PHILIPPINE LONG DISTANCE TELEPHONE CO
Form 6-K
March 06, 2007

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6 -K

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16

of the Securities Exchange Act of 1934

For the month of March 2007

Commission File Number 1-03006

Philippine Long Distance Telephone Company

(Exact Name of Registrant as specified in its Charter)

Ramon Cojuangco Building

Makati Avenue

Makati City

Philippines

(Address of principal executive offices)

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.)

Form 20-F: √ Form 40-F:

(Indicate by check mark whether by furnishing the information contained in this form, the registrant is also thereby furnishing the information to the commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act 1934.)

Yes: No: √

(If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-_____)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY

By: /s/ Ma. Lourdes C. Rausa-Chan
Ma. Lourdes C. Rausa-chan
Senior Vice President, Corporate Affairs and Legal Services Head and Corporate Secretary

Date: March 6, 2007

EXHIBITS

Exhibit Number		Page
	Announcement date March 6, 2007	
1.1	Management s Discussion and Analysis of Financial Condition and Results of Operations for the Year Ended December 31, 2006	44
1.2	Auditor s Opinion	2
1.3	Consolidated Financial Statements as at December 31, 2006 and 2005 and for the years ended December 31, 2006, 2005 and 2004	104

Exhibit 1.1

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the Year Ended December 31, 2006

In the following discussion and analysis of our financial condition and results of operations, unless the context indicates or otherwise requires, references to we, us, our or PLDT Group mean the Philippine Long Distance Telephone Company and its consolidated subsidiaries, and references to PLDT mean the Philippine Long Distance Telephone Company, not including its consolidated subsidiaries (see Note 2 Summary of Significant Accounting Policies and Practices to the accompanying audited consolidated financial statements for a list of these subsidiaries, including a description of their respective principal business activities).

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying audited consolidated financial statements and the related notes. Our financial statements, and the financial information discussed below, have been prepared in accordance with Philippine generally accepted accounting principles, or Philippine GAAP, which differ in certain significant respects from generally accepted accounting principles in the United States.

The financial information appearing in this report and in the accompanying audited consolidated financial statements is stated in Philippine pesos. All references to pesos, Philippine pesos or Php are to the lawful currency of the Philippines; all references to U.S. dollars, US$ or dollars are to the lawful currency of the United States; all references to Japanese yen, JP¥ or ¥ are to the lawful currency of Japan and all references to Euro or are to the lawful currency of the European Union. Translations of Philippine peso amounts into U.S. dollars in this report and in the accompanying audited consolidated financial statements were made based on the exchange rate of Php49.045 to US$1.00, the volume weighted average exchange rate at December 31, 2006 quoted through the Philippine Dealing System.

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

A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. We have chosen these assumptions or bases in good faith, and we believe that they are reasonable in all *material respects. However, we caution you that forward-looking statements and assumed facts or bases almost always vary from actual results, and the differences between the results implied by the forward-looking statements and assumed facts or bases and actual results can be material, depending on the circumstances. When considering forward-looking statements, you should keep in mind the description of risks and cautionary statements in this report. You should also keep in mind that any forward-looking statement made by us in this report or elsewhere speaks only as at the date on which we made it. New risks and uncertainties come up from time to time, and it is impossible for us to predict these events or how they may affect us. We have no duty to, and do not intend to, update or revise the forward-looking statements in this report after the date hereof. In light of these risks and uncertainties, any forward-looking statement made in this report or elsewhere might not occur.*

Financial Highlights and Key Performance Indicators

	December 31,		**Increase (Decrease)**	
	2006	**2005**	**Amount**	**%**
(in millions, except for operational data, exchange rates and earnings per common share)				
Consolidated Balance Sheets				
Total assets	Php244,883	Php250,197	(Php5,314)	(2)
Property, plant and equipment	164,693	176,974	(12,281)	(7)
Cash and cash equivalents and short-term investments	26,080	32,809	(6,729)	(21)
Total equity	104,313	74,369	29,944	40
Notes payable and long-term debt	80,159	103,544	(23,385)	(23)
Net debt(1) to equity ratio	0.52x	0.95x		

	Years Ended December 31,		**Increase (Decrease)**	
	2006	**2005**	**Amount**	**%**
Consolidated Statements of Income				
Revenues and other income	Php133,843	Php126,044	Php7,799	6
Expenses	91,654	87,429	4,225	5
Income before income tax	42,189	38,615	3,574	9
Net income attributable to equity holders of PLDT	35,116	34,112	1,004	3
Net income	35,320	34,479	841	2
Net income margin	26%	27%		
Earnings per common share basic	187.91	189.96	(2.05)	(1)
Consolidated Statements of Cash Flows				
Net cash provided by operating activities	70,186	76,213	(6,027)	(8)
Net cash used in investing activities	36,126	11,694	24,432	209
Capital expenditures	*21,111*	*14,990*	*6,121*	*41*
Net cash used in financing activities	45,722	60,794	(15,072)	(25)
Operational Data				
Number of cellular subscribers	24,175,384	20,408,621	3,766,763	18
Number of fixed line subscribers(2)	1,776,647	1,842,507	(65,860)	(4)
Number of broadband subscribers	264,649	117,586	147,063	125

Fixed Line	*133,159*	*88,811*	*44,348*	*50*
Wireless	*131,490*	*28,775*	*102,715*	*357*
Number of employees	28,219	18,926	9,293	49
Fixed Line	*8,711*	*9,197*	*(486)*	*(5)*
Wireless	*5,358*	*5,137*	*221*	*4*
Information and Communications Technology	*14,150*	*4,592*	*9,558*	*208*

Exchange Rates	**Php per US$**
December 31, 2006	Php49.045
December 31, 2005	53.062
December 31, 2004	56.341

____

(1) Net debt is derived by deducting cash and cash equivalents and short-term investments from long-term debt.

(2) Previously set forth as number of fixed lines in service. The 2005 figures were restated to reflect the effect of the change in parameters used to align with the PLDT Group s policy on subscriber count with the planned use of an integrated billing system for our subscribers.

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 by Smart Communications, Inc., or Smart, and Pilipino Telephone Corporation, or Piltel, our cellular service providers; Smart Broadband, Inc., or Smart Broadband (formerly known as Meridian Telekoms, Inc., or Meridian), our wireless broadband provider; Wolfpac Mobile, Inc., or Wolfpac, our wireless content operator; Mabuhay Satellite Corporation, or Mabuhay Satellite, ACeS Philippines Cellular Satellite Corporation, or ACeS Philippines, and Telesat, Inc., or Telesat, our satellite and very small aperture terminal, or VSAT, 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., Subic Telecommunications Company, Inc., PLDT-Maratel, Inc., Piltel, Bonifacio Communications Corporation and PLDT Global Corporation, or PLDT Global, which together account for approximately 4% of our consolidated fixed line subscribers; and

• *Information and Communications Technology* information and communications infrastructure and services for Internet applications, Internet protocol-based solutions and multimedia content delivery provided by PLDT s subsidiary ePLDT, Inc., or ePLDT; call center services provided under *ePLDT Ventus*, including Parlance Systems, Inc., or Parlance, and Vocativ Systems, Inc., or Vocativ; business process outsourcing, or BPO, provided by SPi Technologies, Inc., or SPi (consolidated on July 11, 2006); Internet access and gaming services provided by ePLDT s subsidiaries, 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, Level Up!, Inc., or Level Up!; and
e-commerce, and IT-related services provided by other investees of ePLDT, as discussed in *Note 9 Investments in Associates* to the accompanying audited consolidated financial statements.

We registered total revenues and other income of Php133,843 million in 2006, an increase of Php7,799 million, or 6%, as compared to Php126,044 million in 2005, primarily due to an increase in our service revenues and other income by Php4,078 million and Php4,066 million, respectively. Other income in 2006 included a net reversal of a provision for onerous contract amounting to Php3,529 million as a result of an amendment to the Air Time Purchase Agreement. Please see
Note 23 Provisions and Contingencies to the accompanying audited consolidated financial statements for further discussion.

Expenses increased by Php4,225 million, or 5%, to Php91,654 million in 2006 from Php87,429 million in 2005, largely resulting from increases in compensation and benefits, asset impairment, depreciation and amortization, and professional and other contracted services, partly offset by lower provisions, cost of sales and taxes and licenses.

Net income attributable to equity holders of PLDT increased by Php1,004 million, or 3%, to Php35,116 million in 2006 from Php34,112 million in 2005. However, basic earnings per common share decreased to Php187.91 in 2006 from Php189.96 in 2005 due to an increase in the weighted average number of common shares outstanding from 172.1 million in 2005 to 184.5 million in 2006.

Results of Operations

The table below shows the contribution by each of our business segments to our revenues and other income, expenses and net income for the years ended December 31, 2006 and 2005. Most of our revenues are derived from our operations within the Philippines.

	Wireless	Fixed Line	ICT	Inter-segment Transactions	Total
(in millions)					
For the year ended December 31, 2006					

Revenues and other income	Php81,546		Php54,219		Php7,220		(Php9,142)	Php133,843	
Service	78,383		49,134		6,543		(8,920)	125,140	
Non-service	2,457		79		553		(122)	2,967	
Equity share in net income of associates									
Other income	706		5,006		124		(100)	5,736	
Expenses	44,692		48,535		7,569		(9,142)	91,654	
Income (loss) before income tax	36,854		5,684		(349)			42,189	
Net income (loss) for the period	30,376		5,255		(311)			35,320	
Net income (loss) attributable to equity holders of PLDT	30,096		5,253		(233)			35,116	
For the year ended December 31, 2005									
Revenues and other income	79,158		49,990		3,438		(6,542)	126,044	
Service	74,677		49,663		2,953		(6,231)	121,062	
Non-service	3,036		41		351		(116)	3,312	
Equity share in net income of associates					7			7	
Other income	1,445		286		127		(195)	1,663	
Expenses	40,694		49,897		3,380		(6,542)	87,429	
Income (loss) before income tax	38,464		93		58			38,615	
Net income (loss) for the period	33,664		769		46			34,479	
Net income (loss) attributable to equity holders of PLDT	33,222		768		122			34,112	
Increase (Decrease)	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**	**Amount**	**Amount**	**%**
Revenues and other income	Php2,388	3	Php4,229	8	Php3,782	110	(Php2,600)	Php7,799	6
Service	3,706	5	(529)	(1)	3,590	122	(2,689)	4,078	3
Non-service	(579)	(19)	38	93	202	58	(6)	(345)	(10)
Equity share in net income of associates					(7)	(100)		(7)	(100)
Other income	(739)	(51)	4,720	1,650	(3)	(2)	95	4,073	245
Expenses	3,998	10	(1,362)	(3)	4,189	124	(2,600)	4,225	5
Income (loss) before income tax	(1,610)	(4)	5,591	6,012	(407)	(702)		3,574	9
Net income (loss) for the period	(3,288)	(10)	4,486	583	(357)	(776)		841	2
Net income (loss) attributable to equity holders of PLDT	(3,126)	(9)	4,485	584	(355)	(291)		1,004	3

Wireless

Revenues and Other Income

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

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

	Years Ended December 31,					
					Increase (Decrease)	
	2006	**%**	**2005**	**%**	**Amount**	**%**
(in millions)						
Wireless services:						
Service Revenues						
Cellular	Php75,605	93	Php72,409	91	Php3,196	4
Wireless broadband, satellite, VSAT and others	2,778	3	2,268	3	510	22
	78,383	96	74,677	94	3,706	5
Non-service Revenues						
Sale of cellular handsets and SIM-packs	2,457	3	3,036	4	(579)	(19)
Other Income	706	1	1,445	2	(739)	(51)
Total Wireless Revenues and Other Income	Php81,546	100	Php79,158	100	Php2,388	3

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 the same period 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 and other income, service revenues contributed 96% and 94% in 2006 and 2005, respectively.

Cellular Service

Our cellular service revenues consist of:

- revenues derived from actual usage of the network by prepaid subscribers and any unused peso value of expired prepaid cards or electronic air time loads, net of content costs and discounts given to dealers;

- monthly service fees from postpaid subscribers, including: (1) charges for calls in excess of allocated free local calls; (2) toll charges for national and international long distance calls; (3) charges for text messages of our service customers in excess of allotted free text messages; and (4) charges for value-added services, net of related content provider costs;

- revenues generated from incoming calls and messages to our subscribers, net of interconnection expenses; fees from reciprocal traffic from international correspondents; and revenues from inbound international roaming calls for the service; and

- other charges, including those for reconnection and migration.

Our cellular service revenues in 2006 amounted to Php75,605 million, an increase of 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.

