 2006, all of the remaining 3,842,000 shares of the Series VII were converted to PLDT's common stock. As at December 31, 2007 and 2006, the negative fair market value of these embedded call options amounted to Php231 million and Php224 million, respectively.

Short-term Foreign Currency Options

In 2006, PLDT entered into short-term U.S. dollar currency option contracts to hedge our other short-term foreign currency obligations. There were no outstanding currency option contracts as at December 31, 2007. As at December 31, 2006, outstanding U.S. dollar currency option contracts amounted to US\$7 million with an average rating of US\$50.40.

Smart

Smart entered into U.S. dollar forward foreign exchange sale contracts to hedge a portion of monthly dollar revenues maturing in 2008. As at December 31, 2007, outstanding forward foreign exchange sale contracts not accounted for under hedge accounting amounted to US\$55 million with an average exchange rate of Php42.997.

Smart also entered into short-term U.S. dollar forward foreign exchange sale contracts for a total amount of US\$50 million as at December 31, 2007 to hedge 100% of the total expected loan proceeds from the undrawn US\$50 million Nord/LB Facility with an average exchange rate of Php43.561.

Smart's other embedded derivatives were bifurcated from service and purchase contracts. As at December 31, 2007 and 2006, outstanding contracts included service contracts with foreign equipment suppliers and various suppliers covering handset importations denominated in U.S. dollars, which is not the functional currency of a substantial party to the contract or the routine currency of the transaction.

Financial Risk Management Objectives and Policies

The main risks arising from our financial instruments are liquidity risk, foreign exchange risk, interest rate risk and credit risk. The importance of managing those risks has significantly increased in light of the considerable change and volatility in both the Philippine and international financial markets. Our board of directors reviews and approves policies for managing each of these risks. Our policies for managing these risks are summarized below. We also monitor the market price risk arising from all financial instruments.

Liquidity Risk

We need to manage our liquidity profile to be able to finance our operations and capital expenditures, service our maturing debts and meet our other financial obligations. To cover our financing requirements, we 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 flows, including our loan maturity profiles, and continuously assess conditions in the financial markets for opportunities to pursue fund-raising initiatives. These activities may include bank loans, export credit agency-guaranteed facilities, debt capital and equity market issues.

Any excess funds are primarily invested in short-dated and principal-protected bank products that provide flexibility of withdrawing the funds anytime. We also allocate a portion of our cash in longer tenor investments such as fixed income securities issued or guaranteed by the Republic of the Philippines, or ROP, and Philippine banks and corporates, managed funds and other structured products linked to the ROP. We regularly evaluate available financial products and monitor market conditions for opportunities to enhance yields at acceptable risk levels. Our investments are also subject to certain restrictions contained in our debt covenants. Our funding arrangements are designed to keep an appropriate balance between equity and debt and to provide financing flexibility while enhancing our businesses.

A summary of the maturity profile of our financial liabilities as at December 31, 2007 and 2006 based on contractual undiscounted payments is set out in *Note 24 – Contractual Obligations and Commercial Commitments*.

Foreign Currency Exchange Risk

The revaluation of our foreign currency-denominated financial assets and liabilities as a result of the appreciation or depreciation of the Philippine peso is recognized as foreign exchange gains or losses as at the balance sheet date. The extent of foreign exchange gains or losses is largely dependent on the amount of foreign currency debt and hedges we carry. While a certain percentage of our revenues are either linked to or denominated in U.S. dollars, most 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 such, a strengthening or weakening of the Philippine peso against the U.S. dollar will decrease or increase in Philippine peso terms both the principal amount of our unhedged foreign currency-denominated debts and the related interest expense of our foreign currency-denominated capital expenditures and operating expenses as well as our U.S. dollar-linked and U.S. dollar-denominated revenues. 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.

To manage our foreign exchange risks and to stabilize our cash flows to improve investment and cash flow planning, we enter into forward foreign exchange contracts, 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. We use forward foreign exchange purchase contracts, currency swap contracts and foreign currency option contracts to manage the foreign currency risks associated with our foreign currency-denominated loans. We also enter into forward foreign exchange sale contracts to manage foreign currency risks associated with our U.S. dollar-linked and U.S. dollar-denominated revenues. 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 foreign currency option contracts, and fixed to floating coupon only swap agreements. We accounted for these instruments as either cash flow hedges, wherein changes in the fair value are recognized as cumulative translation adjustments in equity until the hedged transaction affects the consolidated statement of income or when the hedging instrument expires, or transactions not designated as hedges, wherein changes in the fair value are recognized directly as income or expense for the year.

