CHINA LIFE INSURANCE CO LTD
Form 6-K
May 05, 2005
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Commission File Number 001-31914

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

May 5, 2005

China Life Insurance Company Limited

(Translation of registrant s name into English)

16 Chaowai Avenue

Chaoyang District

Beijing 100020, China

Tel: (86-10) 8565-9999

(Address of principal executive offices)

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

Form 20-F x Form 40-F ¨

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): ¨

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): ¨

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 of 1934:

Yes ¨ No x

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

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On May 4, 2005, China Life Insurance Company Limited published its annual report as required under the rules of the Hong Kong Stock Exchange for the year ended December 31, 2004, a copy of which is attached as Exhibit 99.1 hereto.

EXHIBIT LIST

Exhibit	Description
99.1	Annual Report dated April 18, 2005.

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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.

		China Life Insurance Company Limited (Registrant)
	By:	/s/ MIAO FUCHUN (Signature)
	Name:	**Miao Fuchun**
Date: May 5, 2005	Title:	**Director and Vice President**

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EXHIBIT 99.1

Corporate Information

Company Name

China Life Insurance Company Limited

Directors

Executive Directors

Wang Xianzhang

Miao Fuchun

Non-executive Directors

Wu Yan

Shi Guoqing

Independent non-executive Directors

Long Yongtu

Chau Tak Hay

Sun Shuyi

Cai Rang

Fan Yingjun

Supervisors

Liu Yingqi

Wu Weimin

Jia Yuzeng

Ren Hongbin

Tian Hui

Company Secretaries

Zheng Yong

Heng Kwoo Seng

Authorized Representatives

Miao Fuchun

Zheng Yong

Registered Office

China Life Tower

16 Chaowai Avenue, Chaoyang District

Beijing 100020, China

Tel: 86(10) 8565 9999

Fax: 86(10) 8525 2232

Website: www.e-chinalife.com

Place of business in Hong Kong

18th Floor, C.L.I. Building

313 Hennessy Road, Wanchai

Hong Kong

Tel: (852) 2881 1226/2545 8111

Fax: (852) 2577 2293/2544 4395

Auditors

PricewaterhouseCoopers

Legal Advisers

King & Wood

Allen & Overy

Debevoise & Plimpton LLP

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H Share registrar and transfer office

Computershare Hong Kong Investor Services Limited

Room 1712-1716, 17th Floor

Hopewell Centre

183 Queen s Road East

Hong Kong

Depositary

JPMorgan Chase Bank

4 New York Plaza, New York

New York 10004

Places of listing

H Share: The Stock Exchange of Hong Kong Limited

Stock code: 2628

American depositary shares

The New York Stock Exchange

Stock code: LFC

Principal bankers

Industrial and Commercial Bank of China

55 Fuxingmennei Street

Xicheng District

Beijing 100032

Agricultural Bank of China

A23 Fuxing Street

Xicheng District

Beijing 100037

China

Bank of China

1 Fuxingmennei Street

Xicheng District

Beijing 100818

China

China Construction Bank

25 Jinrong Street

Xicheng District

Beijing 10032

China

Bank of Communications

188 Yin Cheng Zhong Lu

Shanghai 200120

China

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Our Mission

China Life Insurance Company Limited, Mainland China s largest life insurance company, provides insurance service to over 100 million long-term policy holders.

We strive to maximize shareholder value, and at the same time committed to meeting the increasingly sophisticated insurance needs of our customers by providing a broad range of products and services.

With our highly experienced management team, and our nationwide network of branches and service centres, China Life s distribution capability is unparalleled.

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Financial Summary

For the year ended/as at December 31

RMB million (except earnings per share)	**Actual 2004**	Actual 2003	Proforma 2003
Total revenues	**76,806**	78,883	60,442
Net profit	**7,171**	(1,428)	5,857
Basic and diluted earnings per share (RMB)*	**0.27**	(0.07)	0.29
Investment assets	**374,890**	279,248	
Total Assets	**433,671**	328,720	
Total shareholders equity	**66,530**	62,436	

* Please refer to Note 20 to the Financial Statements.

Company Profile

China Life Insurance Company Limited (the Company or China Life or We) was registered in Beijing, China on June 30, 2003 according to the Company Law of the People s Republic of China. The Company was successfully listed on the New York Stock Exchange and the Hong Kong Stock Exchange on December 17 and 18, 2003, respectively. The Company is the leading life insurance company in China s life insurance market (for the purpose of this annual report, China s life insurance market refers to the life insurance market in the People s Republic of China, excluding the Hong Kong Special Administrative Region, the Macau Special Administrative Region, and Taiwan). Our distribution network, comprised of exclusive agents, direct sales representatives, and dedicated and non-dedicated agencies, is the most extensive in China.

Our products and services include individual life insurance, group life insurance, accident and health insurance. The Company is China s largest life insurance company, a leading provider of annuity products and life insurance for both individuals and groups, and a leading provider of accident and health insurance. As of December 31, 2004, we had nearly 60 million individual and group life policies and annuities, and long-term health insurance policies in force. We also provide both individual and group accident and short-term health insurance policies. Through its controlling shareholding in China Life Insurance Assets Management Co., Ltd. (AMC), the Company is the largest insurance asset management company, and one of the largest institutional investors in China.

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Chairman s Statement

Dear Shareholders,

I am pleased to present to you the Company s operating results for the financial year ended December 31, 2004. During our first full financial year following our restructuring and listing, the Company made substantial progress towards our strategic goal of establishing ourselves as a world-class life insurance company. Operations remained steady and stable, our business continued to grow, and we made significant improvements to our internal control mechanisms. We have worked diligently to fulfill the commitments made to our shareholders.

Note: All of the Company s financial data in this statement and Business Review for the twelve months ended December 31, 2003 are on an unaudited pro forma basis giving effect to the restructuring of the Company as if it had come into effect on January 1, 2003.

ACHIEVING STEADY OPERATIONS AND CONTINUOUS GROWTH

For the year ended December 31, 2004, the Company s gross written premiums and policy fees reached RMB66,257 million, an increase of 25.2% from the previous year. Growth in first year gross written premiums attributable to regular premium risk-type products reached 94.5%. Based on the People s Republic of China Generally Accepted Accounting Principles (PRC GAAP), the growth rate of our premiums reached 11.4%, which not only surpassed the average growth rate of China s insurance industry by 4.2 percentage points, but was also higher than China s GDP growth rate of 9.5%. By steadily and continuously expanding our business, we maintained our leading position in China s life insurance industry while enhancing our profitability. For the year ended December 31, 2004, the Company s net profit reached RMB7,171 million.

We disclosed our annual embedded value figures for the first time in this year s annual results announcement. As at December 31, 2004, the Company s embedded value was RMB90,073 million. The value of new business for the year ended December 31, 2004 was RMB6,504 million. These two figures provide useful information to investors in two respects. Embedded value is an actuarially determined estimate of the economic value of the life insurance business of an insurance company based on a particular set of assumptions about future experience, excluding the economic value of future new business. The value of one year s sales provides an indication of the value being created for investors by new business activity and hence the potential of the business.

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ADJUSTING BUSINESS STRUCTURE TO ENHANCE PROFITABILITY

In 2004, we continued to adjust our business structure with a view to further improving profitability. In the area of product development, we focused on expanding our product suite of risk-type participating policies. We effectively utilized sales results targets to incentivize our sales team, thereby driving the growth of risk-type and regular premium products. During the year, the premiums of our risk-type products reached an increase of 28.9% from the previous year, resulting in significantly higher profitability of our business. Growth in first year gross written premiums from risk-type regular premium products was higher than that from risk-type single-premium products by more than 133.3 percentage points, enhancing the long-term sustainability of profitability.

ENHANCING COMPETITIVENESS BY EXPANDING SALES CHANNELS

We have the largest sales team in China and the most extensive distribution network, covering almost all county level administrative regions, except in the Tibet Autonomous Region. Our three major distribution channels are individual agents, direct sales team and intermediaries such as banks and post offices. As at December 31, 2004, we had approximately 668,000 individual agents, a direct sales team with 12,000 full-time staff, and a network of more than 87,000 cooperating bank branches and post offices. We use results targets such as profit level, revenue from risk-type products and revenue from regular premium products to guide adjustments of the business structure of individual agents and intermediaries, resulting in overall business quality improvements.

ENHANCING INTERNAL CONTROL AND CORPORATE GOVERNANCE

In the area of business management, we underwent a comprehensive reorganization and reform of our business handling procedures, and designed a new life insurance business management system, based on customer needs as our guidance. Regarding information management, we further developed, integrated and improved our core operating system by formulating an information utilization strategy. In 2004, we further strengthened internal control measures by introducing and improving several regulations and guidelines including the Internal Control Handbook, Internal Control Mechanism for Financial Reporting, Staff Ethics Guidelines, Internal Control Guidelines for Prevention of Fraud.

We placed strong emphasis on the effective functioning of the Board of Directors, the Supervisory Committee and the committees formed under the Board of Directors. We also enhanced the role of our independent directors, and appointed a Chief Actuary to strengthen our investment and risk management capabilities. Besides strict adherence to relevant Chinese law, efforts were also made to meet the requirements of regulatory standards for overseas listings. Under the precondition that the needs for our strategic development are met, we have invested significant resources and are working towards compliance with the Code on Corporate Governance Practices in Hong Kong and U.S. Sarbanes-Oxley Act. We improved our information disclosure as part of our efforts in enhancing transparency and corporate governance.

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CONTROLLING COSTS AND MAINTAINING FINANCIAL STRENGTH

Under the precondition of ensuring continued business development, we stepped up cost control efforts. In 2004, we met the budget targets set by the Board of Directors. Our consolidated cost control ratio was 18.6%, which was 1.5 percentage points lower than 2003. We will continue to use centralized procurement to control major cost item expenses and financial budgets to increase profitability and to control branch and subsidiary expenses.

With regards to financial management, we ensured that our business development targets were met through effective budget management. We have striven to lower our cost ratios at a reasonable pace while at the same time ensuring the continuous development of our business. In the area of risk management, we enhanced our investment risk management capabilities to improve investment returns. These measures effectively strengthened our budget management and financial risk control abilities, which in turn improved overall efficiency. Our solvency was maintained at a healthy level; as at December 31, 2004, our actual solvency ratio reached 3.15 times the minimum regulatory requirement.

DIVIDENDS

The Company will declare no shareholder dividends for 2004.

MAJOR LITIGATIONS

The nine putative class action lawsuits filed in the United States District Court for the Southern District of New York against the Company and certain of its officers and directors between March 16, 2004 and May 14, 2004 has been ordered to be consolidated and restyled In re China Life Insurance Company Limited Securities Litigation, No. 04 CV 2112 (TPG). Plaintiffs filed a consolidated amended complaint on January 19, 2005, which names the Company, Wang Xianzhang, Miao Fuchun and Wu Yan as defendants. The consolidated amended complaint alleges that the defendants named therein violated Section 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder. The Company has engaged U.S. counsel to contest vigorously on behalf of the Company. The defendants jointly moved to dismiss the consolidated amended complaint on March 21, 2005. The likelihood of an unfavourable outcome is still uncertain.

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2005 OUTLOOK

With improvements in the policy environment, a diversification of channels for investment, and increasing market competition, 2005 will present many opportunities and challenges. We will maintain our strategic focus on steady business growth: to further improve our business structure, and to enhance our profitability. In addition, we will continue our efforts to improve our investment performance and enhance shareholder value.

Finally, I would like to take this opportunity to extend my heartfelt gratitude to our staff for their hard work and dedication. I would also like to express my sincere thanks for the support of our shareholders, as well as for the close cooperation of the Board of Directors, the Supervisory Committee, and the Management.

Wang Xianzhang

Chairman

Beijing, China

April 18, 2005

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Global

Stature & Prominence

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Business Review

GROSS WRITTEN PREMIUMS AND DEPOSITS

RMB million	2004
Individual life insurance	
Risk-type products	**50,113**
First-year written premiums	**19,900**
Single written premiums	**2,526**
Regular written premiums	**17,374**
Renewal written premiums	**30,213**
Deposit products	**66,981**
First-year deposits	**54,662**
Single deposits	**52,343**
Regular deposits	**2,319**
Renewal deposits	**12,319**
Policy fees	**4,796**
Group life insurance	
Risk-type products	**344**
First-year written premiums	**295**
Single written premiums	**261**
Regular written premiums	**34**
Renewal written premiums	**49**
Deposit products	**21,756**
First-year deposits	**21,738**
Single deposits	**21,726**
Regular deposits	**12**
Renewal deposits	**18**
Policy fees	**398**
Accident and health insurance	
Gross	**10,606**
Accident insurance	
Written premiums	**4,977**
Short-term health insurance	
Written premiums	**5,629**

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1. INDUSTRY OVERVIEW

Pursuant to the data released by the China Insurance Regulatory Commission (CIRC), insurance penetration (measured by total insurance premiums as a percentage of GDP) of the PRC was 3.4% in 2004, representing an increase of 2.1% from 2003; insurance density (means the per capita premiums based on the permanent population) was RMB332 in 2004, representing an increase of 15.5% from 2003. According to the statistics prepared under the PRC accounting standards issued by the CIRC, the gross written premiums of the life insurance sector in the PRC grew by 7.2% compared with 2003, representing the steady growth of this sector.

The PRC economy and its GDP have been growing at a high speed, fuelling the rise in the general living standards and the awareness of insurance in the country. Such a backdrop has spawned new development opportunities for the insurance industry. In 2004, the CIRC announced a series of proactive policies to further expand the investment channels for insurance assets. For example, insurance assets are permitted to invest in subordinate bonds and equity market. Besides, the foreign currency assets held by insurance institutions are also allowed to invest in overseas capital market. Investment returns on assets held by insurance institutions are expected to improve. At the same time, full-scale opening-up in insurance market led to an increase in the number of new entrants to the market and thus more intense competition among insurers occurred in the PRC. The Company believes that it will not face serious competition from these new entrants, including those specialised insurers in the near future. The Company emphasizes on the research and analysis of development trends and policy changes of macro economy and the formulation of corresponding strategies.

2. BUSINESS OVERVIEW

2004 was the first year after the Company s restructuring and listing. Its business development strategy in 2004 was to achieve sustained growth and prudent operation to improve profitability and to generate attractive returns for investors . Aggressive efforts were made to pursue business restructuring in line with customer demand and profitability. The focus was on driving the sales of risk-type products, particularly regular premium products. In 2004, the Company s business sustained its rapid growth and its asset scale continued to expand as it moved ahead to realize the objective of business restructuring. The Company s gross written premiums and policy fees for the year ended December 31, 2004 were RMB66,257 million, representing an increase of 25.2% from 2003. Its total revenues calculated in accordance with the PRC accounting standards grew at a rate of 11.4%, higher than the industry average of 7.2%.