Smart markets nationwide cellular communications services under the brand names *Smart Buddy, Smart Gold, addict mobile, addict mobile prepaid*, or *amp*, *Smart Infinity* and *Smart Kid prepaid. Smart Buddy, amp* and *Smart Kid prepaid* are prepaid services while *Smart Gold, Smart Infinity* and *addict mobile* 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.

Smart continues to offer products and services that provide value to its subscribers. In 2005, Smart launched a series of promotions to test the market demand for fixed rate or bucket plans for voice and text. Under a service branded as *Smart 258*, subscribers had the option to register for unlimited on-network voice calling or text messaging. *Smart 258* has since been modified a number of times, with variations involving changes in load denominations and periods of network availability. The promotion offered unlimited on-network texting, carrying denominations of Php15, Php30 and Php60 with corresponding expiration periods of one, two and four days. Bucket pricing promotions have now become a key driver for subscriber activations and usage stimulation.

In 2006, Smart has focused on segmenting its market by offering sector-specific, value-driven packages such as *All Text* a new variety of top-up service providing a fixed number of messages with prescribed validity periods. Current offerings include *All Text 10 Bonus*, with a suggested retail price of Php12, which includes 15 messages without expiration and *All Text 20*, which includes 100 on-network messages for Php20, with a validity period of one day. *All Text* also has a voice counterpart in *All Talk 20* which is a call package allowing three calls of up to three minutes each for local on-network calls, valid for one day. Other voice offerings include: (a) the *Flat Rate Call* promotion, which allows a subscriber to make an on-network call of up to three minutes for Php10 or extend the call to five minutes for Php15; and (b) *Tipid Talk*, a call package which allows a subscriber to make four calls of up to 30 seconds each for local on-network calls, valid for one day for Php10 and another variant allowing four calls of up to 15 seconds each for local on-network calls, valid for one day for Php5.50. *All Text 20*, *All Text 10 Bonus, All Talk 20* and *Tipid Talk* are now permanent offerings, while the *Flat Rate Call* promotion is valid until March 3, 2007. On January 18, 2007, Smart introduced *LAHATxt*, a top-up service which offers a bundle of text messages available to all networks. *LAHATxt 35* is available to all Smart prepaid subscribers and provides for 100 text messages to all networks for Php35 with a one day validity period. On the other hand, *Talk N Text* subscribers have *LAHATxt 20* which allows a subscriber to make 50 text messages to all networks for Php20, also valid for one day.

Smart likewise has in place various promotions to stimulate international usage. In June 2006, *Smart IDD Libre Text Abroad* was launched wherein subscribers earned one free international text for every minute of IDD calling. In October 2006, this was replaced by *International Budget Text* packages. These packages, which have a limited duration and a varying number of allowable messages, enable subscribers to send international text to pre-registered recipients of the subscriber s choice on supported overseas carriers.

Smart expanded its roster of services with the commercial launch of its 3G services in May 2006. These services include video calling, video streaming, high-speed Internet browsing and 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, 2006 and 2005:

	Years Ended December 31,			
			Increase (Decrease)	
	2006	**2005**	**Amount**	**%**
(in millions)				
Cellular service revenues	Php75,605	Php72,409	Php3,196	4
By component	*73,893*	*70,507*	*3,386*	*5*
Voice	35,221	35,444	(223)	(1)
Data	38,672	35,063	3,609	10
By service type	*73,893*	*70,507*	*3,386*	*5*
Prepaid	68,846	66,023	2,823	4

Postpaid	5,047	4,484	563	13
Others(1)	*1,712*	*1,902*	*(190)*	*(10)*

(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.

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

	Years Ended December 31,			
			Increase (Decrease)	
	2006	**2005**	**Amount**	**%**
Systemwide traffic volumes (in millions)				
Calls (in minutes)	5,667	5,467	200	4
Domestic	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)
Text messages	238,362	95,959	142,403	148
Standard	32,052	40,781	(8,729)	(21)
Bucket-Priced	203,669	52,373	151,296	289
Value-Added Services	2,641	2,805	(164)	(6)

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 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-channeling 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:

	Years Ended December 31,			
			Increase (Decrease)	
	2006	**2005**	**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	1,640	1,698	(58)	(3)
	34,403	30,808	3,595	12
Value-added services				
Non-Zed(1)	2,474	2,290	184	8
*Smart Zed*TM	335	523	(188)	(36)
Smart Money	68	84	(16)	(19)
Mobile Banking	5	5		
Roaming SMS, Pasaload, MMS and WAP	1,387	1,352	35	3
	4,269	4,254	15	
Total	Php38,672	Php35,062	Php3,610	10

(1) Value-added services developed by Smart on its own platform.

Text messaging-related services contributed revenues of Php34,403 million in 2006, an increase of Php3,595 million, or 12%, compared to Php30,808 million in 2005, and accounted for 89% and 88% 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 258 Unlimited Text* promotion and its variant bucket-priced text promotional offerings. Text messaging revenues from the various bucket plans totaled Php11,054 million. Value-added services, which contributed revenues of Php4,269 million in 2006, increased by Php15 million from Php4,254 million in 2005, primarily due to higher usage of *Non-Zed* and roaming SMS services, partially offset by decreased usage of *Smart Zed* and *Smart Money* services in 2006 as compared to 2005. The decline in *Smart Zed* usage was primarily due to increased competition from other content providers while the decline in *Smart Money* revenue was on account of reduced usage of *Smart Money* by dealers as a settlement tool for load transactions.

Standard text messages totaled 32,052 million in 2006, a decrease of 8,729 million, or 21%, from 40,781 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.

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:

	Years Ended December 31,			
			Increase	
	2006	**2005**	**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:

	Years Ended December 31,							
	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)

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 dealer 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 dealer 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. 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.

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 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

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, equivalent to Php1 plus 50 free SMS, 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* or *Smart Load* All Text ; 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 example, if a customer activated a SIM card in April but had not reloaded by May 31, this customer would not be counted as a subscriber. The rationale for this change stems from our observance of SIM-swapping activities in the market. SIM-swapping refers to the promotional activity wherein subscribers can exchange their current prepaid SIM card for another operator s SIM card at no cost to the subscriber. We believe that these activities have given rise to a situation where certain subscribers swap their SIM cards between mobile operators upon full usage of the pre-stored air time, which may result in our subscriber base reflecting a certain number of transient subscribers at any one point in time. In May 2005, we terminated our SIM swapping promotions; as a result, our churn rates increased in the third and fourth quarters of 2005, but leveled off beginning in the first quarter of 2006.

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, VSAT and Other Services

Our revenues from wireless broadband, satellite, VSAT and other services consist mainly of wireless broadband service revenues for Smart Broadband, rentals received for the lease of Mabuhay Satellite s transponders and Telesat s VSAT facilities to other companies, 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.

Smart Broadband 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 consist of:

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

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.

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 Php44,692 million, an increase of Php3,998 million, or 10%, from Php40,694 million in 2005. A significant portion of this increase was attributable to higher rent, asset impairment, financing costs and compensation and benefits, which was partially offset by lower cost of sales and taxes and licenses. As a percentage of our total wireless revenues and other income, expenses associated with our wireless business accounted for 55% and 51% in 2006 and 2005, respectively.

Cellular business expenses accounted for 98% of our wireless business expenses, while wireless broadband, satellite, VSAT 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:

	Years Ended December 31,					
					Increase (Decrease)	
	2006	%	2005	%	Amount	%
(in millions)						
Wireless services						
Depreciation and amortization	Php10,752	24	Php10,156	25	Php596	6
Rent	7,887	18	5,592	14	2,295	41
Compensation and benefits(1)	5,041	11	4,249	11	792	19
Cost of sales	4,887	11	6,148	15	(1,261)	(21)
Maintenance	3,646	8	3,655	9	(9)	
Selling and promotions	3,013	7	3,418	8	(405)	(12)
Professional and other contracted services	1,831	4	1,656	4	175	11
Financing costs	1,700	4	513	1	1,187	231
Asset impairment	1,391	3			1,391	100
Taxes and licenses	1,018	2	1,544	4	(526)	(34)
Communication, training and travel	891	2	960	2	(69)	(7)
Provisions	829	2	575	1	254	44
Insurance and security services	797	2	947	2	(150)	(16)
Amortization of intangible assets	312	1	244	1	68	28
Other expenses	697	1	1,037	3	(340)	(33)
Total	Php44,692	100	Php40,694	100	Php3,998	10

---

(1) Includes salaries and benefits, incentive plan, pension and manpower rightsizing program, or 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 domestic fiber optic network, or DFON, facilities leased by Smart from PLDT, as well as higher satellite transmission and site rental expenses. As at December 31, 2006, we had 4,377 GSM cell sites and 6,099 base stations, compared with 4,305 GSM cell sites and 5,982 base stations as at December 31 , 2005.

Compensation and benefits expenses increased by Php792 million, or 19%, to Php5,041 million, primarily due to higher accrued bonuses, pension benefits, long-term incentive plan costs and other employee benefits of Smart. Smart s employee headcount increased by 219, or 4%, to 5,306 in 2006 as compared to 5,087 in 2005. For further discussion on our long-term incentive plan, please see *Note 21 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:

	Years Ended December 31,			
			Decrease	
	2006	2005	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)

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.

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

Financing costs increased by Php1,187 million, or 231%, to Php1,700 million in 2006 from Php513 million in 2005 due to the combined results of: (1) lower foreign exchange gains recognized in 2006 as a result of lower dollar-denominated debt balances; and (2) higher amortization of debt discount brought about by the prepayment of Piltel s debt in 2006. These increasing effects were partially offset by: (1) lower interest expense owing to lower debt balances; (2) higher capitalized interest and interest income; and (3) gain on derivative transactions in 2006 as against a loss on derivative transactions in 2005. The breakdown of our financing costs for our wireless business for the years ended December 31 , 2006 and 2005 is as follows:

	Years Ended December 31,			
			Change	
	2006	2005	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)
Loss (gain) on derivative transactions net	(39)	118	(157)	(133)
Capitalized interest	(248)	(85)	(163)	(192)
Interest income	(1,197)	(1,135)	(62)	(5)
Foreign exchange gains net	(1,722)	(3,047)	1,325	43
	Php1,700	Php513	Php1,187	231

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

Taxes and licenses decreased by 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.

Provisions increased by Php254 million, or 44%, to Php829 million primarily due to an increase in the provision for subscriber and carrier receivables coupled with the reversal of the provision for non-trade receivables booked in 2005, partially offset by lower level of write-down of slow-moving handsets to net realizable values. The breakdown of provisions for the years ended December 31, 2006 and 2005 is as follows:

	Years Ended December 31,			
			Increase (Decrease)	
	2006	**2005**	**Amount**	**%**
(in millions)				
Doubtful accounts	Php627	Php253	Php374	148
Write-down of inventories to net realizable values	202	322	(120)	(37)
	Php829	Php575	Php254	44

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.

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 Tax* 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

Revenues and Other Income

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 Php54,219 million, an increase of Php4,229 million, or 8%, from Php49,990 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:

	Years Ended December 31,				Increase (Decrease)	
	2006	**%**	**2005**	**%**	**Amount**	**%**
(in millions)						
Fixed line services:						
Service Revenues						
Local exchange	Php16,923	31	Php18,519	37	(Php1,596)	(9)
International long distance	9,933	18	12,245	24	(2,312)	(19)
National long distance	6,921	13	7,233	14	(312)	(4)
Data and other network	13,725	26	10,399	21	3,326	32
Miscellaneous	1,632	3	1,267	3	365	29
	49,134	91	49,663	99	(529)	(1)
Non-Service Revenues	79		41		38	93
Other Income	5,006	9	286	1	4,720	1,650
Total Fixed Line Revenues and Other Income	Php54,219	100	Php49,990	100	Php4,229	8

Service Revenues

Local Exchange Service

Our local exchange service revenues consist of:

- flat monthly fees for our postpaid and fixed charges for our bundled and data services;
- installation charges and other one-time fees associated with the establishment of customer service;
- revenues from usage of prepaid cards for calls within the local area and any unused peso value of expired prepaid cards; and
- charges for special features, including bundled value-added services such as call waiting, call forwarding, multi-party conference calling, speed calling and caller ID.

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

	Years Ended December 31,			
			Increase (Decrease)	
	2006	**2005**	**Amount**	**%**
Total local exchange service revenues (in millions)	Php16,923	Php18,519	(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	212	193	19	10

Revenues from our local exchange service decreased by Php1,596 million, or 9%, to Php16,923 million in 2006 from Php18,519 million in 2005. The decrease was primarily due to a 4% decline in the number of fixed line subscribers and the appreciation of the peso which required us to make downward adjustments in our monthly local service rates. The percentage contribution of local exchange revenues to our total fixed line service revenues decreased to 34% in 2006 as compared to 37% in 2005.