The following table shows our consolidated foreign currency-denominated monetary financial assets and liabilities and their Philippine peso equivalents as at December 31, 2007 and 2006:

	2007		2006	
	U.S. Dollar	Php ⁽¹⁾	U.S. Dollar	Php ⁽²⁾
	(in millions)			
Noncurrent Financial Asset				
Derivative financial assets	US\$1	Php59	US\$9	Php434
Current Financial Assets				
Cash and cash equivalents	93	3,853	155	7,578
Short-term investments	56	2,324	92	4,521
Trade and other receivables	227	9,400	277	13,589
Derivative financial assets	23	967	1	47
Total current financial assets	399	16,544	525	25,735
Total Financial Assets	US\$400	Php16,603	US\$534	Php26,169
Noncurrent Financial Liabilities				
Interest-bearing financial liabilities – net of current portion	US\$1,126	Php46,612	US\$1,239	Php60,756
Derivative financial liabilities	187	7,741	140	6,872
Total noncurrent financial liabilities	1,313	54,353	1,379	67,628
Current Financial Liabilities				
Accounts payable	160	6,614	268	13,115
Accrued expenses and other current liabilities	95	3,958	74	3,605
Derivative financial liabilities	6	242	2	108
Current portion of interest-bearing financial liabilities	187	7,748	328	16,104
Total current financial liabilities	448	18,562	672	32,932
Total Financial Liabilities	US\$1,761	Php72,915	US\$2,051	Php100,560

⁽¹⁾ The exchange rate used to translate the U.S. dollar amounts into Philippine peso was Php41.411 to US\$1.00, the peso-dollar rate as quoted through the Philippine Dealing System as at December 31, 2007.

⁽²⁾ The exchange rate used to translate the U.S. dollar amounts into Philippine peso was Php49.045 to US\$1.00, the peso-dollar rate as quoted through the Philippine Dealing System as at December 31, 2006.

As at March 13, 2008, the peso-dollar exchange rate was Php41.417 to US\$1.00. Using this exchange rate, our consolidated net foreign currency-denominated financial liabilities as at December 31, 2007 would have increased by Php8 million.

As at December 31, 2007, approximately 88% of our total consolidated debts was denominated in U.S. dollars. Consolidated foreign currency-denominated debt was reduced to Php52,540 million as at December 31, 2007 from Php76,646 million as at December 31, 2006. PLDT's outstanding long-term principal only currency swap contracts and foreign currency option contracts amounted to US\$550 million and US\$136 million, respectively, as at December 31, 2007. Consequently, the unhedged portion of consolidated debts amounts was approximately 45% (or 36%, net of our U.S. dollar cash balances) as at December 31, 2007.

For the year ended December 31, 2007, approximately 34% of our consolidated revenues were either denominated in U.S. dollars or were linked to the U.S. dollars. In this respect, the recent appreciation of the Philippine peso against the U.S. dollar reduced our revenues, and consequently, our cash flow from operations in Philippine peso terms.

The Philippine peso had appreciated by 16% against the U.S. dollar to Php41.411 to US\$1.00 as at December 31, 2007, from Php49.045 to US\$1.00 as at December 31, 2006. Likewise, 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. As a result of the foreign exchange movements as well as the amount of our outstanding foreign currency debts and hedges, we recognized foreign exchange gains of Php2,976 million, Php1,967 million and Php4,906 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Management conducted a survey among our banks to determine the outlook of the peso-dollar exchange rate until our next reporting date of March 31, 2008. Our outlook is that the peso-dollar exchange rate may weaken/strengthen by 2% as compared to the exchange rate of Php41.411 to US\$1.00 as of year end 2007. At December 31, 2007, if the peso-dollar exchange rate had weakened/strengthened by 2%, with all other variables held constant, profit after tax for the year would have been Php663 million higher/lower and our Stockholders' equity would have been Php649 million higher/lower, mainly as a result of foreign exchange gains, losses on translation of U.S. dollar-denominated net assets/liabilities, marked-to-market valuation of financial assets/liabilities and foreign exchange gains/losses on translation of cash flow hedges transactions.