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The Company started its business restructuring in 2003 with the aim to enhance its profitability and sustaining its steady growth. In this connection, the Company formulated its business plans and budgets in a way to take full consideration of the business restructuring. In respect of product strategy, the primary focus was on risk-type participating products. Besides, performance standards were established, with the levels of risk-type premiums and regular premiums as the leading benchmarks for assessing the performance of branches. Such a measure proved effective in driving branches to undertake business restructuring, maintaining the high growth rate of risk-type products and regular premium products. For the year ended December 31, 2004, the total risk-type written premiums were RMB61,063 million, representing a 28.9% increase from 2003. In particular, the first year risk-type written premiums (including those attributable to long-term health insurance but excluding those involving accident and short-term health insurance) were RMB20,195 million, representing an increase of 49.5% from 2003. The first-year regular risk-type written premiums (including those attributable to long-term health insurance) were RMB17,408 million, representing an increase of 94.5% from 2003 and accounting for 86.2% of the first-year risk-type written premiums (including those attributable to long-term health insurance but excluding those involving accident and short-term health insurance). As a result of its solid business growth after the restructuring, the Company has maintained its leadership in the life insurance sector in the PRC.

3. PRINCIPAL INSURANCE BUSINESSES OF THE COMPANY

The Company offers individual and group life insurance, accident and health insurance. It had about 60 million individual and group life insurance policies, annuity contracts and long-term health insurance policies in force as at December 31, 2004.

(1) Individual Life Insurance

For the year ended December 31, 2004, the Company s gross written premiums and policy fees attributable to individual life insurance were RMB54,909 million, representing 82.9% of the gross written premiums and policy fees for the year and an increase of RMB12,621 million, or 29.8%, over RMB42,288 million in 2003.

The risk-type gross written premiums attributable to individual life insurance were RMB50,113 million, representing an increase of RMB13,205 million, or 35.8%, over RMB36,908 million in 2003. The first-year risk-type gross written premiums attributable to individual life insurance were RMB19,900 million, which accounted for 39.7% of the written premiums attributable to individual life insurance. The first-year risk-type regular written premiums attributable to individual life insurance were RMB17,374 million, which accounted for 87.3% of the first-year risk-type written premiums attributable to individual life insurance.

The Company markets both participating and non-participating life insurance products. On the basis of the HK generally accepted accounting principles, the gross written premiums attributable to individual life insurance participating products and non-participating products for the year ended December 31, 2004, were RMB22,363 million and RMB27,750 million respectively.

Participating endowment products form one of the most important product series of the Company.

(2) Group Life Insurance

For the year ended December 31, 2004, the Company s gross written premiums and policy fees attributable to group life insurance were RMB742 million, representing 1.1% of the gross written premiums and policy fees for the year and an increase of RMB310 million, or 71.8%, over RMB432 million in 2003.

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The Company offers both participating and non-participating group life insurance products.

(3) Accident and Short-term Health Insurance

For the year ended December 31, 2004, the Company s gross written premiums attributable to accident and short-term health insurance were RMB10,606 million, representing an increase of RMB401 million, or 3.9%, over RMB10,205 million in 2003. In particular, the gross written premiums attributable to accident insurance amounted to RMB4,977 million, accounting for 7.51% of the gross written premiums and policy fees for the year, while the gross written premiums and policy fees attributable to short-term health insurance were RMB5,629 million, representing 8.50% of the gross written premiums and policy fees for the year.

4. DISTRIBUTION CHANNELS

The Company has the largest and most extensive distribution force and network in the life insurance sector in the PRC, covering almost every county level administrative regions in China, except the Tibet Autonomous Region.

Exclusive agents, direct sales force and intermediaries comprising mainly banks and post offices are the three major distribution channels of the Company.

(1) Exclusive agents

Exclusive agents (including those who are not yet qualified as agents) is the Company s primary distribution channel for individual life, individual accident and individual health insurance products. In 2004, the Company s exclusive agents expanded mildly. As at December 31, 2004, the Company retained nearly 668,000 agents at its over 9,300 field offices. These two figures represented an increase of about 13,000 and 1,100 from 2003 respectively.

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The Company has training programs, marketing tools and IT systems in place to support the operation of its exclusive agent sales force. Under its training system for new agents, the Company has standardized practices for the recruitment of new agents. At the same time, various measures are pursued to reduce the turnover of exclusive agents. To support the Company s overall development strategy in large and medium cities, the Chartered Insurance Agency Management (CIAM) qualification certification program was introduced to improve the quality of senior agent management in those cities. Based on the market segmentation study, a special sales force will be established for the high-end market segment. The Company also engaged in cooperation with internationally renowned training institutions such as the Life Office Management Association (LOMA) and Life Insurance Marketing and Research Association (LIMRA), as well as colleges and universities in China, to enhance the professional standard and overall service quality of its agents. As at December 31, 2004, the percentage of certificate holders for exclusive agents was 72%, representing an increase of 8.5 percentage points over the 63.5% in 2003.

The Company retains designated supervisors to manage exclusive agents and hires full-time trainers to offer training to them. Besides, the Company has set up product management and customer service standards, which all field offices and agents must meet.

Apart from commissions and performance-based bonuses, the Company also provides pensions, as well as group life and medical insurance protection for its exclusive agents based on individual service history and performance. In addition, the Company also organizes sales contests for field offices and sales units to motivate its sales agents. Sales summits and cultural marketing programs are also held for exclusive agents from time to time to serve as non-monetary incentives in order to enhance their sense of belonging and corporate unity.

The Jin Ding Project , the objective of which is to improve overall sales performance, was implemented with the participation of the Company s exclusive agents across the nation during the year. The Company expects that this three to five-year project will help improve the innovation of exclusive agents in marketing and management practices, thus enhancing their professional standards and competitiveness.

Apart from the provision of a centralized business support and information management system for its exclusive agents, the Company has also developed the Risk Warning System and Credit Rating System to enhance the control of operation risks of exclusive agents. In particular, the focus of Risk Warning System for Exclusive Agents is on the prevention of any irregularities of exclusive agents. The system has been launched nationwide after completion of trial run and assessment. The purpose of the Credit Rating System is to strengthen the professional ethics of exclusive agents. The system is expected to be fully implemented in 2005.

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(2) Direct sales force

The Company s direct sales force is the primary distribution channel for its group life insurance and annuities, group accident and health insurance products. As at December 31, 2004, the Company retained a total of approximately 12,000 full-time employees, representing an increase of 20% from 10,000 in 2003, in its direct sales force. These direct sales representatives were allocated to over 4,000 branch offices of the Company, covering almost all counties of China, except in the Tibet Autonomous Region. The training system for the direct sales force has been preliminarily established. A critical customer sales team was formed by the Company to enhance its professional standards and competitive edge to market large companies and key-account customers in large-scale industries.

(3) Intermediaries

The Company also provides a variety of individual and group life insurance products through intermediaries. This distribution channel is largely made up of commercial bank branches, post offices, credit cooperatives, as well as professional insurance agencies and insurance brokers. The Company has established bancassurance business relationships with branches of commercial banks and post offices. As at December 31, 2004, the Company had cooperated with more than 87,000 bank branches and post offices with 12,000-strong customer relationship team, which offers supporting services to the businesses.

5. BUSINESS MANAGEMENT

After eight months of efforts, the Company has completed a customer-oriented business reform program with the purpose of implementing an industry-leading and forward-looking life insurance business management system. To cope with changes in business trends and corporate development, the Company upgraded its core business processing system and developed a group annuity system. In addition, the Company amended its Code of Practices for Underwriting , Code of Practices for Claims Management and Code of Practices for Conservation , prepared the Code of Practices for Group Annuity and established a customer service management system.

(1) Underwriting and claims management

Supported by its computer system, the Company managed its underwriting and claims management operations and exercised risk control by setting down authorization limits on its branch offices and implementing a hierarchy-based system of underwriters and claims inspectors. Material cases with significant uncertainties beyond the authorization of provincial branches were handled directly by the head office. In a bid to enhancing its service quality, the Company also offered regular training sessions for its underwriters and claims inspectors. Periodic and ad hoc inspections were conducted on a company-wide basis. Under the recent reform of its human resource system, the Company has also established qualification standards as part of the entry requirements for professional underwriters.

(2) Customer service

The Company mainly provides customer service through its customer service teams at different branches and field offices throughout China and with the support of an advanced call center. In 2004, the Company s customer service system was further optimized, as proven by the significant improvement in the quality of service. During the year, its centralized service platform 95519 Call Center successfully achieved the CCCS-OP-2003 National Call Center Operating Performance Standards and was granted the Award of the Best Performing Call Centre in China

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2004. On the other hand, the 95519 SMS Customer Service System was also introduced to all branches of the Company.

6. PRODUCT DEVELOPMENT

A Product Development Committee has been established during the year. Comprising members from the management, heads of various core business departments and professionals of the Company, the Committee is responsible for formulating product development plans and strategies for the Company. It sets down the direction of product development and engages in the discussion, studies and resolution of serious issues in the product development process. In 2004, the Company optimized its product development process and implemented an incentive scheme to encourage product innovation. Coping with changes in market needs, the Company successfully developed several new products including joint life, unit-link and universal products.

7. ACTUARIAL MANAGEMENT

The Company undertakes periodic and thorough monitoring, analysis and research on the performance of its products, including profitability and risk assessments, to support the setting up of a scientific pricing system. In 2004, the company terminated or modified certain products based on their profitability performance. For example, the SHENGMING LUYIN long term health insurance plan was terminated. In 2004, the Company s actuarial work focused on the research on mortality, expenses and morbidity. MoSes, an international advanced actuarial software system, was introduced. In the long term, the focus is on liability valuation, product profitability assessment, cash flow analysis, actuarial risk control and experience analysis, preparation of various actuarial reports, assistance in formulating investment strategies, assistance in formulating reinsurance strategies. All the work mentioned above is to support the Company s sustainable solid growth in an effective manner.

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8. IT INFRASTRUCTURE

The Company has been establishing its proprietary IT infrastructure on the bases of its Application System, Database System, Foundation System and Governance System. In 2004, the Company completed its IT strategic planning, laying down specific goals and objectives for its IT development in the future. The core business processing system has been upgraded. In addition, the Company completed the development of CBPS8 version system, which catered to for such products as life insurance, health insurance, joint life, group annuity, unit-link and universal products. The development of the Group Annuity Business Processing System and unit-link and universal Business Processing System has also been completed successfully. The Company has realized the centralization of provincial data. Furthermore, the Company achieved paper-less operation with continued improvements in office automation and increased utilization of the remote education and video conferencing system.

9. INTERNAL CONTROL

(1) Internal control structure

The Company s internal control is carried out by a multi-level management system, comprising the Supervisory Committee, the Audit Committee and Risk Management Committee under the Board of Directors, the Internal Control Committee under the management, and the audit department and risk management department of the Company. The audit department is the supervisory department in charge of the execution of internal control policies of the Company, and has already built a vertically integrated management structure and a centralized audit system.

(2) Internal control system

In 2004, the Company formulated and improved various internal documents, including the Internal Control Manual , Internal Control Manual for Prevention of Malpractices and Internal Management System for Financial Reporting . To facilitate the implementation of various internal control measures, the Company further classified the duties covered by the Internal Control Manual and prepared the Internal Control Guidelines . The Internal Control Audit Guidelines and Internal Control Rating Measures were also developed for governing the supervision and assessment activities in relation to the internal control system to promote its enhancement and effective implementation.

The Company has been in compliance with all applicable laws and regulations of the PRC, as well as the rules of the jurisdictions in which it is listed. In 2004, the Company pursued optimization of the internal control systems at its branches and prepared itself towards compliance with Sarbanes-Oxley Act Section 404. As it continued to enhance and optimize its internal control system, the Company identified and actively addressed certain issues that need to be resolved in the process. The Company believes that the continued improvement and effective operation of its internal control system is beneficial for its risk control and management and in the best interests of its customers and shareholders.

10. INVESTMENTS

Under the approval of competent authorities, including China Securities Regulatory Commission and CIRC, the Company was permitted to directly invest in the equity markets in China. Besides, the Company has also submitted an application for the permission to invest overseas with its foreign currency denominated fund, which is pending for the approval of the relevant authorities. As at December 31, 2004, the Company held RMB374,890 million in investment assets.

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The Strategy Committee under the Board of Directors, together with the Investment Decision-Making Committee and the Investment Risk Management Committee, form the Investment Decision-Making and management organ of the Company. In August 2004, the Company established the investment department, which, as a special unit to carry out the investment management and operation functions of the Company, is responsible for strengthening the professional management of the Company s investment activities. Through the formulation of rules, such as the Investment Guidelines , the Company guides and manages the activities of the primary trustee of its investment assets, China Life Insurance Asset Management Company Limited.

In line with the new trends of the expansion of investment channels and latest changes in capital markets, the Company amended the Investment Guidelines in a timely manner. New investment criteria were set up to further improve the Company s investment management system. In 2004, the Company formulated, standardized and fine-tuned various regulatory documents in relation to the systems for investment and the related risk management. Such documents as the Investment Management System and Investment Risk Management System, which have already been reviewed and approved by the board of Directors, are being implemented.

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The Company undertook extensive research and analysis of the impact of major changes in macro economy, including rising interest rate, on its business development. Its investment portfolio and structure were timely adjusted and enhanced under the principle of prudence to ensure proper matching between its assets and liabilities. As at December 31, 2004, the investment portfolio of the Company was as follows:

RMB million	
Fixed maturity securities	150,234
Non-trading securities, at estimated fair value	69,791
Held-to-maturity securities	79,603
Trading securities, at estimated fair value	840
Equity securities	17,271
Non-trading securities, at estimated fair value	12,597
Trading securities, at estimated fair value	4,674
Term deposits	175,498
Policy loans	391
Securities purchased under agreements to resell	279
Cash and cash equivalents	27,217

Term deposits

Term deposits, primarily held by commercial banks in China, represented 46.8% of the Company s total investment assets as at December 31, 2004.

Fixed maturity securities

Fixed maturity securities, such as Chinese treasury bonds, Chinese financial institutional bonds and Chinese corporate bonds above specified ratings, represented 40.1% of the Company s total investment assets as at December 31, 2004.

Equity investment

Securities investment funds consist of Chinese domestic investment funds that are primarily invested in securities which are issued by Chinese companies and traded on China s securities exchanges. Such investments represented 4.6% of the Company s total investment assets as at December 31, 2004.

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11. FINANCIAL MANAGEMENT

During the year, the Company took further steps to improve its performance appraisal system and strengthen its efforts on budget control to ensure all branches actively pursued the strategy of business restructuring and realized various business development objectives. Apart from striving for business development, the Company sought to categorize its expenses in a systematic manner and offer incentive scheme for expense management to achieve more stringent control of expenses for cost reduction. During the year, the Company continued to pursue centralized procurement and effectively reduced the expenditure on bulk items. Besides, financial expenses management policies were set up to support the continued healthy growth and business restructuring of the Company.

The Company has upgraded its financial information management system and stepped up efforts in integrating its information management. Besides, efforts are also made to further improve its financial management systems, including the Financial Reporting and Internal Control Manual , Comprehensive Budget Management Measures , Funds Management Measures , Accounting Personnel Management Measures and Fixed Assets Investment Measures . The Company believes that the implementation of these measures will be effective in the control and management of financial risks.

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Embedded Value

BACKGROUND

China Life prepares financial statements to public investors in accordance with Hong Kong GAAP. An alternative measure of the value and profitability of a life insurance company can be provided by the embedded value method. Embedded value is an actuarially determined estimate of the economic value of the life insurance business of an insurance company based on a particular set of assumptions about future experience, excluding the economic value of future new business. In addition, the value of one year s sales represents an actuarially determined estimate of the economic value arising from new life insurance business issued in one year.