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 and subscriber retention strategy. Prepaid subscribers are charged based on usage at a rate of Php1.00 per minute for local calls, but the rates charged for prepaid and postpaid fixed line subscribers for national and international long distance calls are the same. A prepaid fixed line subscriber is recognized as an active subscriber when that subscriber activates and uses a prepaid call card. Prepaid fixed line subscribers can reload their accounts by purchasing call cards that are sold in denominations of Php500, Php300 and Php150. All sales of prepaid cards, whether through dealers or through PLDT's business offices, are non-refundable.

In May 2006, PLDT launched *Pwede! Card*, a convergent product made possible by our NGN capability. *Pwede! Card* is the first reloadable PIN-based prepaid card that provides access to a range of voice and Internet services at affordable rates. *Pwede! Card* is applicable to a host of fixed line and wireless services including local, domestic and international long distance calls, text messaging, payphones and prepaid Internet service.

In July 2006, PLDT launched *Telepwede*, a new brand of our prepaid fixed line service. *Telepwede* subscribers are charged Php2 per local call (for an unlimited duration) and Php5 per hour for Internet connection. *Telepwede* subscribers can reload for as low as Php145 per month, which is inclusive of a Php30 load balance that can be used for outgoing calls and a Php115 access charge for incoming calls.

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

International Long Distance Service

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

• inbound call revenues representing settlements from foreign telecommunications carriers for inbound international calls, virtual transit and hubbing service and reverse charged calls such as received collect and home country direct service;

• access charges paid to us by other Philippine telecommunications carriers for terminating inbound international calls to our local exchange network; and

• outbound call revenues representing amounts billed to our customers (other than our cellular customers) for outbound international calls, net of amounts payable to foreign telecommunications carriers for terminating calls in their territories.

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

	Years Ended December 31,			
			Increase (Decrease)	
	2006	2005	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 Php51.332 in 2006 and Php55.085 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.

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

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

National Long Distance Service

Our national long distance service revenues consist of:

- per minute charges for calls made by our fixed line customers outside of the local service areas but within the Philippines, net of interconnection charges payable for calls carried through the backbone network of, and/or terminating to the customer of, another telecommunications carrier;

- access charges received from other telecommunications carriers for calls carried through our backbone network and/or terminating to our customers; and

- fixed charges paid by other telephone companies, charges retained by PLDT for calls terminating to cellular subscribers within the local area, and local access charges paid by cellular operators for calls by cellular subscribers that terminate to our local exchange network.

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

	Years Ended December 31,			
			Decrease	
	2006	**2005**	**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.

In February 2005, we launched a Php10 per call promotion to PLDT landline subscribers nationwide and for calls to PLDT, Smart and *Talk N Text* subscribers. This promotion was launched with the objective of determining a more effective tariff structure that would stimulate landline usage. Under the promotion, NDD calls between any PLDT landline subscribers nationwide or to all Smart and *Talk 'N Text* subscribers were charged Php10 per call instead of being charged on a per minute basis.

In January 2006, PLDT launched the *10-10-10* promotion where we charge a flat rate of Php10 for unlimited calls terminating from PLDT to PLDT and Smart and *Talk N Text* subscribers for a Php50 monthly service fee.

PLDT limited the Php10 per call service for Smart and *Talk N Text* to subscribers who registered on or before February 24, 2006. PLDT fixed line subscribers, however, can still register and avail themselves of the unlimited Php10 per call service for national long distance calls within the PLDT network.

Data and Other Network Services

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

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

	Years Ended December 31,			
			Increase	
	2006	**2005**	**Amount**	**%**
(in millions)				
Data and other network service revenues	Php13,725	Php10,399	Php3,326	32
Number of DSL broadband subscribers	133,159	88,811	44,348	50
Number of PLDT Vibe narrowband subscribers	297,250	266,703	30,547	11

In 2006, our data and other network services posted revenues of Php13,725 million, an increase of Php3,326 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.

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 to enterprises and value-added service providers.

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 the same period in 2005. *DSL* offers a number of packages with speeds and monthly fees varying from
256 kbps at Php999 per month to up to 1 Mbps at Php3,000 per month.

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.

The continued growth in data services revenues can be attributed to several product offerings. The steady demand for dedicated connectivity or private networking from the corporate market using PLDT s traditional bandwidth offerings Fibernet, Arcstar, Acacia, I-Gate, Diginet, BRAINS, among others continues to provide us with a stable revenue source. Through Diginet, we also provide Smart s increasing fiber optic and leased line data requirements, which are included under our national data services. Diginet revenues increased by Php2,335 million, or 53%, to Php6,771 million in 2006 as compared to Php4,436 in 2005 mainly due to Smart s DFON rental of Php4,940 million and Php3,062 million in 2006 and 2005, respectively.

In June 2006, we introduced *Shops.Work UnPlugged*, or *SWUP*, to address the need of retailers and banks for real-time wireless data communication. *SWUP* is the first bundled solution in the Philippines that makes wireless cashier point-of-sale and wireless card terminals possible. Retailers will now be able to reach out to a bigger market in areas where physical connections are unavailable and expand the banking system with wireless automated teller machines.

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 and 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.

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 ACeS International Limited, or AIL (please see *Note 23 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 Php48,535 million in 2006, a decrease of Php1,362 million, or 3%, as compared to Php49,897 million in 2005. The decrease was primarily due to lower provisions, financing costs and rent, 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:

	Years Ended December 31,					
					Increase (Decrease)	
	2006	**%**	**2005**	**%**	**Amount**	**%**
(in millions)						
Fixed line services:						
Depreciation and amortization	Php20,406	42	Php20,251	41	Php155	1
Compensation and benefits(1)	10,298	21	8,541	17	1,757	21

Financing costs	7,271	15	8,581	17	(1,310)	(15)
Maintenance	3,553	7	3,309	7	244	7
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	2	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
Provisions	92		2,297	5	(2,205)	(96)
Other expenses	695	2	863	2	(168)	(19)
Total	Php48,535	100	Php49,897	100	(Php1,362)	(3)

____

(1) Includes salaries and 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 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 manpower rightsizing program. For further discussion on our long-term incentive plan, please see *Note 21 Employee Benefits* to the accompanying audited consolidated financial statements.

Financing costs decreased by Php1,310 million, or 15%, to Php7,271 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: (1) lower foreign exchange gains recorded in 2006 as a result of lower foreign currency debt levels; and (2) higher hedge costs. The breakdown of financing costs for our fixed line business for the years ended December 31, 2006 and 2005 is as follows:

	Years Ended December 31,			
			Change	
	2006	**2005**	**Amount**	**%**
(in millions)				
Interest on loans and related items	Php6,254	Php9,058	(Php2,804)	(31)
Hedge costs	1,446	1,234	212	17
Loss (gain) on derivative transactions net	447	510	(63)	(12)
Accretion on financial liabilities net	206	322	(116)	(36)
Financing charges	14	150	(136)	(91)
Capitalized interest	(301)	(419)	118	28

Foreign exchange gains net	(354)	(1,889)	1,535	81
Interest income	(441)	(385)	(56)	(15)
	Php7,271	Php8,581	(Php1,310)	(15)

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.

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.

Provisions decreased by Php2,205 million, or 96%, to Php92 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. The breakdown of provisions for our fixed line business for the years ended December 31, 2006 and 2005 is as follows:

	Years Ended December 31,			
			Decrease	
	2006	**2005**	**Amount**	**%**
(in millions)				
Doubtful accounts	Php45	Php1,944	(Php1,899)	(98)
Write-down of inventories to net realizable value	9	157	(148)	(94)
Onerous contracts and assessments	38	196	(158)	(81)
	Php92	Php2,297	(Php2,205)	(96)

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 Income Tax

Provision for income tax amounted to Php429 million in 2006 as compared to a benefit from income tax of Php676 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 Php5,255 million, an increase of Php4,486 million, or 583%, as compared to Php769 million in 2005 mainly as a result of an increase in other income and a 3% decrease in fixed line-related expenses, particularly provisions and financing costs.

Information and Communications Technology

Revenues and Other Income

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

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

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

For further discussion, see *Note 2 Summary of Accounting Policies and Practices Basis of Preparation* to the accompanying audited consolidated financial statements.

In 2006, our information and communications technology business generated revenues of Php7,220 million, an increase of Php3,782 million, or 110%, from Php3,438 million in 2005. This increase was largely due to the consolidation of SPi and Level Up! and the continued increase of our call center revenues. Going forward, we currently expect revenues from our call center and BPO businesses to continue to contribute significantly to our information and communications technology revenues in light of the growing demand for our call center and BPO services.

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

	Years Ended December 31,					
					Increase (Decrease)	
	2006	**%**	**2005**	**%**	**Amount**	**%**
(in millions)						
Service Revenues						
Call center	Php2,624	36	Php1,944	57	Php680	35
BPO	2,580	36			2,580	100
Internet and gaming	796	11	556	16	240	43
*Vitro*ä data center	428	6	376	11	52	14
Others	115	1	77	2	38	49
	6,543	90	2,953	86	3,590	122
Non-service Revenues						

Point Product Sales	553	8	351	10	202	58
Other Income	124	2	127	4	(3)	(2)
Equity in net income of associates			7		(7)	(100)
Total ICT Revenues and Other Income	Php7,220	100	Php3,438	100	Php3,782	110

Service Revenues

Service revenues generated by our information and communications technology segment amounted to Php6,543 million in 2006, an increase of Php3,590 million, or 122%, as compared to Php2,953 million in 2005 primarily as a result of the consolidation of SPi and Level Up! and the continued growth of our call center business.

Call Center

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

Call center revenues consist of:

- inbound calls for customer care, product inquiries, sales and technical support based on active minutes, billable hours and full-time equivalents;

- outbound calls for sales and collections based on active minutes, billable hours and full-time equivalents; and

• service income for e-mail handling, web chat, web co-browsing, data entry and BPO based on transaction volume.

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

• an increase in programs being handled by Vocativ from 2005 brought about by the acquisition of additional clients in 2006, as Ventus entered into an alliance with one of India s leading BPO companies to serve their voice requirements;

• an increase in the number of registered minutes for Parlance s inbound projects and hours for outbound projects;

• an increased call volume handled by Ventus due to the expansion of our domestic call center group, which currently serves internal (Smart) and external (credit card companies) clients;

• the expansion of Vocativ s existing Taguig facility by 530 seats from approximately 1,190 seats in 2005 to approximately 1,720 seats in 2006;

• the expansion of Ventus existing Iloilo facility by 130 seats from approximately 370 seats in 2005 to approximately 500 seats in 2006;

• the expansion of Ventus back-up/overflow Makati facility by 220 seats from approximately 80 seats in 2005 to approximately 300 seats in 2006, which provided capacity for seasonal requirements of Iloilo-based programs;

• the commencement of operations at the 820-seat Ventus Pasig call center in August 2006; and

• the commencement of operations at the 780-seat Parlance Libertad call center in September 2006.

Call center revenues accounted for 40% and 66% of total information and communications technology service revenues in 2006 and 2005, respectively.

Business process outsourcing

BPO revenues consist of:

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

We provide our BPO services primarily through SPi and its subsidiaries, which we acquired on July 11, 2006. In 2006, BPO contributed revenues of Php2,580 million, primarily from SPi services, and accounted for 39% of service revenues of our information and communications technology business in 2006.

Internet and gaming

ePLDT has also invested in a number of other e-commerce and Internet-related businesses, which include:

- a 99.6% interest in Infocom, an Internet service provider offering consumer prepaid and postpaid Internet access, corporate leased lines, dedicated dial-up, multi-user dial-up, broadband Internet access through DSL, web consulting and development, hosting and other value-added services. In addition, Infocom, through its Customer Service Outsourcing Group, handles PLDT group s nationwide technical helpdesk operations;

- a 75% interest in Digital Paradise, an Internet café business with the brand *Netopia*;

- a 60% interest in netGames, a publisher for Massively Multi-player Online Games in the Philippines and the Philippine licensee of Khan Online, Pangya and Flyff, and the owner of Juanworld, a community gaming portal;

- a 60% interest in Level Up!, a leading publisher of online games in the Philippines with approximately 80% of the online gaming market. Level Up! was acquired on May 1, 2006;

- a 51% interest in Airborne Access, the country s leading operator of WiFi hotspots, which provides wireless Internet access in hotspots equipped with WiFi access points; and

- a 51% interest in Digital Paradise Thailand, an affiliate of Digital Paradise, offering similar products and services with four branches in Bangkok, Thailand.