Interest Rate Risk

Our exposure to the risk of changes in market interest rates relates primarily to our long-term debt obligations and short-term borrowings with floating interest rates.

Our policy is to manage interest cost through a mix of fixed and variable rate debts. We evaluate the fixed to floating ratio of our loans in line with movements of relevant interest rates in the financial markets. Based on our assessment, new financing will be priced either on a fixed or floating rate basis. 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 risk associated with our liabilities and not for trading purposes.

The following tables set out the carrying amount, by maturity, of our financial instruments that are exposed to interest rate risk for the years ended December 31, 2007 and 2006. Financial instruments that are not subject to interest rate risk were not included in the table.

Year Ended December 31, 2007

	Below 1 year	1-2 years	2-3 years	3-5 years	Over 5 years	In U.S. Dollar	In Php	Discount/ Debt Issuance Cost In Php	Carrying Value In Php	Fair Value	
										In U.S. Dollar	In Php
(in millions)											
Liabilities:											
Long-term Debt											
Fixed Rate											
US\$ Notes	-	136	-	250	300	686	28,403	387	28,016	770	31,901
Interest rate	-	10.500%	-	11.375%	8.350%	-	-	-	-	-	-
US\$ Fixed Loans	55	46	23	9	280	413	17,123	4,016	13,107	342	14,078
Interest rate	4.49% to 8.9%	4.49% to 6.0%	4.515% to 4.7%	4.700%	2.250%	-	-	-	-	-	-
Philippine Peso	-	-	-	93	38	131	5,420	33	5,387	125	5,168
Interest rate	7.090%	6.500%	6.500%	5.625% to 6.50%	6.125% to 6.50%	-	-	-	-	-	-
Variable Rate											
U.S. Dollar	98	92	58	28	-	276	11,445	28	11,417	276	11,445
Interest rate	0.05% to 2.75% over US\$ LIBOR	0.05% to 2.75% over US\$ LIBOR	0.05% to 2.5% over US\$ LIBOR	0.75% to 0.815% over US\$ LIBOR	-	-	-	-	-	-	-
Philippine Peso	14	14	13	13	-	54	2,228	8	2,220	54	2,227
Interest rate	MART1 + 0.75% to 5.70%	MART1 + 0.75% to 5.70%	MART1 + 0.75% to 5.70%	MART1 + 0.75%	-	-	-	-	-	-	-
						1,560	64,619	4,472	60,147	1,567	64,819
Interest rate swap (fixed to floating)											
U.S. Dollar (US\$31 million)	-	-	-	-	-	3.5	144	-	144	3.5	144
Japanese Yen (JP¥3,759 million)	-	-	-	-	-	-	-	-	-	-	-
Fixed Rate on US\$ notional	11.375%	11.375%	11.375%	11.375%	11.375%	-	-	-	-	-	-
Variable Rate on JP¥ 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, 2006

	Below 1 year	1-2 years	2-3 years	3-5 years	Over 5 years	In U.S. Dollar	In Php	Discount/Debt Issuance Cost In Php	Carrying Value In Php	Fair Value	
										In U.S. Dollar	In Php
(in millions)											
Liabilities:											
Long-term Debt											
<i>Fixed Rate</i>											
US\$ Notes	130	-	167	-	550	847	41,510	539	40,971	965	47,228
Interest rate	7.85% to 10.625%	-	10.50%	-	8.35% to 11.375%	-	-	-	-	-	-
US\$ Fixed Loans	69	55	46	33	280	483	23,683	5,326	18,357	376	18,438
Interest rate	1.75% to 10%	4.49% to 10%	4.49% to 10%	4.515% to 4.70%	2.25%	-	-	-	-	-	-
Philippine Peso	-	-	-	17	-	17	810	2	808	21	1,035
Interest rate	-	-	-	15%	-	-	-	-	-	-	-
<i>Variable Rate</i>											
U.S. Dollar	128	92	81	53	-	354	17,392	74	17,318	355	17,392
Interest rate	GOVCO's Cost + 0.20%; 0.05% to 2.75% over US\$ LIBOR	0.05% to 2.75% over US\$ LIBOR	0.05% to 2.75% over US\$ LIBOR	0.05% to 2.5% over US\$ LIBOR	-	-	-	-	-	-	-
Philippine Peso	6	11	11	23	-	51	2,511	12	2,499	51	2,511
Interest rate	3% over 90-day PHIBOR, MART1 + 0.75%	MART1 + 0.75%	MART1 + 0.75%	MART1 + 0.75%	-	-	-	-	-	-	-
						1,752	85,906	5,953	79,953	1,768	86,604
<i>Interest rate swap (fixed to floating)</i>											
U.S. Dollar (US\$63 million)	-	-	-	-	-	9	423	-	423	9	423
Japanese Yen (JP¥7,519 million)	-	-	-	-	-	-	-	-	-	-	-
Fixed Rate on US\$ notional	11.375%	11.375%	11.375%	11.375%	11.375%	-	-	-	-	-	-
Variable Rate on JP¥ notional	8.11% over LIBOR	8.11% over LIBOR	8.11% over LIBOR	8.11% over LIBOR	8.11% over LIBOR	-	-	-	-	-	-