China Life believes that reporting the Company s embedded value and value of one year s sales provides useful information to investors in two respects. First, the value of the Company s in-force business represents the total amount of distributable earnings, in present value terms, that can be expected to emerge over time, in accordance with the assumptions used. Second, the value of one year s sales provides an indication of the value being created for investors by new business activity and hence the potential of the business. However, the information on embedded value and value of one year s sales should not be viewed as a substitute of financial measures under Hong Kong GAAP or any other accounting basis. Investors should not make investment decisions based solely on embedded value information and the value of one year s sales.

It is important to note that actuarial standards with respect to the calculation of embedded value are still evolving and that no universal standard has yet been adopted which defines the form, calculation methodology or presentation format of the embedded value of an insurance company. Hence, differences in assumptions, methodology, definition, accounting basis and disclosure level may cause inconsistency when comparing the disclosed embedded values of different companies.

Also, embedded value calculation involves substantial technical complexity and estimates can vary materially as key assumptions are changed. Therefore, special care is advised when interpreting embedded value results.

The embedded value and value of one year s sales shown in this section have not considered the financial effect of the policy management agreements, property leasing agreement, trademark license agreement and non-competition agreement China Life has entered into with China Life Insurance (Group) Company. The impact of transactions between China Life and China Life Insurance Asset Management Company has not been considered either.

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DEFINITIONS OF EMBEDDED VALUE AND VALUE OF ONE YEAR S SALES

The embedded value of a life insurer is defined as the sum of the adjusted net worth and the value of in-force business allowing for the cost of capital supporting a company s desired solvency margin.

The adjusted net worth is equal to the sum of:

Net assets, defined as assets less policy reserves and other liabilities, all measured on a PRC statutory basis; and

Net of tax adjustments for relevant differences between the market value of assets and the value determined on a PRC statutory basis, together with relevant net of tax adjustments to other liabilities.

According to the PRC accounting basis, an impairment provision is not required until the market value of the long-term investment has been consistently lower than the book value for more than two years. As the embedded value is based on market value, it is necessary to make adjustments to the value of net assets under the PRC accounting basis.

The market value of assets can fluctuate significantly between different valuation dates due to the impact of the prevailing market environment. Hence the adjusted net worth can also fluctuate significantly between different valuation dates.

The value of in-force business and the value of one year s sales are calculated as the discounted value of the projected stream of future after-tax distributable profits for existing business in force at the valuation date and for one year s sales in the 12 months preceding the valuation date respectively. Distributable profits are those profits arising after allowance for policy reserves on the required PRC statutory reserving basis and after allowance for solvency margins at the required regulatory minimum level. The allowance for cost of solvency margin takes into account the support to the statutory minimum solvency margin provided by the Staff Welfare Fund.

The value of in-force business and the value of one year s sales have been determined using a traditional discounted cash flow methodology. This methodology makes implicit allowance for the cost of investment guarantees and policyholder options, asset/liability mismatch risk, credit risk and the economic cost of capital through the use of a risk-adjusted discount rate.

ASSUMPTIONS

For the purpose of calculating the value of in-force business and the value of one year s sales, we have assumed an investment return of 3.70% in 2004, grading to 5.17% in 2013 (remaining level thereafter). Assumed investment returns are based on the company s long term strategic asset mix and expected future returns. The risk-adjusted discount rate used is 11.5%. Other assumptions are determined by considering recent operating experience of the company and expected future outlook.

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PREPARATION

The embedded value and the value of one year s sales were prepared by China Life with assistance from the Tillinghast business of Towers Perrin, an international firm of consulting actuaries. Tillinghast considers that the methodology adopted to determine these values is reasonable in the context of the current environment as a commonly adopted methodology for the purposes of providing an embedded value disclosure in the normal course of financial reporting. Tillinghast also considers that the assumption set adopted to determine these values, taken as a whole, is reasonable for this same disclosure purpose.

SUMMARY OF RESULTS

The embedded value as at December 31, 2004 and the value of one year s sales for the 12 months to December 31, 2004 are shown below.

Table 1

Embedded Value as at December 31, 2004 and Value of One Year s Sales in the 12 months to December 31, 2004 (RMB million)

ITEM	ITEM NUMBER	RMB MILLION
Adjusted Net Worth	A	52,909
Value of In-Force Business before Cost of Solvency Margin	B	44,998
Cost of Solvency Margin	C	(7,834)
Value of In Force Business after Cost of Solvency Margin	D = B + C	37,164
Embedded Value	**E = A + D**	**90,073**
Value of One Year s Sales before Cost of Solvency Margin	F	8,550
Cost of Solvency Margin	G	(2,046)
Value of One Year s Sales after Cost of Solvency Margin	**H = F + G**	**6,504**

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SENSITIVITY TESTING

Sensitivity testing was performed using a range of alternative assumptions. In each of the sensitivity tests, only the assumption referred to was changed, with all other assumptions remaining unchanged. The results are summarised below.

Table 2

Sensitivity Results (RMB million)

	VALUE OF IN-FORCE BUSINESS AFTER COST OF SOLVENCY MARGIN	VALUE OF ONE YEAR S SALES AFTER COST OF SOLVENCY MARGIN
Risk discount rate of 12.5%	33,370	5,661
Risk discount rate of 10.5%	41,491	7,476
10% increase in investment return	43,203	7,738
10% decrease in investment return	31,128	5,273
10% increase in expenses	36,536	5,955
10% decrease in expenses	37,792	7,053
10% increase in mortality rate for non-annuity products and 10% decrease in mortality rate for annuity products	36,820	6,387
10% decrease in mortality rate for non-annuity products and 10% increase in mortality rate for annuity products	37,509	6,568
10% increase in lapse rates	36,092	6,229
10% decrease in lapse rates	38,304	6,797
10% increase in morbidity rates	36,503	6,374
10% decrease in morbidity rates	37,829	6,635
Solvency margin at 150% of statutory minimum	32,528	5,337
10% increase in claim ratio of short term business	36,966	6,067
10% decrease in claim ratio of short term business	37,361	6,941

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Management Discussion & Analysis

Recent Developments

Class Action Litigations

The nine putative class action lawsuits filed in the United States District Court for the Southern District of New York against the Company and certain of its officers and directors between March 16, 2004 and May 14, 2004 have been ordered to be consolidated and restyled *In re China Life Insurance Company Limited Securities Litigation, No. 04 CV 2112 (TPG)*. Plaintiffs filed a consolidated amended complaint on January 19, 2005, which names the Company, Wang Xianzhang, Miao Fuchun and Wu Yan as defendants. The consolidated amended complaint alleges that the defendants named therein violated Section 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder. We have engaged U.S. counsel to contest vigorously on behalf of us. The defendants jointly moved to dismiss the consolidated amended complaint on March 21, 2005.

SEC Informal Inquiry

On April 27, 2004, we received an informal inquiry, dated April 26, 2004, from the U.S. Securities and Exchange Commission (SEC) requesting us to produce documents and other relevant information on certain matters. The SEC has advised us that the informal inquiry should not be construed as an indication by the SEC or its staff that any violations of law have occurred, or as a reflection upon any person, entity or security. We intend to cooperate and are cooperating fully with the inquiry.

OPERATING RESULTS

The restructuring of our predecessor CLIC was legally effective under PRC law and the restructuring on June 30, 2003; for accounting purposes, however, the restructuring is deemed to have occurred as of September 30, 2003. Accordingly, our historical profit and loss accounts data for 2003 includes data for our predecessor through September 30, 2003 and data for the Company from October 1, 2003 through December 31, 2003. As described more fully below, the year-on-year changes for many of the line items discussed below reflect the effect of the restructuring. For example, net premiums earned and policy fees for 2004 and for the time period from October 1, 2003 through December 31, 2003 does not include any net premiums and policy fees attributable to the non-transferred policies which were retained by CLIC. Likewise, the investment assets retained by CLIC are not included in our balance sheet as of December 31, 2003 and the income from such retained investment assets attributable to the period from October 1, 2003 through December 31, 2003 and for 2004, both realized and unrealized, is not included in our profit and loss accounts. The impact of the restructuring on accident and health insurance business is less significant than that on individual and group businesses, since a greater portion of accident and health policies are comprised of transferred policies.

Year Ended December 31, 2004 Compared with Year Ended December 31, 2003

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Net Premiums Earned and Policy Fees

Net premiums earned and policy fees decreased by RMB2,208 million, or 3.3%, to RMB65,008 million in 2004 from RMB67,216 million in 2003. This decrease was primarily due to the effect of the restructuring described above as well as a decrease in policy fees from the individual life insurance business, offset in part by increases in net premiums earned from the individual life insurance business, group life insurance business and accident and health insurance business.

Net premiums earned and policy fees attributable to the transferred and new policies increased by RMB14,201 million, or 28.0%, to RMB65,008 million in 2004 from RMB50,807 million in 2003. This increase was primarily due to increases in net premiums earned from the individual life insurance, group life insurance business and the accident and health insurance businesses, offset in part by a decrease in policy fees from the individual life insurance business. Net premiums earned from risk-type participating products were RMB22,363 million in 2004, an increase of RMB8,946 million, or 66.7%, from RMB13,417 million in 2003. This increase was primarily due to an increased market demand, as well as our increased sales efforts, for endowment products. Of total net premiums earned in 2004 and attributable to the transferred and new policies, RMB2,780 million was attributable to single premium products and RMB47,670 million was attributable to regular premium products (including both first-year and renewal premiums). Of total net premiums earned in 2003 and attributable to the transferred and new policies, RMB4,553 million was attributable to single premium products and RMB32,610 million was attributable to regular premium products.

Individual Life Insurance Business

Net premiums earned and policy fees from the individual life insurance business decreased by RMB3,639 million, or 6.2%, to RMB54,902 million in 2004 from RMB58,541 million in 2003. This decrease was primarily due to the restructuring effect, as well as a reduction in policy fees, offset in part by increases in sales of endowment products and whole life products, as a result of the adjustment of our product selling strategy in the last quarter of 2003 to concentrate more on risk-type products.

Net premiums earned and policy fees from the individual life insurance business attributable to the transferred and new policies increased by RMB12,614 million, or 29.8%, to RMB54,902 million in 2004 from RMB42,288 million in 2003. This increase was primarily due to increases in sales of endowment products and whole life products, offset in part by a reduction in policy fees, as a result of the adjustment of our product selling strategy in the last quarter of 2003 to concentrate more on risk-type products and regular premium products.

Group Life Insurance Business

Net premiums earned and policy fees from the group life insurance business increased by RMB154 million, or 26.2%, to RMB742 million in 2004 from RMB588 million in 2003. This increase was primarily due to an increase in sales of investment-type products, which led to a growth in policy fees, and an increase in sales of whole-life insurance products, notwithstanding the effect of the restructuring described above.

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Net premiums earned and policy fees from the group life insurance business attributable to the transferred and new policies increased by RMB310 million, or 71.8%, to RMB742 million in 2004 from RMB432 million in 2003. This increase was primarily due to an increase in sales of investment-type products, which led to a growth in policy fees and an increase in sales of whole-life insurance products.

Accident and Health Insurance Business

Net premiums earned from the accident and health insurance business (which comprises short-term products) increased by RMB1,277 million, or 15.8%, to RMB9,364 million in 2004 from RMB8,087 million in 2003. Gross written premiums from the accident insurance business increased by RMB97 million, or 2.0%, to RMB4,977 million in 2004 from RMB4,880 million in 2003 and gross written premiums from the health insurance business increased by RMB304 million, or 5.7%, to RMB5,629 million in 2004 from RMB5,325 million in 2003. These changes were primarily due to our increased sales efforts for short-term products, as well as an increase in sales of our long-term products with short-term riders.

Substantially all of the net premiums earned were from transferred and new policies.

Net Investment Income

Net investment income increased by RMB1,492 million, or 15.2%, to RMB11,317 million in 2004 from RMB9,825 million in 2003. This increase was primarily due to an overall growth in investment assets during 2004, notwithstanding the restructuring effect described above.

As of December 31, 2004, total investment assets were RMB374,890 million and the investment yield for the year ended December 31, 2004 was 3.5%. As of December 31, 2003, total investment assets were RMB279,248 million and the investment yield for the year ended December 31, 2003 was 3.4% (which includes the investment yield for investment assets held by CLIC through September 30, 2003). This increase was primarily due to an increase in interest income from floating rate negotiable deposits and higher yields from newly issued bonds and subordinated bonds, as a result of an increase in benchmark deposit rate by the Chinese central bank in 2004.

Net Realized Gains/Losses on Investments

Net realized losses on investments was RMB237 million in 2004, compared to net realized gains of RMB868 million in 2003. This change reflected net realized losses of RMB317 million on debt securities which was primarily due to the impairment of bonds entrusted with Min Fa Security Limited Company, and net realized gains of RMB80 million on securities investment funds in 2004. In 2003, net realized gains was RMB550 million on debt securities and RMB318 million on securities investment funds. See note 4.1 of the notes to the financial statements included elsewhere in this annual report for more information on the bonds entrusted with Min Fa Security Limited Company.

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Net Unrealized Gains/Losses on Investments

We reflect unrealized gains or losses on investments designated as trading in current period income. Our net unrealized losses on investments was RMB1,061 million in 2004, compared to net unrealized gains of RMB247 million in 2003. The results in 2004 reflected net unrealized gains of RMB11 million on debt securities and net unrealized losses on securities investment funds of RMB1,072 million, due to a deep fall in the securities market in 2004.

Deposits and Policy Fees

Deposits are gross additions to policyholder contract deposits. Total deposits decreased by RMB2,464 million, or 2.7%, to RMB88,737 million in 2004 from RMB91,201 million in 2003. Policy fees decreased by RMB902 million, or 14.8%, to RMB5,194 million in 2004 from RMB6,096 million in 2003. These decreases were primarily due to the effect of restructuring described above and decreased sales of investment-type products in the individual life insurance business, offset in part by increased sales of participating annuity products in group life insurance business.

Total deposits attributable to the transferred and new policies increased by RMB1,302 million, or 1.5%, to RMB88,737 million in 2004 from RMB87,435 million in 2003. Policy fees attributable to the transferred and new policies decreased by RMB363 million, or 6.5%, to RMB5,194 million in 2004 from RMB5,557 million in 2003. These changes reflected increased sales of participating annuity products in group life insurance business, and decreased sales of investment-type products in the individual life insurance business, as well as an increase in the proportion of investment-type products that are single premium products. Total deposits from participating products increased by RMB1,040 million, or 1.3%, to RMB81,416 million in 2004 from RMB80,376 million in 2003. Total policy fees from participating products decreased by RMB563 million, or 13.4%, to RMB3,651 million in 2004 from RMB4,214 million in 2003.

Individual Life Insurance Business

Deposits in the individual life insurance business decreased by RMB12,981 million, or 16.2%, to RMB66,981 million in 2004 from RMB79,962 million in 2003. Policy fees from the individual life insurance business decreased by RMB972 million, or 16.9%, to RMB4,796 million in 2004 from RMB5,768 million in 2003. These decreases reflected effect of restructuring described above, as well as the adjustment of our product selling strategy to concentrate more on risk type products, which led to a decrease in sales of investment type products.