Internet service revenues consist of:

- revenues derived from actual usage of the Internet access network by prepaid subscribers and any unused peso value of expired prepaid cards or electronic Internet time loads, net of discounts given to dealers;

- monthly service fees from postpaid corporate and consumer subscribers including: (1) charges for Internet usage in excess of allocated free plan Internet hours; (2) one-time installation and activation fees; and (3) fees for value added services including e-mail and web hosting services;

- one-time fees generated from the reselling of Internet-related solutions such as security solutions and domain registration;

- franchise and royalty fees for *Netopia* Internet cafés, including a one-time subscription fee and monthly recurring franchise fees based on certain conditions in the franchise agreement;

- revenues from community access of computers and desktop publishing based on actual usage, net of discounts given to users; and

- online gaming revenues from unique subscribers, including one-time sale of gaming cards and electronic pins, and top-up fees upon actual consumption of gaming credits or after expiration of any unused peso value thereof.

Revenues from our Internet 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 Php13 million and Php139 million, respectively. Our Internet business revenues accounted for 12% and 19% of service revenues of our information and communications technology business in 2006 and 2005, respectively.

*Vitro*ä data center

ePLDT operates an Internet data center under the brand name *Vitro*ä 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*ä revenues consist of:

- monthly service fees derived from co-location services, server hosting, hardware and software maintenance services, website development and maintenance services, web hosting, data recovery security services and other value-added services; and

- installation charges or one-time fees associated with the set-up of services and professional services of Vitro s certified professionals.

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

Others

Other revenues consist of:

- fees generated from the issuance of digital certificates and licenses; and

- revenues derived from IT helpdesk/contact center solutions and terminals for credit, debit and credit card transactions.

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

Please refer to *Note 9 Investments in Associates* to the accompanying audited consolidated financial statements for further discussion on ePLDT s other information and communications technology services.

Non-service Revenues

Non-service revenues consist of sales generated from reselling certain software licenses, server solutions, networking products, storage products and data security products. In 2006,
non-service revenues generated by our information and communications technology business increased by 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.

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 decreased to Php124 million in 2006 from Php127 million in 2005 primarily due to Infocom s sale of its *NOW* cable Internet business in 2005; no similar transaction was recorded in 2006.

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 Php7,569 million in 2006, an increase of Php4,189 million, or 124%, from Php3,380 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:

	Years Ended December 31,					
					Increase (Decrease)	
	2006	**%**	**2005**	**%**	**Amount**	**%**
(in millions)						
Information and communications technology services:						
Compensation and benefits(1)	Php3,033	40	Php1,351	40	Php1,682	125
Professional and other contracted services	888	12	82	2	806	983
Depreciation and amortization	712	9	415	12	297	72
Cost of sales	476	6	300	9	176	59
Rent	462	6	362	11	100	28
Asset impairment	427	6	26	1	401	1,542
Maintenance	373	5	283	8	90	32
Selling and promotions	350	5	120	4	230	192
Communication, training and travel	276	4	98	3	178	182
Amortization of intangible assets	136	2			136	100
Equity share in net losses of associates	74	1			74	100
Financing costs	73	1	39	1	34	87
Taxes and licenses	71	1	36	1	35	97
Provisions	64	1	54	2	10	19
Insurance and security services	34		14		20	143

Other expenses	120	1	200	6	(80)	(40)
Total	Php7,569	100	Php3,380	100	Php4,189	124

____

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

Compensation and benefits increased by Php1,682 million, or 125%, to Php3,033 million largely due to the increased number of employees and corresponding salaries and employee benefits resulting from the expansion of our call center businesses and the consolidation of SPi and Level Up! in 2006. ePLDT s employee headcount increased by 9,558, or 208% to 14,150 in 2006 from 4,592 in 2005.

Professional and other contracted services increased by Php806 million to Php888 million primarily due to services sub-contracted by SPi from third parties related to its BPO services.

Depreciation and amortization charges increased by Php297 million, or 72%, to Php712 million primarily due to an increase in the depreciable asset base in relation to the expansion of our call center businesses and the consolidation of SPi in July 2006.

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

Rent expenses increased by Php100 million, or 28%, to Php462 million primarily due to the opening of two additional call center sites in 2006 which led to increased rental of leased circuits.

Asset impairment increased by Php401 million to Php427 million primarily due to the impairment of ePLDT s notes receivable from Technology Support Services, Inc. Please see *Note 12 Notes Receivable* to the accompanying audited consolidated financial statements for further discussion.

Maintenance expenses increased by Php90 million, or 32%, to Php373 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 Php230 million, or 192%, to Php350 million mainly due to higher advertising and marketing spending of netGames and Level Up!.

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

An amortization of intangible assets amounting to Php136 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.

ePLDT s equity share in net losses of associates amounted to Php74 million in 2006, primarily due to ePLDT s share in net losses of its SPi s associate.

Financing costs increased by Php34 million, or 87%, to Php73 million, primarily due to the consolidation of SPi in July 2006.

Taxes and licenses increased by Php35 million, or 97%, to Php71 million due to higher business-related taxes accrued and paid in 2006 as compared to 2005.

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

Insurance and security services increased by Php20 million, or 143%, to Php34 million, primarily due to higher premium costs and an increase in the value of assets insured in 2006 as compared to 2005.

Other expenses decreased by Php80 million, or 40%, to Php120 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 Php38 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

In 2006, our information and communications technology business segment registered a net loss of Php311 million as against a net income of Php46 million in 2005 mainly as a result of a 124% increase in ICT-related expenses and the recent opening of two call centers, partly offset by the increase in ICT revenues mainly from our call center business and the consolidation of SPi.

Liquidity and Capital Resources

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

	Years Ended December 31,	
	2006	**2005**
(in millions)		
Cash Flows		
Net cash provided by operating activities	Php70,186	Php76,213
Net cash used in investing activities	36,126	11,694
Capital expenditures	*21,111*	*14,990*
Net cash used in financing activities	45,722	60,794
Net increase (decrease) in cash and cash equivalents	(12,306)	2,738

	December 31,	
	2006	**2005**
(in millions)		
Capitalization		
Long-term portion of interest-bearing financial liabilities net of current portion:		
Long-term debt	Php63,771	Php84,860
Obligations under capital lease	106	344
Preferred stock subject to mandatory redemption	1,369	11,974
	65,246	97,178
Current portion of interest-bearing financial liabilities:		
Notes payable	205	

Long-term debt maturing within one year	16,183	18,684
Obligations under capital lease maturing within one year	924	754
	17,312	19,438
Total interest-bearing financial liabilities	82,558	116,616
Total equity	104,313	74,369
	Php186,871	Php190,985
Other Financial Data		
Total assets	Php244,883	Php250,197
Property, plant and equipment - net	164,693	176,974
Cash and cash equivalents	17,753	30,059

As at December 31 , 2006, our consolidated cash and cash equivalents totaled Php17,753 million. Principal sources of consolidated cash and cash equivalents in 2006 were cash flows from operating activities amounting to Php70,186 million and drawings from Smart s and ePLDT s debt facilities aggregating Php9,724 million. These funds were used principally for capital outlays of Php21,111 million, total debt principal payments of Php30,259 million and investments of Php11,187 million.

Operating Activities

Our consolidated net cash flows from operating activities decreased by Php6,027 million, or 8%, to Php70,186 million in 2006, from Php76,213 million in 2005.

A significant portion of our cash flow is generated by our wireless business, which contributed approximately 58% and 59% of our service revenues in 2006 and 2005, respectively. Revenues from our fixed line and information and communications technology services accounted for 37% and 5%, respectively, of our service revenues in 2006 compared to 39% and 2%, respectively, in 2005.

Cash flows from operating activities of our wireless business amounted to Php38,053 million in 2006, a decrease of Php8,493 million, or 18%, compared to Php46,546 million in 2005. However, cash flows from operating activities of our fixed line business increased to Php29,720 million in 2006, compared to Php28,864 million in 2005. The overall decrease in our cash flows from operating activities was primarily due to an increase in working capital requirements with the settlement of various current liabilities partially offset by higher collections of accounts receivable. Our wireless business segment accounted for 54% of our cash flows from operating activities while our fixed line segment accounted for 42% in 2006. We believe that our continuing strong cash flows from operating activities on a consolidated basis will allow us to defray our current liabilities despite our current ratio being less than 1:1 as at December 31, 2006.

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

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

Investing Activities

Net cash used in investing activities amounted to Php36,126 million in 2006, an increase of Php24,432 million, or 209%, compared to Php11,694 million in 2005. This was primarily a result of: (1) an increase in capital expenditures by Php6,121 million; (2) payments for purchase of investments by Php10,939 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 Smart Broadband of Php1,201 million; (c) the purchase of a 60% equity interest in Level Up! of Php347 million; (d) the acquisition of approximately 25.5% equity interest in Philweb for Php637 million; and (e) the acquisition of the remaining 20% equity in Wolfpac for Php30 million; and (3) the increase in short-term investments by Php6,710 million in 2006 as compared to a decrease in 2005 mainly due to Smart s increased investment in money market placements with over 90 days maturity in 2006 compared to the maturity of Smart s prepaid forward exchange contracts in 2005.

Our consolidated capital expenditures in 2006 totaled Php21,111 million, an increase of Php6,121 million, or 41%, from Php14,990 million in 2005 primarily due to PLDT s, Smart s and ePLDT s higher capital spending. Smart's capital spending of Php10,545 million in 2006 was used primarily to rollout 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 Php1,530 million was primarily used to fund its continued call center expansion. The balance represented other subsidiaries capital spending. Consolidated capital expenditures in 2005 amounted to Php14,990 million, of which Php8,786 million, Php5,500 million and Php620 million were attributable to Smart, PLDT and ePLDT, respectively.

Financing Activities

On a consolidated basis, we used net cash of Php45,722 million for financing activities, net of loan drawings by Smart, in 2006, a decrease of Php15,072 million, or 25%, compared to Php60,794 million in 2005. The net cash used in financing activities in 2006 was mainly utilized for debt repayments and interest payments by PLDT and Piltel in line with their ongoing debt reduction programs, and dividend payments distributed by PLDT to its common and preferred stockholders.

Debt Financing

Additions to our consolidated long-term debt in 2006 totaled Php9,724 million mainly from Smart's drawings related to the financing of its Phases 8 and 9 GSM facilities. Payments in respect of principal and interest of our total debt amounted to Php30,259 million and Php7,498 million, respectively, in 2006, of which Php16,593 million and Php6,123 million were attributable to PLDT, respectively.

The following table shows our long-term debt, including current portion, as at December 31, 2006 and 2005:

	December 31,		**Increase (Decrease)**	
	2006	**2005**	**Amount**	**%**
(in millions)				
U.S. Dollar Debt:				
Export Credit Agencies-Supported Loans	Php14,981	Php23,126	(Php8,145)	(35)
Fixed Rate Notes	40,972	52,354	(11,382)	(22)
Term Loans	18,611	14,288	4,323	30
Restructured Loans		4,767	(4,767)	(100)
Satellite Acquisition Loans	2,083	3,040	(957)	(31)
	76,647	97,575	(20,928)	(21)
Japanese Yen Debt:				
JBIC s Overseas Investment Loan		3,139	(3,139)	(100)
Export Credit Agency-Supported Loan		709	(709)	(100)
		3,848	(3,848)	(100)
Philippine Peso Debt:				
Peso Fixed Rate Corporate Notes	808	1,576	(768)	(49)
Term Loans	2,499	166	2,333	1,405
Restructured Loans		379	(379)	(100)
	3,307	2,121	1,186	56
	Php79,954	Php103,544	(Php23,590)	(23)

For a complete discussion of our long-term debt, see *Note 17 Interest-bearing Financial Liabilities* to the accompanying audited consolidated financial statements.

Our long-term debt decreased by Php23,590 million, or 23%, to Php79,954 million as at December 31, 2006, largely due to debt amortizations and prepayments in line with PLDT s efforts to reduce its overall debt level, and also due to the appreciation of the peso. PLDT s debt was reduced by 29% to Php52,443 million by December 31 , 2006. In addition, the debt levels of Smart, Mabuhay and ePLDT decreased by 6%, 31% and 65%, respectively, to Php25,371 million, Php2,083 million and Php57 million, respectively, as at December 31, 2006 due to amortizations and prepayments during 2006.

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. As at December 31, 2006, this facility remained undrawn. Please see *Note 17 Interest-bearing Financial Liabilities* to the accompanying audited consolidated financial statements for a detailed discussion of our long-term debt.