Fixed rate financial instruments are subject to fair value interest rate risk while floating rate financial instruments are subject to cash flow interest rate risk.

Repricing of floating rate financial instruments is mostly done on intervals of three months or six months. Interest on fixed rate financial instruments is fixed until maturity of the particular instrument. Financial instruments that are not subject to interest rate risk were not included in the above tables.

Management conducted a survey among our banks to determine the outlook of the U.S. dollar and Philippine peso interest rates until our next reporting date of March 31, 2008. Our outlook is that the U.S. dollar and Philippine peso interest rates may move 190 basis points and 30 basis points higher/lower, respectively, as compared to levels at year-end 2007. At December 31, 2007, if U.S. dollar interest rates had been 190 basis points higher/lower as compared to market levels at year-end 2007, with all other variables held constant, profit after tax for the year would have been Php166 million lower/higher, mainly as a result of higher/lower interest expense on floating rate borrowings and loss/gain on derivatives transactions, except those derivatives designated and considered as effective hedging instruments and our Stockholders' equity would have been Php1,459 million lower/higher mainly as a result of a decrease/increase in the fair value of cash flow hedges. At December 31, 2007, if Philippine peso interest rates had been 30 basis points higher/lower as compared to market levels at year-end 2007, with all other variables held constant, profit before tax for the year would have been Php18 million lower/higher, mainly as a result of higher/lower interest expense on floating rate borrowings and loss/gain on derivatives transactions, except those derivatives designated and considered as effective hedging instruments and our Stockholders' equity would have been Php1,077 million lower/higher mainly as a result of a decrease/increase in the fair value of cash flow hedges.

Credit Risk

Credit risk is the risk that we will incur a loss arising from our customers, clients or counterparties that fail to discharge their contractual obligations. We manage and control credit risk by setting limits on the amount of risk we are willing to accept for individual counterparties and by monitoring exposures in relation to such limits.

We trade only with recognized and creditworthy third parties. It is our policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an on-going basis to reduce our exposure to bad debts.

We established a credit quality review process to provide regular identification of changes in the creditworthiness of counterparties. Counterparty limits are established and periodically reviewed based on latest available financial data on our counterparties' credit ratings, capitalization, asset quality and liquidity. Our credit quality review process allows us to assess the potential loss as a result of the risks to which we are exposed and take corrective actions.

The table below shows the maximum exposure to credit risk for the components of the consolidated balance sheet, including derivative financial instruments.

	Gross Maximum Exposure ⁽¹⁾		Net Maximum Exposure ⁽²⁾	
	2007	2006	2007	2006
	(in million pesos)			
Loans and receivables:				
Advances and refundable deposits	734	647	734	647
Cash and cash equivalents	17,447	16,870	17,406	16,833
Short-term investments	11,366	5,520	11,366	5,520
Investment in debt securities	1,115	–	1,115	–
Foreign administrations	4,324	3,836	4,324	3,836
Retail subscribers	3,861	2,027	3,861	2,027
Corporate subscribers	2,040	1,742	2,040	1,742
Domestic carriers	1,503	1,461	1,503	1,461
Dealers, agents and others	917	1,092	917	1,092
Held-to-maturity investments:				
Investment in debt securities	273	–	273	–
Investments-available-for-sale	143	116	143	116
Held-for-trading:				
Short-term investments	2,049	2,807	2,049	2,807
Forward foreign exchange contracts	193	3	193	3
Long-term foreign currency options	58	139	58	139
Bifurcated embedded derivatives	34	44	34	44
Derivatives used for hedging:				
Forward foreign exchange contracts	670	–	670	–
Long-term currency options	1	295	1	295
Total	46,728	36,599	46,687	36,562