Deposits in the individual life insurance business attributable to the transferred and new policies decreased by RMB10,337 million, or 13.4%, to RMB66,981 million in 2004 from RMB77,318 million in 2003. Policy fees from the individual life insurance business attributable to the transferred and new policies decreased by RMB584 million, or 10.9%, to RMB4,796 million in 2004 from RMB5,380 million in 2003. These decreases were primarily due to the adjustment of our product selling strategy to concentrate more on risk type products, which led to a decrease in sales of investment type products.

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Group Life Insurance Business

Deposits in the group life insurance business increased by RMB10,517 million, or 93.6%, to RMB21,756 million in 2004 from RMB11,239 million in 2003. Policy fees from the group life insurance business increased by RMB70 million, or 21.3%, to RMB398 million in 2004 from RMB328 million in 2003. These increases were primarily due to an increase of sales of participating annuity products, offset in part by the effect of the restructuring described above.

Deposits in the group life insurance business attributable to the transferred and new policies increased by RMB11,639 million, or 115.0%, to RMB21,756 million in 2004 from RMB10,117 million in 2003. Policy fees from the group life insurance business attributable to the transferred and new policies increased by RMB221 million, or 124.9%, to RMB398 million in 2004 from RMB177 million in 2003. These increases were due to increased sales of participating annuity products.

Accident and Health Insurance Business

There are no deposits in our accident and health insurance business.

Insurance Benefits and Claims

Insurance benefits and claims, net of amounts ceded through reinsurance, decreased by RMB10,148 million, or 17.9%, to RMB46,388 million in 2004 from RMB56,536 million in 2003. This decrease was due to the effect of restructuring described above, offset in part by an increase in business volume and the accumulation of liabilities. Life insurance death and other benefits decreased by RMB1,754 million, or 20.5%, to RMB6,816 million in 2004 from RMB8,570 million in 2003. This decrease was principally due to the effect of restructuring described above, offset in part by an increase in the number of policies in force. Life insurance death and other benefits as a percentage of gross written premiums and policy fees decreased to 10.3% in 2004 from 12.4% in 2003.

Insurance benefits and claims, net of amounts ceded through reinsurance, attributable to the transferred and new policies increased by RMB11,175 million, or 31.7%, to RMB46,388 million in 2004 from RMB35,213 million in 2003. This increase was primarily due to the increase in insurance benefits and claims in the individual life insurance business as a result of an increase in business volume and the accumulation of liabilities. Insurance benefits and claims, net of amounts ceded through reinsurance, attributable to participating products increased by RMB6,401 million, or 45.8%, to RMB20,383 million in 2004 from RMB13,982 million in 2003. Of these insurance benefits and claims attributable to participating products, life insurance death and other benefits increased by RMB2,124 million, or 396.3%, to RMB2,660 million in 2004 from RMB536 million in 2003 and the increase in future life policyholder benefits increased by RMB4,277 million, or 31.8%, to RMB17,723 million in 2004 from RMB13,446 million in 2003.

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Individual Life Insurance Business

Insurance benefits and claims for the individual life insurance business decreased by RMB11,512 million, or 22.6%, to RMB39,435 million in 2004 from RMB50,947 million in 2003. This decrease was due to the effect of the restructuring described above, offset in part by the increase in business volume and the accumulation of liabilities. Of these insurance benefits and claims, life insurance death and other benefits decreased by RMB1,322 million, or 17.1%, to RMB6,422 million in 2004 from RMB7,744 million in 2003 and the increase in future life policyholder benefits decreased by RMB10,190 million, or 23.6%, to RMB33,013 million in 2004 from RMB43,203 million in 2003.

Insurance benefits and claims for the individual life insurance business attributable to the transferred and new policies increased by RMB9,489 million, or 31.7%, to RMB39,435 million in 2004 from RMB29,946 million in 2003. This increase was primarily due to the increase in business volume and the accumulation of liabilities. Of these insurance benefits and claims, life insurance death and other benefits increased by RMB3,074 million, or 91.8%, to RMB6,422 million in 2004 from RMB3,348 million in 2003. This increase was primarily due to an increased impact of the participating products, which we started to sell in 2000, and which pay survivorship benefits to policyholders every three years. The increase in future life policyholder benefits increased by RMB6,415 million, or 24.1%, to RMB33,013 million in 2004 from RMB26,598 million in 2003.

Group Life Insurance Business

Insurance benefits and claims for the group life insurance business decreased by RMB172 million, or 24.3%, to RMB535 million in 2004 from RMB707 million in 2003. This decrease was due to the effect of the restructuring described above, offset in part by the increase in business volume. Of these insurance benefits and claims, life insurance death and other benefits decreased by RMB432 million, or 52.3%, to RMB394 million in 2004 from RMB826 million in 2003 and the increase in future life policyholder benefits was RMB141 million in 2004, compared with a decrease of RMB119 million in 2003.

Insurance benefits and claims for the group life insurance business attributable to the transferred and new policies increased by RMB150 million, or 39.0%, to RMB535 million in 2004 from RMB385 million in 2003. This increase was primarily due to the increase in business volume. Of these insurance benefits and claims, life insurance death and other benefits decreased by RMB76 million, or 16.2%, to RMB394 million in 2004 from RMB470 million in 2003 and the increase in future life policyholder benefits was RMB141 million in 2004, compared with a decrease of RMB85 million in 2003.

Accident and Health Insurance Business

Insurance benefits and claims for the accident and health insurance business increased by RMB1,536 million, or 31.5%, to RMB6,418 million in 2004 from RMB4,882 million in 2003. Substantially all of these amounts related to transferred and new policies. This increase was primarily due to the increase in business volume of health insurance business, which has a relatively higher claim rate and an increase in medical expenses.

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Policyholder Dividends and Participation in Profits

Policyholder dividends and participation in profits increased by RMB841 million, or 69.7%, to RMB2,048 million in 2004 from RMB1,207 million in 2003. Virtually all of these amounts were attributable to the transferred and new policies because our predecessor only began to sell participating products in 2000. This increase was primarily due to increases in our reserves and business volume.

Amortization of Deferred Policy Acquisition Costs

Amortization of deferred policy acquisition costs reflects the amortization of deferred policy acquisition costs attributable to the transferred and new policies. The majority of acquisition costs attributable to the transferred and new policies are deferrable. Amortization of deferred policy acquisition costs increased by RMB1,240 million, or 24.7%, to RMB6,263 million in 2004 from RMB5,023 million in 2003. This increase was primarily due to an increase in number and overall amount of policies in force.

Underwriting and Policy Acquisition Costs

Underwriting and policy acquisition costs primarily reflect acquisition costs attributable to non-transferred policies in the individual life insurance business and group life insurance business, as well as non-deferrable portion of underwriting and policy acquisition costs in transferred and new policies. Underwriting and policy acquisition costs increased by RMB178 million, or 13.8%, to RMB1,472 million in 2004 from RMB1,294 million in 2003. Underwriting and policy acquisition costs were 2.26% of net premiums earned and policy fees in 2004, compared with 1.91% in 2003.

Of this amount, underwriting and policy acquisition costs in the individual life insurance business and group life insurance business together increased by RMB161 million, or 18.1%, to RMB1,051 million in 2004 from RMB890 million in 2003. This increase was primarily due to the increase in business volume during the period, as well as an increase in the sales of risk-type and regular-premium products, which have a relatively higher commission. Underwriting and policy acquisition costs in the accident and health insurance business increased by RMB17 million, or 4.2%, to RMB421 million in 2004 from RMB404 million in 2003. This increase was primarily due to the increase in business volume.

Administrative Expenses

Administrative expenses include the non-deferrable portion of policy acquisition costs attributable to the transferred and new policies, as well as compensation and other administrative expenses. Administrative expenses decreased by RMB277 million, or 4.0%, to RMB6,585 million in 2004 from RMB6,862 million in 2003. This decrease primarily reflected the effect of the restructuring described above, offset in part by the increase in business volume.

Other Operating Expenses

Other operating expenses, which primarily consist of employee housing benefits and expenses of non-core businesses (which includes investments in property, hotels and other operations through subsidiaries), decreased by RMB741 million, or 85.0%, to RMB131 million in 2004 from RMB872 million in 2003. A substantial amount of other operating expenses in 2003 comprises investments in property, hotels and other operations through subsidiaries, which we no longer have after the restructuring. This decrease primarily reflected the effect of the restructuring described above and the effective control of the costs by us.

Interest Credited to Policyholder Contract Deposits

Interest credited to policyholder contract deposits decreased by RMB2,940 million, or 40.5%, to RMB4,320 million in 2004 from RMB7,260 million in 2003. This decrease primarily reflected the effect of the restructuring described above, offset in part by an increase in the total policyholder account balance.

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Interest credited to policyholder contract deposits attributable to the transferred and new policies increased by RMB1,400 million, or 47.9%, to RMB4,320 million in 2004 from RMB2,920 million in 2003. This increase was primarily due to an increase in the total policyholder account balance. Interest credited to participating policyholder contract deposits increased by RMB1,372 million, or 61.4%, to RMB3,607 million in 2004 from RMB2,235 million in 2003.

Income Tax

We pay income tax according to applicable Chinese enterprise income tax regulations and rules. Income tax expense, including current and deferred taxations, increased by RMB1,100 million, or 93.2%, to RMB2,280 million in 2004 from RMB1,180 million in 2003. This increase was primarily due to an increase in profits and the fact that in accordance with PRC law, the Company and China Life Insurance Asset Management Company Limited, which is controlled by the Company, are subject to tax on their income from the dates of their incorporation, June 30, 2003 and November 23, 2003. Our effective tax rate for 2004 was 24% as compared with a statutory tax rate of 33% principally because we had substantial interest income from government bonds which are not taxable.

Net Profit/Loss

For the reasons set forth above, net profit was RMB7,171 million in 2004, compared to a net loss of RMB1,428 million in 2003.

Individual Life Insurance Business

Net profit in the individual life insurance business was RMB8,503 million in 2004, compared to a net loss of RMB208 million in 2003. This result was primarily due to increased sales of risk-type products as well as the increased impact of the more profitable transferred and new policies in the individual life business following the restructuring.

Group Life Insurance Business

Net loss in the group life insurance business was RMB296 million in 2004, an improvement from a net loss of RMB1,263 million in 2003. This result was primarily due to the increased impact of the more profitable transferred and new policies in the group life business following the restructuring.

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Accident and Health Insurance Business

Net profit in the accident and health insurance business decreased by RMB208 million, or 15.1%, to RMB1,172 million in 2004 from RMB1,380 million in 2003. The decrease in profitability was primarily due to the increased relative weight of the health insurance business in the accident and health insurance business. The overall performance of the accident insurance remained strong. The adverse performance of our health insurance business was primarily due to higher medical costs during the period, which were not matched by price increases for our products.

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LIQUIDITY AND CAPITAL RESOURCES

Liquidity Sources

Our principal cash inflows come from insurance premiums, deposits, proceeds from sales of investment assets, investment income and financing through initial public offering. The primary liquidity concerns with respect to these cash inflows are the risk of early contract holder and policyholder withdrawal, as well as the risks of default by debtors, interest rate changes and other market volatilities. We closely monitor and manage these risks.

Additional sources of liquidity to meet unexpected cash outflows are available from our portfolio of cash and investment assets. As of December 31, 2004, the amount of cash and cash equivalents was RMB27,217 million. In addition, substantially all of our term deposits with banks allow us to withdraw funds on deposit, subject to a penalty interest charge. As of December 31, 2004, the amount of term deposits was RMB175,498 million.

Our portfolio of investment securities also may provide us with a source of liquidity to meet unexpected cash outflows. As of December 31, 2004, investments in fixed maturity securities had a fair value of RMB150,351 million. As of December 31, 2004, investments in equity securities, primarily through securities investment funds, had a fair value of RMB17,271 million. However, the PRC securities market is still at an early stage of development, and we are subject to market liquidity risk because the market capitalization and trading volumes of the public exchanges are much lower than in more developed financial markets. We also are subject to market liquidity risk due to the large size of our investments in some of the markets in which we invest. We believe that some of our positions in our investment securities may be large enough to have an influence on the market value. These factors may limit our ability to sell these investments at an adequate price, or at all.

Liquidity Uses

Our principal cash outflows primarily relate to the liabilities associated with our various life insurance, annuity and accident and health insurance products, dividend and interest payments on our insurance policies and annuity contracts, operating expenses, income taxes and dividends that may be declared and payable to our shareholders. Liabilities arising from our insurance activities primarily relate to benefit payments under these insurance products, as well as payments for policy surrenders, withdrawals and loans.

We believe that our sources of liquidity are sufficient to meet our current cash requirements.

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Consolidated Cash Flows

The following sets forth information regarding consolidated cash flows for the periods indicated.

Net Cash provided by operating activities was RMB32,914 million in 2004, a decrease from RMB38,510 million in 2003. This decrease was primarily due to the effect of the restructuring described above.

Net cash used in investing activities was RMB120,526 million in the year ended December 31, 2004 and RMB105,166 million in the year ended December 31, 2003. The increases in cash used in investing activities over all of these periods were primarily due to the growth in premiums and deposits.

Net cash provided by financing activities was RMB72,213 million in the year ended December 31, 2004 and RMB94,743 million in the year ended December 31, 2003. The changes in cash provided by financing activities over these periods were primarily due to the growth in deposits. In addition, our global share offering in December 2003 provided cash proceeds of approximately RMB24,707 million. As of December 31, 2004, a substantial part of the cash proceeds from our global offering was held in bank deposit accounts overseas, and the rest was held in bank deposit accounts as structured deposits in foreign currency in China. We expect to use such proceeds for general corporate purposes and to strengthen our capital base.

Insurance Solvency Requirements

The solvency ratio of an insurance company is a measure of capital adequacy, which is calculated by dividing the actual solvency level of the company (which is its admissible assets less admissible liabilities, determined in accordance with PRC GAAP and relevant rules) by the minimum solvency level it is required to meet. The following table shows the Company s solvency ratio as of December 31, 2004:

	As of December 31, 2004 (RMB million, except percentage data)
Actual solvency	54,456
Minimum solvency	17,264
Solvency ratio	315%

Insurance companies are required to calculate and report annually to the CIRC their solvency level and twelve additional financial ratios to assist it in monitoring the financial condition of insurers. A usual range of results for each of the twelve ratios is used as a benchmark. The departure from the usual range of four or more of the ratios can lead to regulatory action being taken by the CIRC.

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The Company s solvency level as of December 31, 2004 was approximately 3.15 times the minimum regulatory requirement and nine applicable financial ratios were within their usual ranges. Among the twelve financial ratios, the calculation of three other ratios requires financial data of two previous years, and the Company was accordingly not able to calculate such three ratios for the year of 2004 because it was just established in 2003.

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Extensive

Reach

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Report of the Board of Directors

1. PRINCIPAL BUSINESS AND RESULTS

The Company is a leading life insurance company in China s life insurance market. Its individual and group life insurance policies, annuity products, and long-term health insurance policies are sold through the most extensive distribution network in China, which includes exclusive agents, direct sales representatives and dedicated and non-dedicated agencies. The Company also provides individual and group accident and short-term health insurance policies. In addition, the Company has become China s largest insurance asset management company through its controlling shareholding in AMC, as well as one of the largest institutional investors in China. The analysis of operations by business segments during the year is set out in note 3 to the financial statements below.