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

Year	**US$ Loans**		**Peso Loans**	**Total**
2007	US$327	Php16,032	Php289	Php16,321
2008	147	7,211	555	7,766
2009	294	14,429	556	14,985
2010	71	3,471	1,366	4,837
2011	15	728	555	1,283
2012 and onwards	830	40,715		40,715
	US$1,684	Php82,586	Php3,321	Php85,907

Approximately Php45,192 million principal amount of our consolidated outstanding long-term debt as at December 31 , 2006 is scheduled to mature over the period from 2007 to 2011. Of this amount, Php26,009 million was attributable to PLDT, Php17,043 million to Smart and the remainder to Mabuhay Satellite, Maratel and ePLDT.

On June 5, 2006, Piltel made a partial voluntary prepayment of principal under its Peso bank facility, U.S. Dollar bank facility, various Trade Creditor facilities and Notes Indenture. The voluntary prepayment was made in lieu of depositing Excess Cash Flow from the operations of Piltel s business into a Sinking Fund Account. The aggregate voluntary prepayment amount was Php9,325 million (Php6,393 to Smart and Php2,932 million to third party creditors) or US$176 million (US$121 million to Smart and US$55 million to third party creditors,) which was applied proportionally to the various debt facilities as set out in the Intercreditor Agreement dated June 4, 2001 (the Intercreditor Agreement.)

On December 4, 2006, Piltel prepaid the outstanding balance of its principal debt under its Peso bank facility, U.S. Dollar bank facility, Peso Term Note facility, various Trade Creditor Facilities and Notes Indenture in the aggregate amount of Php11,631 million (Php8,061 million to Smart and Php3,570 million to third party creditors) or US$233 million (US$161 million to Smart and US$72 million to third party creditors.) Piltel obtained approval from the Bangko Sentral ng Pilipinas to source dollar payment from authorized agent banks. Please see *Note 17 Interest-bearing financial liabilities* to the accompanying audited consolidated financial statements for further discussion.

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 accounting principles generally accepted in the Philippines, 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.

Please see *Note 17 Interest-bearing Financial Liabilities* to the accompanying audited consolidated financial statements for a detailed discussion of our 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 improving cash flows and reduced debt levels, we restored the payment of dividends in May 2005 and currently intend to gradually increase our dividend payout ratio in succeeding years as we improve our leverage ratios. For 2006, our dividend payout ratio was 60% which we currently intend to increase to 70% in 2007.

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	Foreign Currency Senior Unsecured Debt Rating	BB+	Stable
Moody s Investor Service	Foreign Currency Senior Unsecured Debt Rating	Ba2	Stable
	Local Currency Corporate Family Rating	Baa3	Positive
Fitch	Long-term Foreign Currency Rating	BB	Stable
	Long-term Local Currency Rating	BB+	Stable
	Long-term Foreign Currency Issuer Default Rating	BB+	Stable
	Long-term Local Currency Issuer Default Rating	BBB-	Positive
	National Long-term Rating	AAA(ph1)	Stable

On November 3, 2006, Moody s affirmed PLDT s Ba2 senior unsecured foreign currency rating and changed its outlook to stable from negative. The rating action was prompted by the change in outlook on the Philippines Ba3 country ceiling for foreign currency bonds to stable from negative. On July 18, 2006, Moody s upgraded PLDT s local currency corporate family rating from Ba1 to Baa3 with a positive outlook.

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

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

Equity Financing

PLDT raised Php62 million and Php275 million from the exercise by certain officers and executives of stock options in 2006 and 2005, respectively. In addition, through our subscriber investment plan, or SIP, which provides postpaid fixed line subscribers the opportunity to buy shares of our 10% cumulative convertible preferred stock as part of the upfront payments collected from subscribers, PLDT was able to raise Php4 million and Php10 million in 2006 and 2005, respectively.

Cash dividend payments in 2006 amounted to Php14,897 million, of which Php14,447 million and Php450 million were paid to common and preferred shareholders, respectively, compared to Php10,972 million, of which Php9,587 million and Php1,385 million were paid to common and preferred shareholders, respectively, in 2005.

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

		Date		Amount	
Class	**Declaration**	**Record**	**Paid**	**Per Share**	**Total**
Common Stock	March 1, 2005	March 31, 2005	May 12, 2005	Php14.00	Php2,384
	May 5, 2005	June 3, 2005	July 14, 2005	21.00	3,598
	November 8, 2005	November 28, 2005	December 28, 2005	21.00	3,642
	February 27, 2006	March 20, 2006	April 20, 2006	28.00	5,059
	August 8, 2006	August 21, 2006	September 21, 2006	50.00	9,346
	March 6, 2007	March 20, 2007	April 20, 2007	50.00	9,428

As at December 31, 2006, there were 188.4 million PLDT common shares outstanding compared to 180.8 million common shares outstanding as at December 31, 2005.

Contractual Obligations and Commercial Commitments

Contractual Obligations

The following table discloses our consolidated contractual obligations outstanding as at December 31, 2006:

		Payments Due by Period			
	Total	**Within 1 year**	**2-3 years**	**4-5 years**	**After 5 years**
			(Audited)		
(in millions)					
Long-term debt (1)	Php85,907	Php16,321	Php22,751	Php6,120	Php40,715
Long-term lease obligations:					
Operating lease	3,420	571	1,158	823	868
Capital lease	1,572	1,523	48	1	
Unconditional purchase obligations(2)	834	25	49	172	588
Other long-term obligations	1,629		1,629		

Total contractual obligations	Php93,362	Php18,440	Php25,635	Php7,116	Php42,171

____

(1) Before deducting unamortized debt discount and debt issuance costs.

-

(2) Based on the amended Air Time Purchase Agreement with AIL.

Long-term Debt

For a discussion of our long-term debt, see *Note 17 Interest-bearing Financial Liabilities* to the accompanying audited consolidated financial statements.

Long-term Operating Lease Obligations

Digital Passage Service Contracts. PLDT has existing Digital Passage Service Contracts with foreign telecommunication administrations for several dedicated circuits to various destinations for ten to 25 years expiring at various dates. As at December 31, 2006, PLDT s aggregate remaining obligation under these contracts amounted to approximately Php6 million.

License Agreement with Mobius Management Systems (Australia) Pty Ltd., or Mobius. PLDT entered into a license agreement with Mobius pursuant to which Mobius has granted PLDT a non-exclusive, non-assignable and non-transferable license for the use of computer software components. Under this agreement, Mobius is also required to provide maintenance services for a period of one year at no additional maintenance charge. PLDT may purchase maintenance services upon expiration of the first year for a fee of 15% of the current published license fee. As at December 31 , 2006, PLDT s aggregate remaining obligation under this agreement was approximately Php10 million.

Other Long-term Operating Lease Obligations. The PLDT Group has various long-term lease contracts for periods ranging from two to ten years covering certain offices, warehouses, cell sites, telecommunication equipment locations and various office equipments. In particular, Smart has lease obligations amounting to Php3,053 million as at December 31, 2006 in respect of office and cell site rentals with over 3,000 lessors nationwide, PLDT has lease obligations aggregating Php100 million as at December 31, 2006, ePLDT has lease obligations aggregating Php238 million as at December 31, 2006 in respect of certain office space rentals and PLDT Global has lease obligations aggregating Php13 million as at December 31, 2006 in respect of certain office space rentals.

*Long-term Capital Lease Obligation*s

For a discussion of our long-term capital lease obligations, see *Note 17 Interest-bearing Financial Liabilities* to the accompanying audited consolidated financial statements.

Unconditional Purchase Obligations

Air Time Purchase Agreement with AIL. As discussed in *Note 20 Related Party Transactions* to the accompanying audited consolidated financial statements, PLDT is a party to a Founder National Service Provider, or NSP, Air Time Purchase Agreement entered into with AIL in March 1997, which was amended in December 1998, under which PLDT was granted the exclusive right to sell AIL services as NSP in the Philippines. In exchange, the Air Time Purchase Agreement required PLDT to purchase from AIL a minimum of US$5 million worth of air time annually over ten years commencing on January 1, 2002, the purported date of commercial operations of the Garuda I Satellite. In the event that AIL s aggregate billed revenue is less than US$45 million in any given year, the Air Time Purchase Agreement also states that PLDT has to make supplemental air time purchase payments not to exceed US$15 million per year during the ten-year term.

In March 2003, PLDT, together with the other founder NSPs, entered into a Standstill Agreement with AIL. Under the Standstill Agreement, payments made to AIL under the Air Time Purchase Agreement were based on billings of actual usage pending final agreement on the terms of the proposed amendment to the Air Time Purchase Agreement.

On February 10, 2004, notwithstanding the ongoing negotiations, AIL advised PLDT of the termination of the Standstill Agreement and the reinstatement of the terms under the original Air Time Purchase Agreement effective January 1, 2002 following the lapse of the November 15, 2003 deadline set in the Standstill Agreement for the negotiation of a revised Air Time Purchase Agreement.

On June 21, 2004, AIL also sent PLDT a letter citing PLDT in default under the Air Time Purchase Agreement for non-payment of outstanding amounts and for repudiation of its obligations thereunder. PLDT maintains, however, that the termination of the Standstill Agreement and reinstatement of the terms under the original Air Time Purchase Agreement are premature, considering that the discussions or negotiations on the terms of the proposed revised Air Time Purchase Agreement were still pending between the parties, such that it is highly inequitable for AIL to have unilaterally decided to invoke the provisions of the Standstill Agreement and declared PLDT in default.

The Air Time Purchase Agreement provides that the NSPs obligations to make minimum or supplemental air time purchase payments remain in effect until 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, the latest of which was on December 30, 1998 under the

Amended and Restated Credit Agreement signed with the Banks; and (2) amounts owing to Martin Marietta Overseas Corporation under the Spacecraft Contract dated August 28, 1995, as amended on December 30, 1998.

On September 1, 2006, AIL, PT Asia Cellular Satellite and Inmarsat reached an agreement to pool their resources to develop 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.

PLDT likewise signed a Gateway Services Agreement with Inmarsat, whereby 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 signed a Term Sheet, or Banks Term Sheet, with a majority of the banks which will be used as the basis for further good faith negotiations between the parties thereto with a view to entering into an agreement further amending the Amended and Restated Credit Agreement with AIL s bank creditors.

Under the Banks Term Sheet, a majority of the banks agreed, subject to satisfaction of certain conditions, among other things, to amend the Founder NSP Air Time Purchase Agreement and to
re-denominate AIL debt into non-interest bearing subordinated convertible bonds maturing in 2015; to amortize a senior term loan with a final maturity on August 1, 2013 and a junior term loan with payments on August 1, 2014 and 2015.

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 repay principal and interest payable to the banks in accordance with the Banks Term Sheet.

On February 1, 2007, PLDT (through ACeS Philippines) signed an agreement to purchase LMGT Holdings (ACeS), Inc., or LMGT, and Martin Marietta Overseas Corporation s, or MMOC, 50% equity and debt interest in AIL, for US$750,000 in accordance with a notice of proposed transfer issued by LMGT dated December 22, 2006 pursuant to a right of first refusal under the AIL Shareholders Agreement.

As at December 31, 2006, PLDT s aggregate remaining minimum obligation under the amended Air Time Purchase Agreement was approximately Php834 million.

Other Long-term Obligations

Mandatory Conversion and Purchase of Shares. As discussed in *Note 17 Interest-bearing Financial Liabilities* to the accompanying audited consolidated financial statements, 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.

Each share of Series V, VI and VII Convertible Preferred Stock is convertible at any time at the option of the holder into one PLDT common share. On the date immediately following the seventh anniversary of the issue date of the Series V and Series VI Convertible Preferred Stocks 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 to PLDT common shares. Under a put option exercisable for 30 days, holders of common shares received on mandatory conversion of the Series V, VI and VII Convertible Preferred Stocks will be able to require PLDT to purchase such PLDT common shares for Php1,700 per share, US$36.132 per share, and JP¥4,071.89 per share, respectively.

As at December 31, 2006, 2,675,393 shares of Series V Convertible Preferred Stock and 4,419,916 shares of Series VI Convertible Preferred Stock and all 3,842,000 shares of Series VII Convertible Preferred Stock had been voluntarily converted to PLDT common shares. As at December 31, 2006, 46,047 shares of Series V and 875,188 shares of Series VI Convertible Preferred Stocks remained outstanding. The aggregate value of the put option based on outstanding shares as at December 31, 2006 was Php1,629 million, which is puttable on June 4, 2008, if all of the outstanding shares of Series V and VI Convertible Preferred Stocks would be mandatorily converted and all the underlying shares of common stock would be put to PLDT at that time. The market value of the underlying shares of common stock was Php2,349 million, based on the market price of PLDT common shares of Php2,550.00 per share as at December 31, 2006.

Please refer to *Note 17 Interest-bearing Financial Liabilities* to the accompanying audited consolidated financial statements for further discussion.

Commercial Commitments

As at December 31 , 2006, our outstanding commercial commitments, in the form of letters of credit, amounted to Php1,546 million. These commitments will expire within one year.