⁽¹⁾ Gross financial assets before taking into account any collateral held or other credit enhancements or offsetting arrangements.

⁽²⁾ Gross financial assets after taking into account any collateral held or other credit enhancements or offsetting arrangements.

The table below provides information regarding the credit quality by class of our financial assets according to our credit ratings of counterparties:

	Total	Neither past due nor impaired		Past due but not impaired	Impaired
		Class A ⁽¹⁾	Class B ⁽²⁾		
	(in million pesos)				
December 31, 2007					
Loans and receivables:					
Advances and refundable deposits	734	734	–	–	–
Cash and cash equivalents	17,447	15,150	2,297	–	–
Short-term investments	11,366	10,637	729	–	–
Investment in debt securities	1,115	1,115	–	–	–
Retail subscribers	8,179	1,389	637	1,823	4,330
Corporate subscribers	7,915	641	187	1,166	5,921
Foreign administrations	5,371	1,828	861	1,635	1,047
Dealers, agents and others	2,151	983	315	196	657
Domestic carriers	1,884	119	11	1,373	381
Held-to-maturity investments:					
Investment in debt securities	273	273	–	–	–
Investments-available-for-sale	143	113	30	–	–
Held-for-trading:					
Short-term investments	2,049	2,049	–	–	–
Forward foreign exchange contracts	193	190	3	–	–
Long-term foreign currency options	58	58	–	–	–
Bifurcated embedded derivatives	34	34	–	–	–
Derivatives used for hedging ⁽³⁾ :					
Forward foreign exchange contracts	670	670	–	–	–
Long-term currency options	1	1	–	–	–
Total	59,583	35,984	5,070	6,193	12,336

	Total	Neither past due nor impaired		Past due but not impaired	Impaired
		Class A ⁽¹⁾	Class B ⁽²⁾		
(in million pesos)					
December 31, 2006					
Loans and receivables:					
Advances and refundable deposits	647	647	–	–	–
Cash and cash equivalents	16,870	15,756	1,114	–	–
Short-term investments	5,520	5,218	302	–	–
Corporate subscribers	8,160	1,267	206	211	6,476
Retail subscribers	7,874	681	220	1,132	5,841
Foreign administrations	6,342	1,609	816	1,411	2,506
Dealers, agents and others	2,587	1,222	7	89	1,269
Domestic carriers	1,965	372	30	1,060	503
Investments-available-for-sale	116	90	26	–	–
Held-for-trading:					
Short-term investments	2,807	2,807	–	–	–
Long-term foreign currency options	139	139	–	–	–
Bifurcated embedded derivatives	44	44	–	–	–
Forward foreign exchange contracts	3	3	–	–	–
Derivatives used-for-hedging:					
Long-term currency options	295	295	–	–	–
Total	53,369	30,150	2,721	3,903	16,595

⁽¹⁾ This includes low risk and good paying customer accounts with no history of account treatment for a defined period and no overdue accounts as at report date; and deposits or placements to counterparties with good credit rating or bank standing financial review;

⁽²⁾ This includes medium risk and average paying customer accounts with no overdue accounts as at report date, and new customer accounts for which sufficient credit history has not been established; and deposits or placements to counterparties not classified as Class A; and

⁽³⁾ Gross receivables from counterparties, before any offsetting arrangements.