2. RESULTS AND ALLOCATION

The results of the Group for the year are set out in the Company s consolidated profit and loss account on page 66.

3. RESERVES

Details of the reserves of the Group are set out in note 23 to the financial statements below.

4. CHARITABLE DONATIONS

The total amount of charitable donations of the Group for the year was RMB18.92 million.

5. FIXED ASSETS

Details of the movement in fixed assets of the Group are set out in note 8 to the financial statements below.

6. SHARE CAPITAL

Details of the movement in share capital of the Company are set out in note 22 to the financial statements below.

7. BANK BORROWINGS

As at December 31, 2004, the Group did not have any bank borrowings.

8. PURCHASE, SALES OR REDEMPTION OF THE COMPANY S SHARES

During the year, the Company and its subsidiary have not purchased, sold or redeemed any of the Company s securities.

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9. SHARE OPTIONS

As part of the incentive scheme, the Company grants stock appreciation rights to members of the senior management. The issuance of stock appreciation rights does not involve any issuance of new shares, nor does it have any dilutive effect on the shareholders. Stock appreciation rights are expected to be granted to approximately 100 members of the senior management, including members of the Board of Directors and the Supervisory Committee (excluding independent non-executive Directors), the president, vice-president, heads of key departments of the headquarters, general managers and certain deputy general managers of the principal branches, as well as senior professionals and technicians in key positions. After obtaining the approval of the Board of Directors, stock appreciation rights may be issued to members of the senior management in 2005.

10. DIRECTORS

Brief descriptions of the Directors of the Company are set out from page 52 to page 54.

11. BIOGRAPHICAL DETAILS OF DIRECTORS, SUPERVISORS AND MEMBERS OF THE SENIOR MANAGEMENT

Brief descriptions of the Directors, Supervisors and members of the senior management of the Company are set out from page 52 to page 57.

12. DIRECTORS SERVICE CONTRACTS

Mr. Long Yongtu and Mr. Chau Tak Hay, independent non-executive Directors of the Company, entered into independent non-executive Directors service contracts with the Company on February 6, 2004 in Beijing respectively. The term of appointment of these two independent non-executive Directors is three years, commencing from the date of the general meeting (i.e. August 18, 2003) at which resolutions were passed for their appointment as independent non-executive Directors of the Company. Upon the expiration of the term and with the consent of both parties, independent non-executive Directors may be re-appointed. However, the term of re-appointment shall not exceed six years.

Mr. Sun Shuyi, Mr. Cai Rang and Mr. Fan Yingjun, independent non-executive Directors of the Company, entered into independent non-executive Directors service contracts with the Company on October 9, 2004 in Beijing respectively. The term of appointment of these three independent non-executive Directors is three years, commencing from the date of the general meeting (i.e. June 18, 2004) at which resolutions were passed for their appointment as independent non-executive Directors of the Company. Upon the expiration of the term and with the consent of both parties, such independent non-executive Directors may be re-appointed. However, the term of re-appointment shall not exceed six years.

Save as mentioned above, none of the other Directors of the Company has entered into any service contract with the Company (excluding contracts expiring or determinable by the employer within one year without payment of compensation (other than statutory compensation)).

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13. DIRECTORS AND SUPERVISORS INTERESTS IN MATERIAL CONTRACTS

None of the Directors or Supervisors had any individual beneficial interest, directly or indirectly, in any material contracts entered into by the Company or its subsidiary at any time during the year.

14. DIRECTORS AND SUPERVISORS RIGHTS TO ACQUIRE SHARES

At no time during the year had the Company authorized its Directors, Supervisors or their respective spouses or children under the age of 18 to benefit by means of the acquisition of shares or debentures of the Company or any of its other associated corporations, and no such rights for the acquisition of shares or debentures were exercised by them.

15. DIRECTORS AND SUPERVISORS INTERESTS IN SHARES

During the year, none of the Directors or Supervisors had any interests in the shares and underlying shares or debentures of the equity derivatives of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance of Chapter 571 of the Laws of Hong Kong (the SFO)) that were required to be recorded in the register of the Company required to be kept pursuant to Section 352 of the SFO or which had to be notified to the Company and the Hong Kong Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

16. DIVIDEND

No dividend will be declared for the year.

17. PRE-EMPTIVE RIGHTS AND ARRANGEMENTS ON OPTIONS OF SHARES

According to the Articles of Association of the Company and the relevant PRC laws, there is no provision for any pre-emptive rights of the shareholders of the Company. At present, the Company does not have any arrangement on the options of shares.

18. SUBSTANTIAL SHAREHOLDERS AND PERSONS WHO HAVE AN INTEREST OR SHORT POSITION DISCLOSEABLE UNDER DIVISIONS 2 AND 3 OF PART XV OF THE SFO

As at December 31, 2004, the following persons (other than the Directors, Supervisors and chief executive of the Company) had interests in the shares of the Company as recorded in the register required to be kept by the Company pursuant to Section 336 of the SFO:

Name of Substantial Shareholder	Capacity	Long Positions No. of Domestic	Percentage of total number of Domestic Shares in issue
China Life Insurance (Group) Company	Beneficial owner	19,323,530,000	100%

Name of Substantial Shareholder	Capacity	Long Positions No. of H Shares	Percentage of total number of H shares in issue
Li Ka-shing *(Note 1)*	Founder of discretionary trusts & interest of controlled corporations	428,358,620	5.76%
Li Ka-Shing Unity Trustee Company Limited *(Note 1)*	Trustee	428,358,620	5.76%
Li Ka-Shing Unity Trustee Corporation Limited *(Note 1)*	Trustee & beneficiary of trust	428,358,620	5.76%
Li Ka-Shing Unity Trustcorp Limited *(Note 1)*	Trustee & beneficiary of trust	428,358,620	5.76%
Cheung Kong (Holdings) Limited *(Note 1)*	Interest of controlled corporations	428,358,620	5.76%
Lee Shau Kee *(Note 2)*	Founder of discretionary trusts & interest of controlled corporations	428,358,620	5.76%
Rimmer (Cayman) Limited *(Note 2)*	Trustee	428,358,620	5.76%
Riddick (Cayman) Limited *(Note 2)*	Trustee	428,358,620	5.76%
Hopkins (Cayman) Limited *(Note 2)*	Interest of controlled corporations	428,358,620	5.76%
Henderson Development Limited *(Note 2)*	Interest of controlled corporations	428,358,620	5.76%
Richbo Investment Limited *(Note 2)*	Beneficial owner	428,358,620	5.76%
J.P. Morgan Chase & Co. *(Note 3)*	Investment manager, custodian and asset proprietor	462,431,260	6.21%

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Note 1:

These references to 428,358,620 H Shares relate to the same block of shares in the Company.

These 428,358,620 H Shares are held by Mitcham Resources Limited (Mitcham) and Hutchison International Limited (HIL) in the following proportion:

Name of Corporations	**No. of H Shares**
HIL	214,179,310
Mitcham	214,179,310

HIL is a wholly-owned subsidiary of Hutchison Whampoa Limited (HWL). Certain subsidiaries of Cheung Kong (Holdings) Limited (CKH) in turn together hold one-third or more of the issued share capital of HWL.

Mitcham is a wholly-owned subsidiary of Cheung Kong Investment Company Limited which in turn is a wholly owned subsidiary of CKH.

Li Ka-Shing Unity Holdings Limited, of which each of Mr. Li Ka-shing, Mr. Li Tzar Kuoi, Victor and Mr. Li Tzar Kai, Richard is interested in one-third of the entire issued share capital, owns the entire issued share capital of Li Ka Shing Unity Trustee Company Limited (TUT1). TUT1 as trustee of The Li Ka-Shing Unity Trust, together with certain companies which TUT1 as trustee of The Li Ka-Shing Unity Trust is entitled to exercise or control the exercise of more than one-third of the voting power at their general meetings, hold more than one-third of the issued share capital of CKH.

In addition, Li Ka-Shing Unity Holdings Limited also owns the entire issued share capital of Li Ka-Shing Unity Trustee Corporation Limited (TDT1) as trustee of The Li Ka-Shing Unity Discretionary Trust (DT1) and Li Ka-Shing Unity Trustcorp Limited (TDT2) as trustee of another discretionary trust (DT2). Each of TDT1 and TDT2 holds units in The Li Ka-Shing Unity Trust.

By virtue of the SFO, each of Mr. Li Ka-shing, being the settlor and may being regarded as a founder of each of DT1 and DT2 for the purpose of the SFO, TUT1, TDT1, TDT2 and CKH is deemed to be interested in the 214,179,310 H Shares of the Company and another 214,179,310 H Shares of the Company held by HIL and Mitcham respectively.

Note 2:

These references to 428,358,620 H Shares relate to the same block of shares in the Company.

These 428,358,620 H Shares are held by Richbo Investment Limited (Richbo), an indirect wholly-owned subsidiary of Henderson Development Limited (HDL). Hopkins (Cayman) Limited (Hopkins) as trustee of a unit trust (the Unit Trust) owns all the issued ordinary shares of HDL. Rimmer (Cayman) Limited (Rimmer) and Riddick (Cayman) Limited (Riddick), as trustee of respective discretionary trusts, hold units in the Unit Trust. The entire issued share capital of Hopkins, Rimmer and Riddick are owned by Mr. Lee Shau Kee. Accordingly, each of Mr. Lee Shau Kee, HDL, Hopkins, Rimmer, Riddick, and Richbo is taken to have an interest in these 428,358,620 H Shares under the SFO.

Note 3:

Of these shares, 212,051,000 H Shares, 5,200,000 H Shares, 730,000 H Shares, 880,000 H Shares, 642,000 H Shares, 28,900,448 H Shares, 21,363,512 H Shares, 32,720,000 H Shares, 156,532,300 H Shares and 3,412,000 H Shares are respectively held by JF Asset Management Limited, JF Asset Management (Singapore) Limited Co Reg #: 197601586K, JF International Management Inc., J.P. Morgan Fleming Asset Management (London) Limited, J.P. Morgan Fleming Asset Management (Canada) Inc., J.P. Morgan Fleming Asset Management (UK) Limited, J.P. Morgan Investment Management Inc., J.P. Morgan Whitefriars Inc., JPMorgan Chase Bank, N.A. and J.P. Morgan Securities Ltd., all of which are either controlled or indirectly controlled subsidiaries of J.P. Morgan Chase & Co.

Included in the 462,431,260 H Shares are 156,532,300 H Shares (2.10%) which are the lending pool under section 5(4) of the Securities and Futures (Securities Borrowing and Lending) Rules.

Save as disclosed above, the Company is not aware of any other person having any interests or short positions (other than the Directors, Supervisors and chief executive of the Company) in the shares and underlying shares of the Company as recorded in the register required to be kept pursuant to Section 336 of the SFO.

19. INFORMATION OF TAX DEDUCTION

Items for tax deduction while calculating the profit tax of 2004 of the Company:

Gross wages before tax:	RMB2,827 million
Interest income from Government bonds:	RMB2,322 million
Dividend income of funds:	RMB473 million

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20. MANAGEMENT CONTRACTS

No management contracts for the entire or principal businesses of the Company were entered into during the year.

21. CONNECTED TRANSACTIONS

Details of the connected transactions of the Company are set out in the section Connected Transactions and note 21 to the financial statements below.

22. REMUNERATION OF THE DIRECTORS AND MEMBERS OF THE SENIOR MANAGEMENT

Details of the remuneration of the Directors and members of the senior management are set out in note 27 to the financial statements below.

23. BOARD COMMITTEES

The Board of Directors of the Company has established Audit Committee, Management Training and Remuneration Committee, Risk Management Committee and Strategic Committee.

The Audit Committee is responsible for the review and supervision of the Company s financial reporting procedures and internal control system. The Committee is currently comprised of Mr. Sun Shuyi, Mr. Cai Rang and Mr. Fan Yingjun and chaired by Mr. Sun Shuyi.

The Management Training and Remuneration Committee is mainly responsible for the formulation of training and remuneration policy for the senior management of the Company and the administration of the remuneration system of the senior management of the Company. The Committee is currently comprised of Mr. Cai Rang, Mr. Miao Fuchun and Mr. Wu Yan and chaired by Mr. Cai Rang.

The Risk Management Committee is mainly responsible for assisting the management to manage the internal and external risks. The Committee is currently comprised of Mr. Fan Yingjun, Mr. Shi Guoqing and Mr. Chau Tak Hay and chaired by Mr. Fan Yingjun.

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The Strategic Committee is mainly responsible for the formulation of the overall development plan and decision-making procedures of investment. The Committee is currently comprised of Mr. Wang Xianzhang, Mr. Miao Fuchun, Mr. Wu Yan and Mr. Long Yongtu and chaired by Mr. Wang Xianzhang.

24. MAJOR LITIGATION

Between March 16, 2004 and May 14, 2004, nine putative class action lawsuits were filed in the United States District Court for the Southern District of New York against the Company and certain of its officers and directors. These lawsuits were brought on behalf of a class of purchasers of the publicly traded securities of the Company and allege that the defendants named therein violated Section 10(b) and 20(a) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder (Exchange Act Claims), and Sections 11 and 15 of the Securities Act of 1933 by, among other things, omitting to disclose in the prospectus filed in connection with the Company s December 2003 initial public offering of its stock that the National Audit Office of China was conducting an audit of the predecessor of the Company s parent, China Life Insurance Company. The Court ordered that the nine actions be consolidated and restyled In re China Life Insurance Company Limited Securities Litigation, No. 04 CV 2112 (TPG), and that a consolidated amended complaint be filed. Plaintiffs filed a consolidated amended complaint on January 19, 2005, which names the Company, and three directors, namely Wang Xianzhang, Miao Fuchun and Wu Yan, as defendants, and asserts only Exchange Act Claims. These defendants jointly moved to dismiss the consolidated amended complaint on March 21, 2005. Plaintiffs opposition to the motion is currently due May 20, 2005. At this time, the US law firm retained by the Company is unable to express an opinion as to the likelihood of an unfavorable outcome or the amount of damages, if any, that may be awarded.

25. COMPLIANCE WITH THE CODE OF BEST PRACTICE OF THE LISTING RULES

The Directors confirmed that the Company was in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules throughout the year ended December 31, 2004.

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26. AUDITORS

PricewaterhouseCoopers and PricewaterhouseCoopers Zhong Tian Certified Public Accountants Co., Ltd. were the international and PRC auditors to the Company respectively for the year ended December 31, 2004. A resolution for the re-appointment of PricewaterhouseCoopers as the international auditors and PricewaterhouseCoopers Zhong Tian Certified Public Accountants Co., Ltd. as the PRC auditors to the Company will be proposed at the forthcoming Annual General Meeting on June 16, 2005.

By Order of the Board of Directors

Wang Xianzhang

Chairman

Beijing, China

April 18, 2005

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Report of the Supervisory Committee

To all Shareholders,

In 2004, all members of the Supervisory Committee have duly performed their supervisory responsibilities in a stringent manner and adhered to the principle of fidelity to be responsible for the shareholders, review prudently the material issues of the Company and effectively protect the interests of the Company and its shareholders in accordance with the provisions of the Company Law of the PRC and the Company s Articles of Association.