Quantitative and Qualitative Disclosures about Market Risks

Our operations are exposed to various risks, including liquidity risk, foreign exchange risk and interest rate risk. The importance of managing these risks has significantly increased in light of considerable change and continuing volatility in both the Philippine and international financial markets. With a view to managing these risks, we have incorporated financial risk management functions in our organization, particularly in our treasury operations and equity issues and sales of certain assets.

Liquidity Risk Management

We seek to manage our liquidity profile to be able to finance our capital expenditures and service our maturing debts. To cover our financing requirements, we currently intend to use internally generated funds and proceeds from debt and equity issues and sales of certain assets.

As part of our liquidity risk management program, we regularly evaluate our projected and actual cash flow information and continuously assess conditions in the financial markets for opportunities to pursue fund-raising initiatives. These initiatives may include bank loans, export credit agency-guaranteed facilities, and debt capital and equity market issues.

Foreign Exchange Risk Management

As at December 31 , 2006, the Philippine peso had appreciated by 8% against the U.S. dollar to Php49.045 to US$1.00 from Php53.062 to US$1.00 as at December 31, 2005. As at December 31, 2005, likewise, the peso appreciated by 6% to Php53.062 to US$1.00 from Php56.341 to US$1.00 as at December 31, 2004. The revaluation of our foreign-currency denominated assets and liabilities is recognized as foreign exchange gains or losses as at the balance sheet date. Since substantially all of our indebtedness is denominated in U.S. dollars, the appreciation or depreciation of the Philippine peso results in the recognition of foreign exchange gains or losses. The extent of foreign exchange gains or losses is largely dependent on the amount of foreign currency debt and hedges we carry. As at December 31, 2006, consolidated foreign currency denominated debt amounted to Php76,647 million, a reduction from Php101,423 million as at December 31, 2005. As such, we recognized foreign exchange gains of Php2,008 million and Php4,906 million in 2006 and 2005, respectively.

While a certain percentage of our revenues is either linked to or denominated in U.S. dollars, substantially all of our indebtedness and related interest expense, a substantial portion of our capital expenditures and a portion of our operating expenses are denominated in foreign currencies, mostly in U.S. dollars.

As at December 31, 2006, approximately 96% of our total consolidated debts were denominated in foreign currencies, principally in U.S. dollars. Thus, a strengthening or weakening of the Philippine peso against the U.S. dollar will decrease or increase both the principal amount of our unhedged foreign currency-denominated debts (representing 43% of our consolidated debts, or 31% net of our U.S. dollar cash balances as at December 31, 2006), and interest expense on our debt in Philippine peso terms. In addition, many of our financial ratios and other financial tests are affected by the movements in the Philippine peso to U.S. dollar exchange rate.

To manage our foreign exchange risks, stabilize cash flows, and improve investment and cash flow planning, we enter into forward foreign exchange contracts, foreign currency swap contracts, currency option contracts and other hedging products aimed at reducing and/or managing the adverse impact of changes in foreign exchange rates on our operating results and cash flows. However, these hedges do not cover all of our exposure to foreign exchange risks.

Specifically, we use forward foreign exchange contracts, foreign currency swap contracts and currency option contracts to manage the foreign currency risk associated with our foreign currency-denominated loans. In order to manage hedge costs of these contracts, we utilize structures that include credit-linkage with PLDT as the reference entity, a combination of currency option contracts, and fixed to floating coupon only swap agreements. Accounted for as either cash flow hedges or transactions not designated as hedges, changes in the fair value of these instruments are recognized as cumulative translation adjustments in equity until the hedged item is recognized directly as income or expense for the period. As at December 31, 2006, PLDT s outstanding forward foreign exchange contracts, principal-only long-term cross-currency swap contracts and currency option contracts amounted to US$202 million; US$550 million; and US$174 million, respectively. Smart had no outstanding forward foreign exchange contracts as at December 31, 2006.

For further discussions of these contracts, see *Note 24 Financial Assets and Liabilities Derivative Financial Instruments* to the accompanying audited consolidated financial statements.

Interest Rate Risk Management

On a limited basis, we enter into interest rate swap agreements in order to manage our exposure to interest rate fluctuations. As at December 31, 2006, PLDT s outstanding interest rate swap contracts amounted to US$63 million. For further discussions of these contracts, see *Note 24 Financial Assets and Liabilities Derivative Financial Instruments* to the accompanying audited consolidated financial statements.

We make use of hedging instruments and structures solely for reducing or managing financial risks associated with our liabilities and not for trading or speculative purposes.

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 2006 was 6.2%, compared to 7.6% in 2005.

OTHER INFORMATION

Smart s Fixed Rate Corporate Notes Issue

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 were priced at 5.625%, while Series B were priced at 6.500%. Funds raised from the issuance of these notes will be used primarily for Smart s capital expenditures for network improvement and expansion.

Related Party Transactions

Cooperation Agreement with First Pacific and certain affiliates, or FP Parties, NTT Communications and DoCoMo

In connection with the transfer by NTT Communications Corporation, or NTT Communications, of approximately 12.6 million shares of PLDT s common stock to NTT DoCoMo, Inc, or DoCoMo, pursuant to a Stock Sale and Purchase Agreement dated January 31, 2006 between NTT Communications and DoCoMo, the FP Parties, NTT Communications and DoCoMo entered into a Cooperation Agreement, dated January 31, 2006. Under the Cooperation Agreement, the relevant parties extended certain rights of NTT Communications under the Stock Purchase and Strategic Investment Agreement dated September 28, 1999, as amended, and the Shareholders Agreement dated March 24, 2000, to DoCoMo, including:

- certain contractual veto rights over a number of major decisions or transactions; and

• rights relating to the representation on the board of directors of PLDT and Smart, respectively, and any committees thereof.

Key provisions of the Cooperation Agreement pertain to, among other things, restrictions on the ownership of shares of PLDT by NTT Communications and DoCoMo, competition, business cooperation, additional rights of DoCoMo, change in control and termination. See *Note 20 Related Party Transactions* to the accompanying audited consolidated financial statements for further details.

Integrated i-mode Services Package Agreement between DoCoMo and Smart An Integrated i-mode Service Package Agreement was entered into by Smart and DoCoMo on February 15, 2006, under which DoCoMo agreed to grant Smart, on an exclusive basis within the territory of the Philippines for a period of five years, an integrated i-mode service package including a non-transferable license to use the licensed materials and the i-mode brand, as well as implementation support and assistance and post-commercial launch support from DoCoMo. Pursuant to this agreement, Smart is required to pay an initial license fee and running royalty fees based on the revenue arising from i-mode subscription fees and data traffic. The initial license fee paid as at December 31, 2006 amounted to Php53 million.

Advisory Services Agreement between DoCoMo and PLDT An Advisory Services Agreement was entered into by DoCoMo and PLDT on June 5, 2006, in accordance with the Cooperation Agreement between PLDT and DoCoMo. Pursuant to the agreement, DoCoMo will provide the services of certain key personnel in connection with certain aspects of the business of PLDT and Smart. Also, the agreement governs the terms and conditions of the appointments and the corresponding fees related thereto. The initial license fee paid as at December 31, 2006 amounted to Php12 million. Outstanding liability under this agreement amounted to Php32 million as at December 31, 2006.

Other Agreements with NTT Communications and/or its Affiliates Under certain agreements, (1) NTT Communications provides advisory services for various business areas of PLDT; (2) PLDT is licensed to market managed data and other services using NTT Communications Arcstar brand; and (3) PLDT and NTT Communications agreed to cooperative arrangements for conventional international telecommunications services. Total fees under these agreements totaled Php184 million and Php256 million for the years ended December 31, 2006 and 2005, respectively. PLDT s outstanding obligations under these agreements amounted to Php18 million and Php23 million as at December 31, 2006 and 2005, respectively.

Agreements between Smart and Asia Link B.V., or ALBV Under certain agreements, ALBV undertakes to provide technical support services and assistance in the operations and maintenance of Smart s cellular business. Total fees under these agreements totaled Php591 million and Php567 million for the years ended December 31, 2006 and 2005, respectively. Outstanding obligations of Smart under these agreements amounted to Php128 million and Php194 million as at December 31, 2006 and 2005, respectively. ALBV is a subsidiary of the First Pacific Group.

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 paid under these agreements amounted to Php360 million and Php468 million for the years ended December 31, 2006 and 2005, respectively. Two directors of PLDT have a direct/indirect interest in or serve as a director/officer of Gotuaco and Malayan.

For a more detailed discussion of the related party transactions enumerated above, see *Note 20 Related Party Transactions* to the accompanying audited consolidated financial statements.

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, 2006 and 2005, 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, 2006, 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, 2006 and 2005, and its financial performance and its cash flows for each of the three years in the period ended December 31, 2006 in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.

/s/ Betty C. Siy-Yap

BETTY C. SIY-YAP

Partner

CPA Certificate No. 57794

SEC Accreditation No. 0098-A

Tax Identification No. 102-100-627

PTR No. 4181272, January 2, 2006, Makati City

March 6, 2007

Exhibit 1.3

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS AT DECEMBER 31, 2006 AND 2005

AND FOR THE THREE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

AND

REPORT OF INDEPENDENT AUDITORS

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2006 and 2005

(in million pesos, except par value and share amounts)

	2006	2005
ASSETS		
Noncurrent Assets		
Property, plant and equipment (Notes 2, 3, 8 and 17)	**164,693**	176,974
Investments in associates (Notes 2, 9 and 17)	**651**	15
Investments-available-for-sale (Notes 2 and 24)	**116**	109
Investment properties (Notes 2, 3 and 10)	**587**	701
Goodwill and intangible assets (Notes 2, 3 and 11)	**12,999**	3,049
Deferred income tax assets (Notes 2 and 6)	**19,658**	15,457
Derivative assets (Notes 2 and 24)	**434**	2,648
Notes receivable (Notes 2, 12 and 24)		346
Prepayments - net of current portion	**843**	1,062
Advances and refundable deposits - net of current portion (Notes 2 and 20)	**1,935**	1,141
Total Noncurrent Assets	**201,916**	201,502
Current Assets		
Cash and cash equivalents (Notes 2, 13 and 24)	**17,753**	30,059
Short-term investments (Notes 2 and 24)	**8,327**	2,750
Trade and other receivables (Notes 2, 3, 14 and 24)	**9,938**	7,856
Inventories and supplies (Notes 2 and 15)	**1,230**	1,548
Derivative assets (Notes 2 and 24)	**47**	37
Current portion of prepayments	**5,519**	5,001
Current portion of advances and refundable deposits (Notes 2 and 20)	**153**	1,444
Total Current Assets	**42,967**	48,695
	244,883	250,197
EQUITY AND LIABILITIES		
Equity Attributable to Equity Holders of PLDT (Notes 2, 7 and 16)		
Preferred stock, Php10 par value, authorized-822,500,000 shares; issued and outstanding-442,375,057 shares as at December 31, 2006 and 443,343,035 shares as at December 31, 2005	**4,424**	4,433
Common stock, Php5 par value, authorized-234,000,000 shares; issued and outstanding-188,434,695 shares as at December 31, 2006 and 180,789,003 shares as at December 31, 2005	**942**	904
Stock options issued (Note 21)	**40**	67
Equity portion of convertible preferred stock (Note 17)	**9**	49
Capital in excess of par value	**66,574**	53,918
Retained earnings (Note 7)	**32,784**	12,583

Cumulative translation adjustments (Note 24)	**(2,018)**	1,253
Total Equity Attributable to Equity Holders of PLDT	**102,755**	73,207
Minority interest	**1,558**	1,162
Total Equity	**104,313**	74,369

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (*continued*)

December 31, 2006 and 2005

(in million pesos, except par value and share amounts)

	2006	2005
Noncurrent Liabilities		
Interest-bearing financial liabilities - net of current portion (Notes 2, 8, 17, 22 and 24)	**65,246**	97,178
Deferred income tax liabilities (Notes 2 and 6)	**478**	49
Derivative liabilities (Notes 2 and 24)	**6,872**	5,777
Provisions for onerous contracts and assessments - net of current portion (Notes 20, 22 and 23)		3,966
Pension and other employee benefits (Notes 2, 3 and 21)	**2,982**	4,252
Customers deposits	**2,204**	2,215
Other noncurrent liabilities (Notes 2, 3, 8, 14 and 18)	**7,581**	7,600
Total Noncurrent Liabilities	**85,363**	121,037
Current Liabilities		
Accounts payable (Notes 2 and 24)	**11,684**	15,966
Accrued expenses and other current liabilities (Notes 2, 3, 17, 19 and 20)	**19,157**	13,306
Unearned revenues (Note 2)	**3,274**	2,656
Derivative liabilities (Notes 2 and 24)	**108**	192
Current portion of provisions for onerous contracts and assessments (Notes 20, 22 and 23)	**446**	408
Current portion of interest-bearing financial liabilities (Notes 2, 8, 17, 22 and 24)	**17,312**	19,438
Dividends payable (Notes 2, 7, 17 and 24)	**788**	746
Income tax payable (Notes 2 and 6)	**2,438**	2,079
Total Current Liabilities	**55,207**	54,791
	244,883	250,197

See accompanying Notes to Consolidated Financial Statements.