The aging analysis of past due but not impaired class of financial assets is as follows:

	Total	Neither past due nor impaired	Past due but not impaired			
			1-60 days	61-90 days	Over 91 days	Impaired
(in million pesos)						
December 31, 2007						
Loans and receivables:						
Advances and refundable deposits	734	734	–	–	–	–
Cash and cash equivalents	17,447	17,447	–	–	–	–
Short-term investments	11,366	11,366	–	–	–	–
Investment in debt securities	1,115	1,115	–	–	–	–
Retail subscribers	8,179	2,026	1,513	231	79	4,330
Corporate subscribers	7,915	828	715	133	318	5,921
Foreign administrations	5,371	2,689	902	316	417	1,047
Dealers, agents and others	2,151	1,298	30	4	162	657
Domestic carriers	1,884	130	88	103	1,182	381
Held-to-maturity investments:						
Investment in debt securities	273	273	–	–	–	–
Investments-available-for-sale	143	143	–	–	–	–
Held-for-trading:						
Short-term investments	2,049	2,049	–	–	–	–
Forward foreign exchange contracts	193	193	–	–	–	–
Long-term foreign currency options	58	58	–	–	–	–
Bifurcated embedded derivatives	34	34	–	–	–	–
Derivatives used for hedging:						
Forward foreign exchange contracts	670	670	–	–	–	–
Long-term currency options	1	1	–	–	–	–
Total	59,583	41,054	3,248	787	2,158	12,336

	Total	Neither past due nor impaired	Past due but not impaired			Impaired
			1-60 days	61-90 days	Over 91 days	
(in million pesos)						
December 31, 2006						
Loans and receivables:						
Advances and refundable deposits	647	647	–	–	–	–
Cash and cash equivalents	16,870	16,870	–	–	–	–
Short-term investments	5,520	5,520	–	–	–	–
Corporate subscribers	8,160	1,473	139	38	34	6,476
Retail subscribers	7,874	901	945	118	69	5,841
Foreign administrations	6,342	2,425	694	267	450	2,506
Dealers, agents and others	2,587	1,229	25	10	54	1,269
Domestic carriers	1,965	402	96	77	887	503
Investments-available-for-sale	116	116	–	–	–	–
Held-for-trading:						
Short-term investments	2,807	2,807	–	–	–	–
Long-term foreign currency options	139	139	–	–	–	–
Bifurcated embedded derivatives	44	44	–	–	–	–
Forward foreign exchange contracts	3	3	–	–	–	–
Derivatives used for hedging:						
Long-term currency options	295	295	–	–	–	–
Total	53,369	32,871	1,899	510	1,494	16,595

Impairment assessments

The main consideration for the impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. Our impairment assessments are classified into two areas: individually assessed allowance and collectively assessed allowance.

Individually assessed allowance

We determine the allowance appropriate for each individually significant loan or advance on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support, the realizable value of collateral, if any, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans and advances that are not individually significant and for individually significant loans and advances where there is no objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it is identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. The impairment allowance is then reviewed by credit management to ensure alignment with our policy.

Capital Management

We aim to achieve an optimal capital structure in pursuit of our business objectives which include maintaining healthy capital ratios and strong credit ratings, and maximizing shareholder value.

In recent years, our cashflow from operations has allowed us to substantially reduce debts and, in 2005, resume payment of common dividends to shareholders. Since then, our strong cashflows have enabled us to make investments in new areas and pay higher dividends.

Our approach to capital management focuses on balancing the allocation of cash and the incurrence of debt as we seek new investment opportunities for new businesses and growth areas. Our current dividend policy is to pay out 70% of our core earnings to our shareholders. Further, in the event no investment opportunities arise, we may consider the option of returning additional cash to our shareholders in the form of special dividends or share buybacks. Philippine corporate regulations prescribe, however, that we can only pay out dividends or make capital distribution up to the amount of our unrestricted retained earnings.

As part of our aim to maximize returns to our shareholders, we obtained approval from our board of directors on January 29, 2008 for a share buyback program of up to two million PLDT common shares. See *Note 17 – Equity*.

Some of our debt instruments contain covenants that impose maximum leverage ratios. In addition, our credit ratings from the international credit ratings agencies are based on our ability to remain within certain leverage ratios.

We monitor capital using several financial leverage measurements, such as net debt to equity ratio. Net debt is derived by deducting cash and cash equivalents and short-term investments from total debt (notes payable and long-term debt). Our objective is to maintain our net debt to equity ratio below 100%.