1. MEETINGS CONVENED BY THE SUPERVISORY COMMITTEE

Four meetings were held by the Supervisory Committee of the Company during the year:

(i) the third meeting of the first Supervisory Committee was held on January 9, 2004 to review and approve the Rules of Procedures for the Supervisory Committee of China Life Insurance Company Limited (Provisional) which have now been enforced;

(ii) the forth meeting of the first Supervisory Committee was held on March 30, 2004 to review and approve in principle the Policy for the Distribution of Dividends to the policyholders for 2003 put forward by the Board of Directors;

(iii) the fifth meeting of the first Supervisory Committee was held on April 23, 2004 to review and approve in principle the Report of the Board of Directors of the Company, Management Operation Report for 2003, the Audited Financial Statements and Auditors Report for 2003 prepared under the PRC accounting standards, the Audited Financial Statements and Auditors Report for 2003 prepared under the Hong Kong accounting standards, the Profit Sharing Proposal for 2003, the Annual Report and the Report of the Supervisory Committee for 2003; approve the appointment of PricewaterhouseCoopers Zhong Tian Certified Public Accountants Co., Ltd. and PricewaterhouseCoopers respectively as the PRC auditors and international auditors of the Company for 2004 and to submit the same for approval by the shareholders general meeting; and to approve the appointment of Mr. Ren Hongbin and Mr. Tian Hui as Supervisors and to submit the same for approval by the shareholders; and

(iv) the sixth meeting of the first Supervisory Committee was held on August 27, 2004 to review and approve the 2004 interim report of the Company.

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In addition, three meetings were held by the Supervisory Committee of the Company since January 1, 2005 until the date of this report:

(i) the seventh meeting of the first Supervisory Committee was held on March 1, 2005 to review and approve in principle the Report regarding the 2005 Financial Budget of China Life Insurance Company Limited , Report regarding the Profit Distribution Policy for 2004 of China Life Insurance Company Limited , Investment Plan for 2005 of China Life Insurance Company Limited and Policy for the Distribution of Dividends to the policyholders for 2004 of China Life Insurance Company Limited presented by the Board of Directors;

(ii) the eighth meeting of the first Supervisory Committee was held on March 30, 2005 to approve the resignation of Mr. Zhou Xinping as a Employee Representative Supervisor of the Company as a result of the changes of his working duties; and

(iii) the ninth meeting of the first Supervisory Committee was held on April 18, 2005 to review and approve in principle the Report of the Board of Directors of the Company, the Management Operation Report for 2004, the 2004 Financial Statements prepared under PRC generally accepted accounting principles and the Auditors Report under PRC generally accepted auditing standards thereof, the 2004 Financial Statements prepared under HK generally accepted accounting principles and the Auditors Reports under HK generally accepted auditing standards and US generally accepted auditing standards thereof, the Annual Report and the Report of the Supervisory Committee for 2004; approve the amendment proposal to the Rules of Procedures for the Supervisory Committee of China Life Insurance Company Limited (Provisional) ; approve the remunerations for the PRC auditors and international auditors for 2004; approve the re-appointment of PricewaterhouseCoopers Zhong Tian Certified Public Accountants Co., Ltd. and PricewaterhouseCoopers respectively as the PRC auditors and international auditors of the Company for 2005 and to submit the same for approval by the shareholders general meeting.

2. CHANGES OF THE SUPERVISORY COMMITTEE AND AMENDMENTS OF ITS RULES OF PROCEDURES

The Supervisory Committee currently consists of five members. It approved the resignation of Zhou Xinping as a Employee Representative Supervisor as a result of the changes of his working duties. On March 30, 2005, Jia Yuzeng was elected as an Employee Representative Supervisor according to the results of the by-election of the Assembly. On the nineth meeting of the Supervisory Committee held on April 18, 2005, Rules of Procedures for the Supervisory Committee of China Life Insurance Company Limited (Provisional) was amended.

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3. INDEPENDENT OPINION FROM THE SUPERVISORY COMMITTEE REGARDING THE RELATED MATTERS DURING 2004

During the reporting period, the Supervisory Committee of the Company performed its duty in a stringent manner and supervised the legality of the operation of the Company in accordance with the terms of reference prescribed in the Company Law of the PRC and the Company s Articles of Association. The Supervisory Committee was of the opinion that:

(i) The legality of the operation of the Company: the Supervisory Committee of the Company carried out supervision regarding the convening procedures and resolutions of general meetings, the holding of general meetings by the Board of Directors, the duty performed by the senior management and the management system of the Company in accordance with the relevant laws and regulations of the state and considered that the Company had operated according to the Company Law, Securities Law and the Articles of Association. In 2004, the Board of Directors of the Company duly performed all resolutions passed in the general meetings and its decisions were in line with the relevant provisions of the Company Law and the Articles of Association. During the reporting period, the entire Board of Directors, general managers, deputy general managers and other senior management of the Company endeavored to the development of the Company sticking to the principles of diligence and integrity without violating any laws, regulations, the Articles of Association or damaging the interests of the Company and shareholders during the performance of their duties.

(ii) Examination of the financial status of the Company: For the reporting period, the Supervisory Committee of the Company reviewed the unqualified audit reports prepared by PricewaterhouseCoopers under generally accepted auditing standards and considered that the Financial Statements provided a true and complete view of the financial position and operating results of the Company and gave an objective and fair assessment of the related issues.

By order of the Supervisory Committee

Liu Yingqi

Chairperson of the Supervisory Committee

Beijing, China

April 18, 2005

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Connected Transactions

To ensure the continual normal operations of the Company s business after the restructuring, the Company, prior to the restructuring, entered into several agreements with CLIC, that document the relationship following the restructuring. In addition, AMC entered into two asset management agreements, one with the Company and one with CLIC. The transactions contemplated under these agreements constitute connected transactions for the Company.

1. POLICY MANAGEMENT AGREEMENT

As part of the Restructuring, CLIC transferred its entire branch services network to the Company. In order to capitalize on the large customer base of CLIC, increase the utilization of our customer service network and increase our revenue sources, CLIC engaged the Company to provide policy administration services relating to the retained policies (non-transferred policies) after the restructuring.

The Company and CLIC entered into a policy management agreement on September 30, 2003 which sets out the responsibilities and duties of the Company to CLIC under these policy administration arrangements. Pursuant to the policy management agreement, the Company agreed to provide policy administration services to CLIC relating to the non-transferred policies, including day-to-day insurance administration services, customer services, statistics and file management, invoice and receipt management, reinstatement of non-transferred policies, applications for and renewal of riders to the non-transferred policies, reinsurance, and handling of disputes relating to the non-transferred policies. The Company acts as a service provider under the agreement and does not acquire any rights or assume any obligations as an insurer under the non-transferred policies.

In consideration of the services provided by the Company under the agreement, CLIC will pay the Company a service fee based on the estimated cost of providing the services, to which a profit margin is added. The service fee is equal to, for each semi-annual payment period, the sum of (1) the number of non-transferred policies in force as of the last day of the period, multiplied by RMB8.0; (2) 2.50% of the actual premiums and deposits in respect of such policies collected during the period. For these purposes, the number of policies in-force for group insurance policies is equal to the number of individuals covered by the policies (excluding those whose policies have lapsed or matured).

The agreement is for an initial term expiring on December 31, 2005, and, subject to the Listing Rules, will be automatically renewed for successive one year terms, unless terminated by either party by giving to the other party not less than 180 days prior written notice to terminate the agreement at the expiration of the then current term.

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2. ASSET MANAGEMENT AGREEMENTS

The AMC has entered into two asset management agreements, effective on November 30, 2003, one with the Company and one with CLIC. The terms of these two asset management agreements are the same. The material terms of the asset management agreement between CLIC and the AMC are set forth below.

Under the asset management agreement between the AMC and CLIC, the AMC agreed to invest and manage assets entrusted to it by CLIC on a discretionary basis, but subject to the investment guidelines and instructions given by CLIC. In accordance with the agreement, CLIC retains the title of the entrusted assets and the AMC is authorized to operate the accounts associated with the entrusted assets for and on behalf of CLIC.

In consideration of the AMC s services provided under the agreement, CLIC agreed to pay the AMC a monthly service fee. The monthly service fee payable is composed of two parts: (1) the aggregate of the monthly service fee for each specified category of assets and (2) the aggregate of the additional service fee for specific transactions made during that month. The monthly service fee is calculated on a monthly basis, by multiplying the average of net asset value of the assets in each such category under management at the end of any given month and the end of the previous month by the applicable annual rate for that month and divided by 12. The monthly additional service fee comprises service fees for (1) additional term deposits and (2) additional securities purchased in primary markets made during that month, and is calculated by multiplying the net additional asset value of the assets in such category at the end of that particular transaction month by the applicable annual rate.

The AMC will produce an annual report, within 90 days of the conclusion of each fiscal year, setting out the average investment rate of return of the assets managed by it. If the average investment rate of return for the assets managed for a particular year exceeds the investment rate of return as previously agreed between CLIC and the AMC for those assets for that year, by at least ten basis points, the AMC will be entitled to an annual performance bonus fee, the amount of which will be agreed between CLIC and the AMC but shall not exceed 50% of the annual service fees for that year. If the average investment rate of return is less than the investment rate of return as agreed between CLIC and the AMC by at least ten basis points, the AMC will be required to rebate a portion of its fee, the amount of which shall not exceed 25% of the annual service fees for that year.

The service fee under the asset management agreement was determined by CLIC and the AMC based on an analysis of the cost of providing the service, market practice and the size and composition of the asset pool to be managed.

The agreement is for an initial term expiring on December 31, 2005, and, subject to the Listing Rules, will be automatically renewed for successive three years terms, unless terminated by either party giving to the other party not less than 90 days prior written notice to terminate the agreement at the expiration of the then current term.

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3. PROPERTY LEASING AGREEMENT

The Company entered into a property leasing agreement with CLIC on September 30, 2003, pursuant to which CLIC agreed to lease to the Company (1) 833 properties owned by CLIC, its subsidiaries and affiliates (Owned Properties) and (2) 1,764 properties which CLIC is entitled to sublet (Leased Properties) for an aggregate initial annual rent (payable quarterly) of approximately RMB335 million. The properties occupied by the Company are mainly used as its office premises. The annual rent payable by the Company to CLIC in relation to CLIC s Owned Properties is determined by reference to market rent or, where there is no available comparison, by reference to the costs incurred by CLIC in holding and maintaining the properties, plus a margin of approximately 5%. The annual rent payable by the Company to CLIC in relation to CLIC s Leased Properties will be determined by reference to the rent payable under the head lease plus the actual costs incurred by CLIC arising in connection with the subletting of the properties.

The agreement is for a fixed term expiring on December 31, 2005, unless otherwise required by the Listing Rules. In relation to CLIC s Leased Properties, the term of such properties will expire at the expiration of the respective head leases, and in any event, will expire no later than December 31, 2005.

Application for waiver from The Hong Kong Stock Exchange

Pursuant to the Listing Rules of the Hong Kong Stock Exchange, the above connected transactions would normally require full disclosure and with prior approval by independent shareholders and/or the Hong Kong Stock Exchange on each occasion it arises, depending on the nature and value of the transaction. The Company, in the course of its application for the listing, has submitted the application for waiver from the Hong Kong Stock Exchange regarding to the full disclosure of the above transactions required by the Listing Rules, and the Hong Kong Stock Exchange has conditionally waived the ongoing disclosure responsibilities of the Company.

Figures for the year ended December 31, 2004

The aggregate value of each of the above connected transactions for the year ended December 31, 2004 is set out below:

Connected Transactions	**The aggregate value for the year ended December 31, 2004** ***(RMB million)***
1. Policy management agreement	1,667
2. Asset management agreement	
(a) between CLIC and the AMC	73
(b) between the AMC and the Company	139
3. Property leasing agreement	335

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Confirmation of independent non-executive Directors:

Independent non-executive Directors have reviewed the above connected transactions and confirmed that the transactions were:

(i) entered into in the ordinary and usual course of the business of the Company;

(ii) conducted either on normal commercial terms or on terms that are fair and reasonable so far as our independent shareholders are concerned;

(iii) entered into either in accordance with the agreements governing those transactions or where there are no such agreements, on terms no less favorable than those available to or from independent third parties; and

(iv) within the relevant annual caps as agreed with the Hong Kong Stock Exchange.

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Stringent

Control, High Management Standards

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Directors, Supervisors and Other Senior Management

DIRECTORS

Executive Directors

Wang Xianzhang, aged 62, is Chairman of the Board and President and has been responsible for the overall management of the Company since 2003. Mr. Wang is also the president of China Life Insurance (Group) Company, Chairman of China Life Asset Management Company Limited Chairman of the Insurance Industry Association of China and Vice Chairman of the Insurance Institute of China. President of CLIC since 2000, Mr. Wang served as Chairman of the board of directors and President of China Insurance Co. Ltd. between 1998 and 2000. The other positions he has occupied over the years include Vice Chairman of the board of directors and President of China Insurance H.K. (Holding) Co. Ltd, Vice President of People s Insurance Company of China (PICC), Vice President of PICC (Group), and General Manager of PICC s Liaoning branch. Mr. Wang graduated from Liaoning University of Finance and Economics (now Northeast University of Finance and Economics) with a major in Foreign Economics and Trade in 1965.

Miao Fuchun, aged 58, became a Director and Vice President of the Company in 2003 and Vice Chairman of China Life Asset Management Company Limited. Before joining the Company, Mr. Miao served as Vice President of CLIC from 1999 to 2003, and as Director of the Central Finance and Economy Office from 1995 to 1999. Mr. Miao s other positions include Director of the Administrative Office of MOFTEC (now the Ministry of Commerce), and Deputy Director and Department Chief of the Administrative Office of the State Council. Mr. Miao, a senior economist, enrolled in Renmin University in 1965, earning both Bachelor s and Master s degrees in Economics.

Non-Executive Directors

Wu Yan, aged 44, has been the Non-Executive Director of the Company since 2003. Mr. Wu also serves as a vice President of CLIC and President and Director of China Life Asset Management Company Limited. He served as party secretary of the Central Finance League and President of the National Finance Youth Union from 1998 to 2003. Prior to that, he served as the vice minister of Central Communist Youth League organization department, party secretary of the Communist Youth League of Xinjiang Autonomous Region, a member of the standing committee of Beortalar Autonomous County Communist Party Committee; and party secretary of the city of Bole. He graduated in 1981 from Xinjiang College of Finance and Economics with a major in finance. In 2002, he graduated from the China Academy of Social Sciences with a Ph.D. in National Economics.

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Shi Guoqing, aged 53, has been the Non-Executive Director of the Company since 2004. Mr. Shi is also the Vice President of China Life Insurance (Group) Company, Chairman of China Life Insurance (Overseas) Co., Ltd., Director of China Life-CMG and Chairman of China Life Investment Management Company Limited. Before taking these positions, he served as Assistant to General Manager of CLIC from 1999 to 2003. Prior to that, Mr. Shi acted as Deputy General Manager of PICC Life from 1995 to 1999. From 1983 to 1995, he acted as a Section Chief of Overseas Business Division 2 and Deputy Chief of Overseas Business Division 1 of PICC, Deputy General Manager and General Manager of China Insurance Co. Ltd. Macao Branch, and Executive Deputy General Manager of International Department of PICC. Mr. Shi a senior economist, graduated from Foreign Trade Business College of Beijing in 1976. During his 28 years in the insurance industry, he has accumulated extensive experiences both in the operation and management of insurance businesses.