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2006, 2005 and 2004

(in million pesos, except per share amounts)

	2006	2005	2004
INCOME			
Service revenues	**125,140**	121,062	115,206
Non-service revenues (Note 5)	**2,967**	3,312	6,269
Equity share in net income of associates		7	
Other income (Notes 4 and 5)	**5,736**	1,663	4,729
	133,843	126,044	126,204
EXPENSES			
Depreciation and amortization (Notes 4 and 8)	**31,870**	30,822	21,405
Compensation and benefits (Notes 5 and 21)	**18,371**	14,136	12,025
Financing costs (Notes 5, 8, 17 and 24)	**9,044**	9,133	19,264
Maintenance (Note 20)	**6,891**	6,705	5,671
Cost of sales (Notes 5, 20 and 22)	**5,522**	6,501	11,352
Selling and promotions	**5,067**	5,093	5,478
Professional and other contracted services (Notes 5 and 20)	**3,298**	2,464	2,228
Rent (Note 22)	**2,275**	2,086	1,907
Asset impairment (Notes 3, 5, 8, 9 and 11)	**1,818**	26	1,412
Taxes and licenses (Note 23)	**1,748**	2,205	1,997
Communication, training and travel	**1,481**	1,465	1,310
Insurance and security services (Note 20)	**1,254**	1,523	1,644
Provisions (Notes 3, 5, 14, 15, 20, 22 and 23)	**985**	2,926	4,851
Amortization of intangible assets (Note 11)	**448**	244	155
Equity in net losses of associates	**74**		74
Other expenses (Note 20)	**1,508**	2,100	2,499
	91,654	87,429	93,272
INCOME BEFORE INCOME TAX	**42,189**	38,615	32,932
PROVISION FOR INCOME TAX (Notes 2 and 6)	**6,869**	4,136	4,973
NET INCOME FOR THE YEAR	**35,320**	34,479	27,959
ATTRIBUTABLE TO:			
Equity holders of PLDT	**35,116**	34,112	28,031
Minority interest	**204**	367	(72)
	35,320	34,479	27,959
Earnings Per Common Share (Note 7)			
Basic	**187.91**	189.96	156.14
Diluted	**187.81**	185.72	154.51

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, 2006, 2005 and 2004

(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, 2004	**4,505**	**847**	**286**	**523**	**49,633**	**(36,982)**	**549**	**19,361**	**771**	**20,132**
Changes in equity:										
Income for the year						28,031		28,031	(72)	27,959
Currency translation differences (Note 24)							17	17	8	25
Net gains on available-for-sale financial assets (Note 24)							(5)	(5)		(5)
Net gain on cash flow hedges (Note 24)							(199)	(199)		(199)
Total income and expense for the year recognized directly to equity							(187)	(187)	8	(179)
Total income and expense for the year						**28,031**	**(187)**	**27,844**	**(64)**	**27,780**
Cash dividends (Note 7)						**(1,527)**		**(1,527)**		**(1,527)**
Issuance of capital stock - net (Note 16)	**(8)**	**2**		**(75)**	**445**			**364**		**364**
Exercised shares		**2**	**(114)**		**386**			**274**		**274**
			(5)		**5**					

Cancelled options shares										
Cost of share-based payments			**14**					**14**		**14**
Minority interest									**150**	**150**
Balances at December 31, 2004	**4,497**	**851**	**181**	**448**	**50,469**	**(10,478)**	**362**	**46,330**	**857**	**47,187**
Balances at January 1, 2005	**4,497**	**851**	**181**	**448**	**50,469**	**(10,478)**	**362**	**46,330**	**857**	**47,187**
Changes in equity:										
Income for the year						34,112		34,112	367	34,479
Currency translation differences (Note 24)							(62)	(62)	(36)	(98)
Net gains on available-for-sale financial assets (Note 24)							4	4		4
Net gain on cash flow hedges (Note 24)							949	949		949
Total income and expense for the year recognized directly to equity							891	891	(36)	855
Total income and expense for the year						**34,112**	**891**	**35,003**	**331**	**35,334**
Cash dividends (Note 7)						**(11,051)**		**(11,051)**		**(11,051)**
Issuance of capital stock - net (Note 16)	**(64)**	**51**		**(399)**	**3,062**			**2,650**		**2,650**
Exercised shares		**2**	**(113)**		**386**			**275**		**275**
Cancelled options shares			**(1)**		**1**					
Minority interest									**(26)**	**(26)**
Balances at December 31, 2005	**4,433**	**904**	**67**	**49**	**53,918**	**12,583**	**1,253**	**73,207**	**1,162**	**74,369**
Balances at January 1, 2006	**4,433**	**904**	**67**	**49**	**53,918**	**12,583**	**1,253**	**73,207**	**1,162**	**74,369**
Changes in equity:										
						35,116		35,116	204	35,320

Income for the year										
Currency translation differences (Note 24)							(766)	(766)	(45)	(811)
Net gains on available-for-sale financial assets (Note 24)							5	5		5
Net loss on cash flow hedges (Note 24)							(2,510)	(2,510)		(2,510)
Total income and expense for the year recognized directly to equity							(3,271)	(3,271)	(45)	(3,316)
Total income and expense for the year						**35,116**	**(3,271)**	**31,845**	**159**	**32,004**
Cash dividends (Note 7)						**(14,915)**		**(14,915)**		**(14,915)**
Issuance of capital stock - net (Note 16)	**(9)**	**38**		**(40)**	**12,567**			**12,556**		**12,556**
Exercised shares (Note 21)			**(27)**		**89**			**62**	**237**	**299**
Balances at December 31, 2006	**4,424**	**942**	**40**	**9**	**66,574**	**32,784**	**(2,018)**	**102,755**	**1,558**	**104,313**

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, 2006, 2005 and 2004

(in million pesos)

	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	**42,189**	38,615	32,932
Adjustments for:			
Depreciation and amortization (Note 8)	**31,870**	30,822	21,405
Interest on loans and related items - net of capitalized interest (Note 5)	**7,360**	10,377	11,853
Accretion on financial liabilities - net (Note 5)	**3,314**	2,882	3,412
Asset impairment (Note 5)	**1,818**	26	1,412
Provision for doubtful accounts (Note 5)	**736**	2,251	3,955
Amortization of intangible assets (Note 11)	**448**	244	155
Loss on derivative transactions - net (Note 5)	**405**	628	864
Write-down of inventories to net realizable values (Note 5)	**211**	479	577
Dividends on preferred stock subject to mandatory redemption (Note 5)	**130**	251	284
Equity share in net (income) loss of associates	**74**	(7)	74
Provisions for onerous contracts and assessments (Note 5)	**38**	196	319
Interest income (Note 5)	**(1,654)**	(1,535)	(942)
Foreign exchange gains (loss) net (Note 5)	**(2,008)**	(4,906)	2,636
Gain on reversal of provision for onerous contracts (Notes 20, 22 and 23)	**(3,529)**		
Gain on debt exchange and debt restructuring transactions (Note 5)			(4,419)
Others	**(1,059)**	(317)	704
Operating income before working capital changes	**80,343**	80,006	75,221
Decrease (increase) in:			
Trade and other receivables	**(1,900)**	(1,036)	2,290
Inventories and supplies	**474**	509	7
Prepayments	**(1,685)**	(3,293)	119
Advances and refundable deposits	**1,337**	(240)	(873)
Increase (decrease) in:			
Accounts payable	**(6,072)**	6,466	2,614
Accrued expenses and other current liabilities	**1,849**	2,457	1,560
Unearned revenues	**574**	(250)	(213)
Pension and other employee benefits	**3,528**	1,316	(750)
Net cash generated from operations	**78,448**	85,935	79,975
Income taxes paid	**(8,262)**	(9,722)	(5,478)
Net cash provided by operating activities	**70,186**	76,213	74,497
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to property, plant and equipment	**(20,562)**	(14,486)	(20,567)
Proceeds from disposal of property, plant and equipment	**735**	912	112

Interest paid capitalized to property, plant and equipment (Notes 5 and 8)	**(549)**	(504)	(595)
Payments for purchase of investments - net of cash acquired (Note 11)	**(11,187)**	(248)	(1,366)
Additions to investment properties			(3)
Proceeds from disposal of investment properties	**72**	11	
Increase (decrease) in short-term investments	**(5,508)**	1,202	(2,212)
Decrease (increase) in investments in notes receivable		(60)	(286)
Interest received	**1,481**	1,408	954
Decrease(increase) in advances and refundable deposits	**(608)**	71	24
Net cash used in investing activities	**(36,126)**	(11,694)	(23,939)

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (*continued*)

For the Years Ended December 31, 2006, 2005 and 2004

(in million pesos)

	2006	2005	2004
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from availment of long-term debt	**9,724**	5,471	12,131
Payments of long-term debt	**(30,108)**	(44,323)	(39,548)
Payments of debt issuance costs	**(34)**	(133)	
Proceeds from notes payable	**212**	329	502
Payments of notes payable	**(151)**	(387)	(2,457)
Payments of obligations under capital lease	**(195)**	(38)	(136)
Interest paid - net of capitalized portion	**(7,498)**	(10,545)	(12,310)
Proceeds from (settlements of) derivatives	**(2,304)**	(1,645)	(210)
Cash dividends paid	**(14,913)**	(10,972)	(1,456)
Proceeds from issuance of capital stock	**66**	285	281
Increase (decrease) in:			
Customers deposits	**(1)**	42	(4)
Other noncurrent liabilities	**(520)**	1,122	667
Net cash used in financing activities	**(45,722)**	(60,794)	(42,540)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**(644)**	(987)	(69)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(12,306)**	2,738	7,949
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**30,059**	27,321	19,372
CASH AND CASH EQUIVALENTS AT END OF YEAR	**17,753**	30,059	27,321

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 ownership by United States entities. In 1967, effective control of PLDT was sold by General Telephone and Electronics Corporation
(a major shareholder since PLDT s incorporation) to a group of Filipino businessmen. In 1981, in furtherance of the then existing policy of the Philippine government to integrate the Philippine telecommunications industry, PLDT purchased substantially all of the assets and liabilities of the Republic Telephone Company, which at that time was the second largest telephone company in the Philippines. In 1998, First Pacific Company Limited, or First Pacific, through its Philippine and other affiliates, acquired a significant interest in PLDT. On March 24, 2000, NTT Communications Corporation, or NTT Communications, through NTT Communications Capital (UK) Ltd., became PLDT s strategic partner with approximately 15% economic and voting interest in the issued common stock of PLDT. Simultaneous with NTT Communications investment in PLDT, we acquired 100% of Smart Communications, Inc., or Smart. On March 14, 2006, NTT DoCoMo, Inc., or DoCoMo, acquired from NTT Communications 7% of PLDT s outstanding common shares held by NTT Communications; NTT Communications retained a 7% equity shareholding.

The common shares of PLDT are listed and traded on the Philippine Stock Exchange, or PSE, and prior to October 19, 1994, were listed and traded on the American Stock Exchange and the Archipelago Exchange (then the Pacific Exchange) in the United States. On October 19, 1994, an American Depositary Receipt, or ADR, facility was established, pursuant to which Citibank N.A., as the depositary, issued ADRs evidencing American Depositary Shares, or ADSs, with each ADS representing one PLDT common share with a par value of Php5 per share. JP Morgan Chase Bank was appointed as successor depositary for PLDT s ADR facility effective February 10, 2003. The ADSs are listed on the New York Stock Exchange, or NYSE, and on the NYSE Arca (formerly Archipelago Exchange) in the United States and are traded on the NYSE.

On December 28, 2006, PLDT issued a notice of its intent to delist the ADSs from NYSE Arca (but will continue and maintain the listing of the ADSs on the NYSE) since there is no additional advantage in having dual listing of the ADS, on both the NYSE and NYSE Arca. The delisting from NYSE Arca will eliminate duplicative administrative burdens and costs. The actual delisting from the NYSE Arca is expected to be effective sometime in the first half of 2007.

PLDT s charter, like those of all other Philippine corporations, was initially limited to a period of 50 years but has since been extended twice for 25 years each, the last extension being for an additional

25-year period through 2028. Under its amended charter (Republic Act No. 7082), which became effective on August 24, 1991, PLDT is authorized to provide virtually every type of telecommunications service, both within the Philippines and between the Philippines and other countries.