	2007	2006
	(in million pesos)	
Long-term debt, including current portion	60,147	79,953
Notes payable	493	201
Total debt	60,640	80,154
Cash and cash equivalents	(17,447)	(16,870)
Short-term investments	(13,415)	(8,327)
Net debt	29,778	54,957
Equity attributable to equity holders of PLDT	111,113	102,521
Net debt to equity ratio	27%	54%

27. Supplemental Cash Flow Information

	2007	2006	2005
		(in million pesos)	
Supplemental information for noncash investing activity:			
Fair value of future earn-out payments	1,048	–	–
Supplemental information for noncash financing activities:			
Conversion of preferred stock subject to mandatory redemption (Note 18)	313	11,020	2,591
Recognition of asset retirement obligations (Note 8)	48	45	63

28. Reclassification of Accounts

Certain accounts in December 31, 2006 and 2005 consolidated financial statements were reclassified to conform with the December 31, 2007 consolidated financial statements presentation.

REGISTRARS, TRANSFER AGENTS AND DEPOSITARY

Registrars and Transfer Agents

COMMON CAPITAL STOCK

Philippine Registrar and Transfer Agent

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
11/F The Enterprise Center, Tower 1
6766 Ayala Avenue corner Paseo de Roxas St.
Makati City, Philippines
Telephone: (632) 830-5406
(632) 830-5416
(632) 830-5423
(632) 830-5399
Fax: (632) 755-5548
Email address: weiserco@hsbc.com.ph
ronaldrodrigo@hsbc.com.ph

SERIAL PREFERRED STOCK

10% CUMULATIVE CONVERTIBLE PREFERRED STOCK - Series A to Z and Series AA to HH

SERIES IV REDEEMABLE NON-CONVERTIBLE PREFERRED STOCK

RIZAL COMMERCIAL BANKING CORPORATION
9th Flr., RCBC Plaza, Yuchengco Tower 1
Ayala Avenue corner Sen. Gil Puyat Avenue
Makati City, Philippines
Telephone: (632) 894-9000
Fax: (632) 894-9569
Email address: fttimonera@rcbc.com
riabella@rcbc.com

SERIES V, VI AND VII CONVERTIBLE PREFERRED STOCK

THE HONGKONG AND SHANGHAI BANKING CORPORATION LIMITED
11/F The Enterprise Center, Tower 1
6766 Ayala Avenue corner Paseo de Roxas St.
Makati City, Philippines
Telephone: (632) 830-5406
(632) 830-5416
(632) 830-5423
(632) 830-5399
Fax: (632) 755-5548
Email address: weiserco@hsbc.com.ph
ronaldrodrigo@hsbc.com.ph

Depositary of American Depositary Shares

AMERICAN DEPOSITARY RECEIPTS

JPMorgan Chase Bank, N.A.
P.O. Box 64504
St. Paul, MN 55164-0504
U.S. Domestic Toll Free: (1-800) 990-1135
International Telephone No.: (1-651) 453-2128
Email address: adr@jpmorgan.com
Website: www.adr.com

The Common Capital Stock of PLDT is listed on the Philippine Stock Exchange (ticker: TEL). PLDT has also established an American Depositary Receipt facility under which American Depositary Shares (ticker: PHI) representing shares of Common Capital Stock are listed and traded on the New York Stock Exchange. The American Depositary Shares are evidenced by American Depositary Receipts issued by the Depositary.

The Series A to Z and Series AA to HH 10% Cumulative Convertible Preferred Stock of PLDT are listed on the Philippine Stock Exchange.

For inquiries, please contact:

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Internet users can access information about PLDT and its products and services at: <http://www.pldt.com.ph>

PLDT's Corporate Governance Manual, Code of Ethics and NYSE Section 303A.11 Disclosure, which summarizes the difference between PLDT's corporate governance practices and those required of U.S. companies listed on the NYSE, may be downloaded from:

Corporate Governance Manual

http://www.pldt.com.ph/download/pldt-corgov_manual.pdf or
http://www.pldt.com.ph/cgov/downloads/pldt-corgov_manual.pdf

Code of Ethics

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)

NYSE 303A.11 Disclosure

<http://www.pldt.com.ph/download/pldt-disclosure.pdf> or
http://www.pldt.com.ph/cgov/downloads/NYSE-PLDT_CG-DISC-07.01.pdf



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