Independent Non-Executive Directors

Long Yongtu, aged 61, was appointed as the Independent Non-Executive Director of China Life Insurance Company Limited in 2003 and is also the General Secretary of Boao Asian Forum. Before leaving government in early 2003, Mr. Long served as Vice Minister and Chief Negotiation Representative of MOFTEC (now the Ministry of Commerce) from 1997 onwards. Mr. Long also served as Assistant to the Minister, Director of International Trade and Economic Affairs, and as Director of International Communication in the same ministry. Between 1980 and 1991, Mr. Long served as the Senior Officer with the Regional Project Department of UNDP, Deputy Representative of the UNDP Korean Delegate Office and Deputy Director of China International Center for Economic and Technical Exchanges. A 1965 graduate of the Foreign Language Department of Guizhou University, Mr. Long studied at the London School of Economics between 1973 and 1974.

Chau Tak Hay, aged 62, became the Independent Non-Executive Director of China Life Insurance Company Limited in 2003. In 2002, Mr. Chau was appointed as the Special Consultant regarding WTO matters to MOFTEC (now the Ministry of Commerce). Prior to this, Mr. Chau occupied a number of important positions in the Hong Kong Government. They include Secretary for Commerce and Industry, Secretary for Broadcasting, Culture and Sport, Director General of Trade, and Secretary for Health and Welfare. Mr. Chau graduated from the University of Hong Kong in 1967.

Sun Shuyi, aged 64, became the Independent Non-Executive Director of the Company in 2004. He has served in the State-owned Asset Supervision and Administration Commission (Sub-ministry level) under the State Council and the Tenth Session of the Chinese People s Political Consultative Conference. He was the Deputy Secretary and Deputy Department Head of the Central Enterprise Working Committee from 1999 to 2003. From 1993 to 1999, Mr. Sun acted as the Deputy Office Head and Deputy Director of the Personnel Department of the Central Guidance Panel on Financial Affairs and a member of the Central Large Enterprise Working Committee From 1988 to 1993, he was the Deputy Head of the Finance Management Department and the Deputy Head and Head of the Production System Department of the State System Reform Commission Mr. Sun graduated from the University of Science and Technology of China in 1963 and is a Senior Engineer and Certified Public Accountants.

Cai Rang, aged 47, became the Independent Non-Executive Director of the Company in 2004. He is the Deputy Secretary of the Communist Party of the Central Iron and Steel Research Institute in China (CISRI) and the Vice Chairman and President of Advanced Technology & Materials Company Limited Before this, he was the Deputy Chief Economist, Assistant to Director and Deputy Director of CISRI from 1987 to 2001, and Assistant Engineer from 1982 to 1984. In 1982, Mr. Cai graduated from the Machinery Faculty of the Northeastern Industry University majoring with a Bachelor s degree in Machinery Architecture. He pursued post graduate studies at the Buffalo School of Management of New York State University

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from 1984 to 1986 to get a MBA degree. He pursued on-the-job studies in the School of Business Administration of Remin University of China and obtained a Doctor s Degree in Business Administration from 1997 to 2001. Mr. Cai is a Senior Economist.

Fan Yingjun, aged 60, became the Independent Non-Executive Director of the Company in 2004. He is the Chairman of Xinxing Pipes Holdings Company (Xinxing Pipes) He acted as the General Manager of China Xinxing Corporation Group (China Xinxing) and Chairman of Xinxing Pipes since 1996. In 1997, he became the Deputy General Manager of China Xinxing and Chairman of Xinxing Pipes. Before that, he served as a Power Plant Technician of Anshan Iron and Steel Group Corporation From 1975 to 1993, Mr. Fan was the technician of the Engineering Guidance Department Section Head, Deputy Chief Engineer and Factory Director of the 2672 factory From 1993 to 1996, he acted as the Deputy General Manager of China Xinxing Group Corporation, General Manager of Xinxing Pipes & Associates and Chairman and Secretary of Communist Party of Xinxing United Pipes Group Corporation Mr. Fan has acquired extensive operational and management experience in the 36 years of working in industrial enterprises in the PRC. He graduated from Xi an Jiaotong University in 1968 majoring in Engineering Physics.

Board of Directors Secretary

Liu Tingan, aged 43, became the Secretary of the Board of Directors of the Company since 2003. From 2000 to 2004, he acted as the General Manager of Capital Allocation Division of CLIC. From 1997 to 2000, he served as the Branch Director of Hainan Development Bank Guangzhou Branch, while from 1994 to 1997 as the Assistant President of Hainan Development Bank Headquarter. Prior to that, he was the Division Chief and Deputy Division Chief of the Planning Division and Integrated Planning and Pilot Division of the State System Reform Commission. Mr. Liu graduated from Jiangxi Finance and Economic College Remin University of China and obtained Bachelor s and Master s degrees in Economics respectively. From 1990 to 1991, he studied in St. Edmund School of Oxford University in Britain. Mr. Liu is a Senior Economist.

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SUPERVISORS

Liu Yingqi, aged 46, is the Chairman of the Board of Supervisors of the Company Between 1998 and 2003, Ms. Liu was General Manager of CLIC s Group Insurance Department and Vice General Manager of CLIC s Anhui branch. Earlier in her career, Ms. Liu worked with PICC s Anhui branch, where she served as both Division Chief of the Accident Insurance Division and Deputy Division Chief of the Life Insurance Division. A 1982 BA in Economics from Anhui University in 1982, Ms. Liu has 18 years operational and management experience in the life insurance industry in China.

Wu Weimin, aged 53, has been a Supervisor of the Company and the General Manager of Compliance Department since 2003. Prior to assuming this role, Mr. Wu served at CLIC where he acted as Disciplinary Committee Deputy Secretary; Director of the Supervision Office, Deputy General Manager of the Organization Department, and Vice General Manager of the Personnel Education Department since 1998. Earlier in his career, Mr. Wu served as Vice General Manager of the PICC (Group) s Human Resources Department and Division Chief of the Compensation Division between 1995 and 1998. Before entering the insurance industry, Mr. Wu held a position in the Ministry of Communications Labor Wages Bureau. In 2000, he studied insurance at the China Insurance Management Staff Institute.

Jia Yuzeng, aged 42, has been the Supervisor of the Company since 2005. Since 2004, he has been the General Manager and the Deputy Director of the Company s Employee Union Affairs Department. During the period from 1988 to 2004, Mr. Jia has been acting as supervisor (at division chief level), supervisory commissioner (at director level) and later as supervisory commissioner (at deputy director level) of the Ministry of Supervision of the People s Republic of China. Mr. Jia previously worked for Beijing No. 2 Foods Corporation from 1980 to 1988. Mr. Jia Yuzeng graduated from Beijing Normal University in the PRC in 1990 and obtained a master degree in business administration from Hong Kong Open University in 2003.

Ren Hongbin, aged 41, has been the Supervisor of the Company since 2004. He has been the General Manager of China National Machinery & Equipment Corporation (Group) since 2001. Since 1986, he had been the Deputy Secretary of the Youth League of Beijing University of Agricultural Engineering and the Sales Executive and Representative in Bangladesh, and General Manager of the Fifth Division of China Engineering and Agricultural Machinery Import & Export Corporation (CEAMIEC), General Manager of Beijing Hualong Import & Export Company He was also Assistant to the General Manager, General Manager of the Turnkey Project Department, Deputy General Manager and General Manager of CEAMIEC. Mr. Ren holds a Bachelor s Degree of Engineering from Beijing University of Agricultural Engineering University. He is a Senior Economist.

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Tian Hui, aged 53, has been the Supervisor of the Company since 2004. Since 2000, he has been the Director and Deputy Secretary of the Communist Party of China Coal International Engineering Research Institute From 1998 to 2000, he was the Deputy Director, Director and Deputy Secretary of the Communist Party of the Beijing Coal Design Institute From 1982 to 1998, Mr Tian was the Deputy Department Head, Department Head and Deputy Director of Shenyang Design Institute of the Ministry of Coal Industry. Mr Tian obtained Bachelor s and Doctor s degrees from Fuxin Minery School and China University of Mining & Technology Beijing respectively and is a Senior Engineer.

OTHER SENIOR MANAGEMENT

Wan Feng, aged 46, has been the Vice President of the Company since 2003. Before joining the Company, Mr. Wan was the Vice President of CLIC, serving as General Manager of its Shenzhen branch; and as the Director of China Life-CMG, a position he has occupied since 1999. Other positions in Mr. Wan s 23-year career in the insurance industry include General Manager of PICC Life s Shenzhen branch from 1997 to 1999, and as the Director and Senior Vice President of the Hong Kong branch of Tai Ping Life Insurance Company. Mr. Wan has also served as Assistant President of the Hong Kong branch of CLIC, and Deputy Chief of the Life Insurance Division of PICC s provincial branch in Jilin. He received a BA Economics degree from Jilin College of Finance and Trade, an MBA from City University of Hong Kong, and a Doctor s Degree in Finance from Nankai University in Tianjin.

Lin Dairen, aged 46, was appointed the Vice President of the Company in 2003. Prior to assuming this position, Mr. Lin served as General Manager of CLIC s Jiangsu branch from 1999 to 2003, and as a Vice General Manager of PICC Life s, Jiangsu branch from 1996 to 1999. Mr. Lin s earlier career included roles as a Vice Division Chief and later Division Chief of the Life Insurance Division of PICC s Jiangsu Branch. Mr. Lin brings to the Company 23 years extensive operations and management experience in the insurance industry and holds a Bachelor s degree in Medicine from Shandong Province Weifang Medical School issued in 1982.

Li Liangwen, aged 53, became the Vice President of the Company in 2003. Mr. Li s earlier career highlights include General Manager of CLIC s Product Development Department from 2000 to 2003, and Vice General Manager of CLIC s Hebei branch from 1996 to 2000. Before joining CLIC, Mr. Li served as Vice General Manager of PICC s Hebei branch, General Manager of PICC s Qinhuangdao branch, and Vice President of China Insurance (U.K.) Limited. A 28 year veteran of the insurance industry in China, Mr. Li has four years overseas experience and graduated from Hebei Normal University in 1975 with a major in English.

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Liu Jiade, aged 42, assumed the Vice President position with the Company in 2003. Immediately prior to taking up this role, Mr. Liu had served as Vice Director of the Finance Bureau of the Ministry of Finance since 2000, and as a Department Chief in the National Debt Finance Bureau of the Ministry of Finance from 1998 to 2000. Other positions Mr. Liu has occupied during his career include Vice County Chief of the People s Government of Guan Tao County in Hebei Province, and as both Vice Department Chief and Department Chief in the Ministry of Finance s Commercial Finance Bureau. During his tenure at the Ministry of Finance, Mr. Liu gained extensive experience in the administration of assets, finance and taxation of insurance companies, banks, trust companies and securities houses. A 1984 graduate of Central Finance College (now Central University of Finance and Economics). Mr. Liu majored in Finance and Economics.

Daniel Joseph Kunesh, aged 60, served as the General Actuary of the Company since 2004. He joined Tillinghast-Towers Perrin since 1985. From 1993 to 2003, Mr. Kunesh was responsible for coordinating the international affairs relating to US GAAP and US Securities and Exchange Commission. He also overlooked the consultancy business on the financial reports, analyses and management systems of life insurance companies. From 1984 to 1985, he acted as the founder and President of Kunesh, Montgomery & Associates. From 1973 to 1983, Mr. Kunesh was a partner of KPMG Peat Marwick, where he participated in the audit of over 150 insurance companies and acquired extensive experience in the finance field. He is also experienced in the actuary field of life insurance. He served as the Associate Actuary of Franklin Life Insurance from 1970 to 1973 and the Assistant Actuary of John Hancock Mutual Life Insurance Company from 1967 to 1970. Mr. Kunesh was the Chairman of the Committee on Life Insurance Financial Reporting of the US Society of Actuaries from 1999 to 2000, and served as a member of the Advisory Committee of the National Association of Insurance Commissioners of the US from 1990 to 1992. He co-authored a book entitled US GAAP for Life Insurance Companies which was published in 2000. Mr. Kunesh obtained a Bachelor s degree in Business Administration from the University of Wisconsin in 1967 and a Master s degree in Actuary from the Northwestern University in 1969.

SIGNIFICANT DIFFERENCES IN CORPORATE GOVERNANCE PRACTICES FOR PURPOSES OF SECTION 303A.11 OF NYSE LISTED COMPANY MANUAL

As a Chinese company with H shares and ADS publicly traded on The Stock Exchange of Hong Kong Limited (the HKSE) and New York Stock Exchange (NYSE), respectively, the Company must comply with the corporate governance standards provided by Chinese company law and other laws, as well as the securities laws and regulations in Hong Kong and United States and the listing requirements of the HKSE and NYSE that are applicable to the Company. The description set forth below includes, for purpose of Section 303A.11 of the NYSE Listed Company Manual, a summary of significant ways the Company s corporate governance practices differ from those followed by U.S. domestic companies under NYSE rules.

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Board Independence The Company identifies its independent directors in accordance with the qualifications provided by relevant Chinese and Hong Kong regulations, which prohibit directors from having, among other things, specified interests in the Company s securities or business, relationships with the management and financial dependence on the Company. These tests vary in certain respects with those set forth under Section 303A.02 of the NYSE Listed Company Manual.

Section 303A.02 of the NYSE Listed Company Manual also requires the board of directors to affirmatively determine that the director has no material relationship with the company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company), and requires companies to identify which directors are independent and disclose the basis for that determination. Under the Rules Governing the Listing of Securities on The Stock Exchange Hong Kong Limited (the HKSE Listing Rules), each independent non-executive director must provide an annual confirmation of his independence to the listed company.

Section 303A.01 of the NYSE Listed Company Manual provides that a U.S. domestic issuer must have a majority of independent directors, unless more than 50% of such issuer s voting power is controlled by an individual, a group or another company (a controlled company). Because more than 70% of the Company s voting power is controlled by CLIC, the Company, as with controlled U.S. domestic companies, would not be required to comply with this independent board requirement. Nevertheless, a majority of the Company s directors are independent non-executive directors as construed under Chinese or Hong Kong regulations.

Non-management directors of U.S. domestic companies are required by Section 303A.03 of the NYSE Listed Company Manual to meet at regularly scheduled executive sessions without management. The Company is not required by Chinese or Hong Kong laws or requirements to, and currently does not hold, such sessions.

Nominating/Corporate Governance Committee Under Section 303A.04 of the NYSE Listed Company Manual, a U.S. domestic company must have a nominating/corporate governance committee composed entirely of independent directors with a written charter that addresses certain specified responsibilities, unless it is a controlled company . The Company, as with controlled U.S. domestic companies, is not required under NYSE rules to have such a nominating/corporate governance committee. The Company is not required by Chinese or Hong Kong laws or regulations to, and currently does not have, a nominating/corporate governance committee.