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, 2006 and 2005 and for the years ended December 31, 2006, 2005 and 2004 were approved and authorized for issuance by the Board of Directors on March 6, 2007.

2. Summary of Significant Accounting Policies and Practices

Basis of Preparation

Our consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments, available-for-sale financial assets and investment properties that have been measured at fair values. The carrying values of recognized assets and liabilities that are hedged items in fair value hedges, and are otherwise carried at cost, are adjusted to record changes in the fair values attributable to the risks that are being hedged.

Our consolidated financial statements are presented in Philippine pesos and all values are rounded to the nearest million except when otherwise indicated.

Statement of Compliance

Our consolidated financial statements have been prepared in compliance with accounting principles generally accepted in the Philippines as set forth under Philippine Financial Reporting Standards, or PFRS. PFRS include statements named PFRS and Philippine Accounting Standards, or PAS, and interpretations issued by the Philippine Accounting Standards Council.

Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year except as follows:

We have adopted the following new and amended PFRS and International Financial Reporting Interpretations Committee, or IFRIC, interpretations during the year. Our adoption of these revised standards and interpretations did not have any effect on our financial statements. Our adoption, however, gave rise to additional disclosures on the following:

- PAS 19 Amendment Employee Benefits;
- PAS 21 Amendment The Effects of Changes in Foreign Exchange Rates;
- PAS 39 Amendment Financial Instruments: Recognition and Measurement;
- PFRS 6 Exploration for and Evaluation of Mineral Resources;
- IFRIC 4 Determining Whether an Arrangement Contains a Lease;
- IFRIC 5 Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
- IFRIC 6 Liabilities arising from Participating in a Specific Market Waste Electrical and Electronic Equipment.

The principal effects of our adoption of the above standards are as follows:

PAS 19, Employee Benefits . As of January 1, 2006, we adopted the amendments to PAS 19. As a result, additional disclosures are made providing information about trends in the assets and liabilities in the defined benefit plans and the assumptions underlying the components of the defined benefit cost. This change has resulted in additional disclosures but has not had any recognition or measurement impact, as we chose not to apply the new option offered to recognize actuarial gains and losses outside of the consolidated statements of income.

***PAS 21, The Effects of Changes in Foreign Exchange Rates*.** As of January 1, 2006, we adopted the amendments to PAS 21. As a result, all exchange differences arising from a monetary item that forms part of our net investment in a foreign operation are recognized in a separate component of equity in the consolidated financial statements regardless of the currency in which the monetary item is denominated. The adoption has had no significant impact on our consolidated financial statements as at December 31, 2006 and 2005.

***PAS 39, Financial Instruments: Recognition and Measurement*.** There were three amendments to PAS 39 issued in 2005 that became effective for financial years beginning on or after January 1, 2006.

Amendment for financial guarantee contracts amended the scope of PAS 39 to require financial guarantee contracts that are not considered to be insurance contracts to be recognized initially at fair value and to be re-measured at the higher of the amount determined in accordance with *PAS 37, Provisions, Contingent Liabilities and Contingent Assets,* and the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with *PAS 18, Revenue*. This amendment did not have an effect on our consolidated financial statements.

Amendment for hedges of forecast intragroup transactions amended PAS 39 to permit the foreign currency risk of a highly probable intragroup forecast transaction to qualify as the hedged item in a cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect the consolidated statements of income. As we currently have no such transactions, the amendment did not have an effect on our consolidated financial statements.

Amendment for the fair value option amended PAS 39 to restrict the use of the option to designate any financial asset or any financial liability to be measured at fair value through the consolidated statements of income. As we have not previously used this option, the amendment did not have an effect on our consolidated financial statements.

***PFRS 6, Exploration for and Evaluation of Mineral Resources*.** PFRS 6 permits an entity to develop an accounting policy for exploration and evaluation assets without specifically considering the requirements of *PAS 8, Accounting Policies, Changes in Accounting Estimates and Errors*. As we are not into exploration of mineral resources, this standard has had no impact on the consolidated financial statements.

***IFRIC 4, Determining Whether an Arrangement Contains a Lease*.** We adopted IFRIC Interpretation 4 as of January 1, 2006, which provides guidance in determining whether arrangements contain a lease to which lease accounting must be applied. Upon adoption of the standard, we reviewed all of the outstanding contracts and agreements and determined the change in accounting policy had no significant impact on us as at December 31, 2006 and 2005.

***IFRIC 5, Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*.** IFRIC Interpretation 5 establishes the accounting treatment for funds established to help finance decommissioning for the PLDT Group s assets. As we do not currently operate on a country where such funds exist, this interpretation has had no impact on the consolidated financial statements.

***IFRIC 6, Liabilities arising from Participating in a Specific Market Waste Electrical and Electronic Equipment*.** IFRIC Interpretation 6 established the recognition date for liabilities arising from the European Union Directive relating to the disposal of Waste Electrical and Electronic Equipment. As we do not have waste electrical and electronic equipment and is not a member of the European Union, this interpretation has had no impact on our consolidated financial statements.

Basis of Consolidation

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

Name of Subsidiary	Place of Incorporation	Principal Activity	Percentage of Ownership Direct	Indirect
Wireless				
Smart	Philippines	Cellular mobile services	100.0	
Smart Broadband, Inc., or Smart Broadband (formerly Meridian Telekoms, Inc., or Meridian)	Philippines	Internet broadband and distributor		100.0
Wolfpac Mobile, Inc., or Wolfpac	Philippines	Mobile applications developer and service provider		100.0
Pilipino Telephone Corporation, or Piltel	Philippines	Providing cellular and fixed line services		92.1
Telesat, Inc., or Telesat	Philippines	Satellite communications services	94.4	
ACeS Philippines Cellular Satellite Corporation, or ACeS Philippines	Philippines	Satellite phone services	88.5	11.5
Mabuhay Satellite Corporation, or Mabuhay Satellite	Philippines	Satellite communications services	67.0	
Fixed Line				
PLDT Clark Telecom, Inc., or ClarkTel	Philippines	Telecommunications services	100.0	
Subic Telecommunications Company, Inc., or SubicTel	Philippines	Telecommunications services	100.0	
PLDT Global Corporation, or PLDT Global	British Virgin Islands	Telecommunications services	100.0	
Smart-NTT Multimedia, Inc., or SNMI	Philippines	Data and network services	100.0	
PLDT-Maratel, Inc., or Maratel	Philippines	Telecommunications services	97.5	
Bonifacio Communications Corporation, or BCC	Philippines	Telecommunications, infrastructure and related value-added services	75.0	
Information and Communications Technology				
ePLDT, Inc.	Philippines	Information and communications infrastructure for internet-based services, e-commerce, call centers and IT-related services	100.0	
Vocativ Systems, Inc., or Vocativ	Philippines	Call center services		100.0
Parlance Systems, Inc., or Parlance	Philippines	Call center services		100.0
ePLDT Ventus, or Ventus	Philippines	Call center services		100.0
	Philippines			100.0

SPi Technologies, Inc., or SPi, and Subsidiaries		Business process outsourcing, or BPO, services	
Infocom Technologies, Inc., or Infocom	Philippines	Internet services	99.6
netGames, Inc., or netGames	Philippines	Publisher of online games	80.0
Digital Paradise, Inc. (formerly Netopia Computer Technologies, Inc.), or Digital Paradise	Philippines	Internet access services	75.0
Level Up!, (Philippines), Inc., or Level Up!	Philippines	Publisher of online games	60.0
Digital Paradise Thailand	Thailand	Internet access services	51.0
Airborne Access Corporation, or Airborne Access	Philippines	Wireless internet services	51.0

Subsidiaries are 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.

We prepare our consolidated financial statements using uniform accounting policies for like transactions and other events with similar circumstances. Intercompany balances and transactions, including intercompany profits and unrealized profits and losses, are eliminated.

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

Smart s 20% Acquisition of Wolfpac

On May 8, 2006, Smart signed a share purchase agreement to acquire the remaining 20% equity interest in Wolfpac, a company engaged in the business of consumer mobile applications software development and content development. Smart acquired an 80% equity interest in Wolfpac in October 2003. The remaining 20% equity interest in Wolfpac was acquired in July 2006.

ePLDT s Acquisition of Level Up!

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

Post- closing condition were completed on April 30, 2006 and 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% of Level Up! at the original purchase price of US$7 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$135 million. As part of the transaction, ePLDT also acquired 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. ePLDT currently intends to have this debt refinanced by SPi in due course.

SPi is the second largest pure-play business process outsourcing, or BPO, service provider and the ninth largest independent BPO service provider worldwide. It has operations in 19 locations in North America, Europe and Asia. Its customers include Fortune 100 companies, non-profit organizations and government agencies in the financial services, healthcare, legal and publishing markets. SPi services these customers onsite, and from facilities in the Philippines, India, U .S., China and Vietnam.

SPi s Acquisition of CyMed, Inc., or CyMed

On August 11, 2006, SPi in turn acquired 100% of the equity interest in CyMed for an aggregate purchase price of US$35 million, inclusive of certain debt obligations.

CyMed is a leading medical transcription company based in Richmond, Virginia, United States of America (USA). It provides medical transcription services and technology products through proprietary processes based on Six Sigma quality management principles. The company currently serves over 400 healthcare systems, independent hospitals, and government-affiliated clinics across the USA. CyMed employs 650 U.S.-based staff members and has offices in the States of Virginia, Tennessee and Ohio.

Investments in Associates

Investment in associates is accounted for using the equity method of accounting. 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 the associate is carried in the 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. The statements of income reflects the share of the results of operations of the associate. Where there has been a change recognized directly in the equity of the associate, we recognize our share in any change and disclose this, when applicable, in our statement of changes in equity. Profits and losses resulting from our transactions with and among our associates are eliminated to the extent of the interest in the associate.

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.

Foreign Currency Translation

The functional and presentation currency of the PLDT Group (except for 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 translated at the functional currency rate of exchange prevailing at the balance sheet date. All differences are taken to the consolidated statements of income except for foreign exchange losses that qualify as capitalizable borrowing costs during the construction period. For income tax purposes, exchange gains or losses are treated as taxable income or deductible expenses in the year such exchange gains or losses are realized.

The functional currency of Mabuhay Satellite, PLDT Global, SPi and certain of its subsidiaries is the U.S. dollar and Digital Paradise Thailand is the Thai Baht. 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 are taken directly to 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 statements of income.

Property, Plant and Equipment

Property, plant and equipment, except for land, are stated at cost less accumulated depreciation and amortization and any impairment in value. Land is stated at cost less any impairment in value.

The initial cost of property, plant and equipment comprises its purchase price and any costs directly attributable in bringing the asset to its working condition and location for its intended use. Expenditures incurred after the assets have been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to income in the year the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as additional costs of property, plant and equipment. Cost also includes asset retirement obligation, interest on borrowed funds used during the construction period and qualified borrowing costs from foreign exchange losses related to foreign currency-denominated liabilities used to acquire such qualifying assets. When assets are sold or retired, their costs and accumulated depreciation, amortization and impairment losses, if any, are eliminated from the accounts and any gain or loss resulting from their disposal is included in the consolidated statements of income of such period.

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

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

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 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 for intended use are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the assets are 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 cost.

All other borrowing costs are expensed as incurred.

Borrowing costs are treated as deductible expenses for income tax reporting purposes in the year they are incurred or realized.

Asset Retirement Obligations

We are legally required under various lease agreements to dismantle the installations on leased sites and restore such sites to their original condition at the end of the lease contract term. We recognized the fair value of the liability for these obligations and capitalized the present value of these costs as part of the balance of the related property and equipment accounts, which are being depreciated on a straight-line basis over the useful lives of the related assets or the contract periods, whichever is shorter.

Investment Properties

Initially, investment properties are 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 reflects market conditions at the balance sheet date. Gains or losses arising from changes in the fair values of investment properties are included in the consolidated statements of income in the year in which they arise.

Investment properties are derecognized when they have either been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Any gain and 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.

Business Combinations and Goodwill

Business combinations are accounted for using the acquisition accounting method. This involves recognizing identifiable assets (including previously unrecognized intangible assets) and liabilities (including contingent liabilities and excluding future restructuring) of our 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 losses. 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 goodwill forms part of a cash-generating unit (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.

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 statements of income.

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 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 is 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, as appropriate, and treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the consolidated statements of income in the expense category consistent with the function of the intangible asset.

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 statements of income when the asset is derecognized.

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

Impairment of Non-Financial Assets

We assess at each reporting date whether there is an indication that an asset 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 between 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 fair value less co