Compensation Committee Section 303A.05 of the NYSE Listed Company Manual requires a U.S. domestic company to have a compensation committee composed entirely of independent directors with a written charter that addresses certain specified duties, unless it is a controlled company . The Company, as with controlled U.S. domestic companies, is not required under the NYSE rules to have such a compensation committee. The Company has established a remuneration committee in accordance with the HKSE Listing Rules, comprised of a majority of non-executive directors as construed under those rules. The remuneration committee is mainly responsible for the formulation of training and remuneration policy for the senior management of the Company.

Audit Committee The NYSE rules set forth two levels of audit committee standards for U.S. domestic companies and foreign private issuers. As a foreign private issuer, the Company is not required to comply, until July 31, 2005, with the audit committee requirements under Section 303A.06 of the NYSE Listed Company Manual, such as audit committee independence and certain functions and powers, and is not subject to the additional qualifications, independence, function and other requirements for U.S. domestic companies provided under Section 303A.07 of the NYSE Listed Company Manual.

The Company has established an audit committee in accordance with the HKSE Listing Rules, comprised entirely of independent non-executive directors as construed under those rules. The audit committee is mainly responsible for the review and supervision of the Company s financial reporting procedures and internal control

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system. The Company plans to comply with the independence and other requirements of Section 303A.06 of the NYSE Listed Company Manual by July 31, 2005.

Corporate Governance Guidelines Under Section 303A.09 of the NYSE Listed Company Manual, a U.S. domestic company must adopt and disclose corporate governance guidelines that addresses specified key subjects. The Company is not required by Chinese or Hong Kong laws or requirements to, and currently does not, have such corporate governance guidelines. However, the Company addresses several of the key subjects required by NYSE Listed Company Manual to be included the corporate governance guidelines in its articles of association, Rules of Procedures for Board of Directors, Rules of Internal Control and other internal corporate documents.

In addition, under the HKSE Listing Rules, the Company is expected, unless specifically disclosed in its interim and annual reports from 2005, to comply with the code provisions of Code on Corporate Governance Practices, which set out the principles of good corporate governance for issuers.

Code of Business Conduct and Ethics Section 303A.10 of the NYSE Listed Company Manual requires U.S. domestic companies to adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers. The Company has adopted a Code of Business Conduct and Ethics for Directors and Senior Officers and Code of Conduct for Employees. The Company has disclosed the form of the Code of Business Conduct and Ethics for Directors and Senior Officers in its annual report under Form 20-F for fiscal year ended December 31, 2003 and is required to disclose in the annual report under Form 20-F any waivers of the code for directors or executive officers. In addition, according to the HKSE Listing Rules, all of the directors of the Company must comply with the Model Code for Securities Transactions by Directors of Listed Companies that sets forth the required standards with which the directors of a listed company must comply in securities transactions of the listed company.

Certification Requirements Under Section 303A.12(a) of the NYSE Listed Company Manual, each U.S. domestic company Chief Executive Officer must certify to the NYSE each year that he or she is not aware of any violation by the company of NYSE corporate governance listing standards. There are no similar requirements under Chinese or Hong Kong laws or requirements.

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Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the Annual General Meeting of China Life Insurance Company Limited (the Company) will be held at Nathan Room, Lower Lobby, Conrad Hong Kong, Pacific Place, 88 Queensway, Hong Kong on Thursday, June 16, 2005 at 10:00 a.m. for the following purposes:

AS ORDINARY RESOLUTIONS:

1. To review and approve the Report of the Board of Directors of the Company for the year 2004;

2. To review and approve the Report of the Supervisory Committee of the Company for the year 2004;

3. To review and approve the audited Financial Statements of the Company and the Auditors Report for the year ended December 31, 2004;

4. To authorize the Board of Directors to determine the remuneration of the Directors and Supervisors;

5. To re-appoint PricewaterhouseCoopers Zhong Tian Certified Public Accountants Co., Ltd., Certified Public Accountants, and PricewaterhouseCoopers, Certified Public Accountants as the PRC auditors and international auditors of the Company, respectively for the year 2005 and to authorize the Board of Directors to determine their remuneration.

AS SPECIAL RESOLUTIONS:

6. As special business, to consider and, if thought fit, pass the following resolution relating to amendments of the Articles of Association of the Company as special resolution:

That the Articles of Association of the Company be amended as follows and to authorize the Board of Directors to complete the registration procedures with the relevant government authorities of the PRC:

(1) Article 57 be expanded with Item (9) as follows:

57. (9) sets out the procedures of voting by way of poll and the rights of shareholders to demand for a poll pursuant to the applicable rules.

(2) The words 5-13 which appear twice in Article 88 be changed to 9 .

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(3) Article 93 be deleted in its entirety and replaced by the following:

93. Meetings of the Board of Directors can be divided into regular meetings and extraordinary meetings. Regular meetings shall be held at least four times per year at approximately quarterly intervals. Regular meetings shall be convened by the Chairman by serving a notice to all Directors at least 14 days before the proposed date of the meeting. Regular meetings do not include the practice of obtaining board consent through the circulation of written resolutions. In case of emergency, an extraordinary meeting may be convened upon request by more than one third of all Directors, the Chairman or General Manager of the Company.

(4) Article 94 be deleted in its entirety and replaced by the following:

94. Notices of regular and extraordinary meetings of the Board of Directors may be delivered by hand, via fax, by speed post or registered post. Deadlines for serving the notices: at least 14 days in advance for regular meetings, and at least two days in advance for extraordinary meetings.

(5) Insert the following at the end of Article 100:

The Directors have the right to inspect documents and relevant information of the Board of Directors, such as resolutions and minutes of meetings of the Board of Directors. Upon receiving a reasonable request from a Director, the Company shall make available the relevant meeting minutes for a reasonable period for the inspection by such Director.

(6) The words 3-7 in Article 111 be amended to 5 .

7. As special business, to consider and, if thought fit, pass the following resolution relating to the granting of a general mandate for the Board of Directors to issue new shares as special resolution:

That:

(1) the Board of Directors be and is hereby authorized to make such amendments to the Articles of Association of the Company as it thinks fit so as to increase the registered capital of the Company and reflect the new capital structure of the Company upon the allotment and issuance of shares of the Company as contemplated in sub-paragraph (2) of this Resolution;

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(2) the Board of Directors be and is hereby granted, during the Relevant Period, an unconditional general mandate to separately or concurrently issue, allot and deal with additional domestic shares and overseas listed foreign shares of the Company, and to make or grant offers, agreements and options in respect thereof, subject to the following conditions:

(i) such mandate shall not extend beyond the Relevant Period save that the Board of Directors may during the Relevant Period make or grant offers, agreements or options which might require the exercise of such powers after the end of the Relevant Period;

(ii) the aggregate nominal amount of the domestic shares and overseas listed shares issued and allotted or agreed conditionally or unconditionally to be issued and allotted (whether pursuant to an option or otherwise) by the Board of Directors otherwise than pursuant to a Rights Issue or any option scheme or similar arrangement, shall not exceed 20% of each of the aggregate nominal amount of the domestic shares and overseas listed shares of the Company in issue as at the date of this Resolution; and the Board of Directors will only exercise its power under such mandate in accordance with the Company Law of the People s Republic of China (PRC) and the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (as amended from time to time) and only if all necessary approvals from the China Securities Regulatory Commission and/or other relevant PRC government authorities are obtained;

(3) for the purposes of this Resolution:

Relevant Period means the period from the passing of this Resolution until the earliest of:

(i) the conclusion of the next annual general meeting of the Company following the passing of this Resolution; or

(ii) the expiration of the 12-month period following the passing of this Resolution; or

(iii) the date on which the authority sets out in this Resolution is revoked or varied by a special resolution of the shareholders of the Company in a general meeting; and

Rights Issue means the allotment or issue of shares in the Company or other securities which would or might require shares to be allotted and issued pursuant to an offer made to all the shareholders of the Company (excluding for such purpose any shareholder who is resident in a place where such offer is not permitted under the law of that place) and, where appropriate, the holder of other equity securities of the Company entitled to such offer, pro rata (apart from fractional entitlements) to their existing holdings of shares or such other equity securities; and

(4) contingent on the Board of Directors resolving to issue shares pursuant to sub-paragraph (2) of this Resolution, the Board of Directors be and is hereby authorized to approve, execute and do or procure to be executed and done, all such documents, deeds, and thing as it may consider necessary in connection with the issue of such new shares (including, without limitation, determining the time and place of issue, making all necessary applications to the relevant authorities, entering into an underwriting agreement (or any other agreements), determining the use of proceeds and making all necessary filings and registrations with the relevant PRC, Hong Kong and other authorities, including but not limited to registering the increased registered capital of the Company with the relevant authorities in the PRC in accordance with the actual increase of capital as a result of the issuance of shares pursuant to sub-paragraph (2) of this Resolution.

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By Order of the Board of Directors

Heng Kwoo Seng
Company Secretary

April 28, 2005

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Notes:

1. Amendments to Articles of Association of the Company

(1) The amendments to Articles 88 and 111 set out in the special resolution under paragraph 6 above was proposed to reflect the definite number of Directors and Supervisors of the Company as a result of the promulgation of Rules 86 and 104 of the Special Regulations on the Articles of Associations of Overseas Listed Companies, which stipulates that there shall be a definite number, instead of a range, of Directors and Supervisors.

(2) The amendments to Articles 57, 93, 94 and 100 set out in the special resolution under paragraph 6 above was proposed as a result of the promulgation of the Code on Corporate Governance Practices (the Code) and the rules on the Corporate Governance Report by The Stock Exchange of Hong Kong Limited in November 2004 and the relevant amendments introduced to the Listing Rules. Save for certain provisions with transitional arrangements, the amended Listing Rules came into force on January 1, 2005. Pursuant to the amendments to the Listing Rules, listed companies shall comply with the relevant corporate governance requirements stipulated in the code provisions of the Code. As such, amendments to the Articles of Association of the Company were proposed to reflect such changes.

(3) The special resolution relating to the amendments to the Articles of Association at the Annual General Meeting is subject to the approval of the China Insurance Regulatory Commission of the PRC and the report to the China Securities Regulatory Commission of the PRC.

2. Grant of general mandate to issue new shares

The purpose of the proposed special resolution under paragraph 7 above is to seek approval from the shareholders in the Annual General Meeting to grant a mandate to the Board of Directors to allot and issue new shares subject to the applicable laws, rules and regulations.

The Board of Directors wishes to state that they have no immediate plan to issue any new shares.

3. Eligibility for attending the Annual General Meeting

Holders of H Shares of the Company whose names appear on the register of members of the Company kept at the Share Registrar of the Company, Computershare Hong Kong Investor Services Limited, and holder of Domestic Shares whose name appears on the domestic shares register maintained by the Company at the close of business of Tuesday, May 17, 2005 are entitled to attend and vote at the Annual General Meeting.

To qualify for attendance and vote at the Annual General Meeting to be held on Thursday, June 16, 2005, all transfers of H Shares accompanied by the relevant share certificates must be lodged with the Company s Share Registrar, Computershare Hong Kong Investor Services Limited of Rooms 1712-1716, 17th Floor, Hopewell Centre, 183 Queen s Road East, Hong Kong not later than 4:00 p.m. on Friday, May 13, 2005.

4. Proxy

(1) Each shareholder entitled to attend and vote at the Annual General Meeting may appoint one or more proxies in writing to attend and vote on his behalf. A proxy need not be a shareholder of the Company. Any shareholder who wishes to appoint a proxy should read the 2004 annual report which will be dispatched to shareholders on or before April 30, 2005.

(2) The instrument appointing a proxy must be in writing by the appointor or his attorney duly authorized in writing, or if the appointor is a legal entity, either under seal or signed by a director or a duly authorized attorney. If that instrument is signed by an attorney of the appointor, the power of attorney authorizing that attorney to sign or other document of authorization must be notarized. To be valid, for holders of Domestic Shares, the form of proxy and notarized power of attorney or other document of authorization must be delivered to the registered office of the Company not less than 24 hours before the time appointed for the Annual General Meeting. To be valid, for holders of H Shares, the above documents must be delivered to the Company s Share Registrar, Computershare Hong Kong Investor Services Limited of 46th Floor, Hopewell Centre, 183 Queen s Road East, Hong Kong, within the same period (Form of proxy for use at the Annual General Meeting is attached herewith).

(3) A proxy of a shareholder who has appointed more than one proxies may only vote on a poll.

5. Registration procedures for attending the Annual General Meeting

(1) A shareholder or his proxy should produce proof of identity when attending the Annual General Meeting. If a corporate shareholder appoints its legal representative to attend the meeting, such legal representative shall produce proof of identity and a copy of the resolution of the board of directors or other governing body of such shareholder appointing such legal representative to attend the meeting.

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(2) Shareholders of the Company intending to attend the Annual General Meeting in person or by their proxies should return the reply slip personally, by post or by facsimile for attending the Annual General Meeting to the registered office of the Company on or before Friday, May 27, 2005.

6. Closure of Register of Members

The register of members of the Company will be closed from Monday, May 16, 2005 to Thursday, June 16, 2005 (both dates inclusive).

7. Miscellaneous

(1) The Annual General Meeting is expected to be held for less than half a day. Shareholders who attend the meeting shall bear their own travelling and accommodation expenses.

(2) The registered office of the Company is: Level 23, China Life Tower, 16 Chaowai Avenue, Chaoyang District, Beijing, The People s Republic of China

Postal code:	100020
Contact office:	Investor Relations Department
Telephone No.:	86 10 8565 9527
	86 10 8565 9032
Facsimile No.:	86 10 8525 2218

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AUDITORS REPORT TO THE SHAREHOLDERS OF

CHINA LIFE INSURANCE COMPANY LIMITED

(Incorporated in the People s Republic of China with limited liability)

We have audited the financial statements of China Life Insurance Company Limited (the Company) and its subsidiary (the Group) as set out on pages 66 to 127 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other persons for the contents of this report.

BASIS OF OPINION

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at December 31, 2004 and of the Group s profit and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, April 18, 2005

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Consolidated Profit and Loss Account

For the year ended December 31, 2004

	Note	**2004**	2003
		RMB million	*RMB million*
REVENUES			
Gross written premiums and policy fees		**66,257**	69,334
Less: Premiums ceded to reinsurers		**(1,182)**	(1,571)
Net written premiums and policy fees		**65,075**	67,763
Net change in unearned premium reserves		**(67)**	(547)
Net premiums earned and policy fees		**65,008**	67,216
Net investment income	4.1	**11,317**	9,825
Net realised (loss)/gain on investments	4.1	**(237)**	868
Net unrealised (loss)/gain on trading securities	4.1	**(1,061)**	247
Other income		**1,779**	727
Total revenues		**76,806**	78,883
BENEFITS, CLAIMS AND EXPENSES			
Insurance benefits and claims			
Life insurance death and other benefits	12	**(6,816)**	(8,570)
Accident and health claims and claim adjustment expenses	12	**(6,418)**	(4,882)
Increase in future life policyholder benefits	12	**(33,154)**	(43,084)
Interest credited to policyholder contract deposits		**(4,320)**	(7,260)
Policyholder dividends and participation in profits		**(2,048)**	(1,207)
Amortisation of deferred policy acquisition costs	6	**(6,263)**	(5,023)
Underwriting and policy acquisition costs		**(1,472)**	(1,294)
Administrative expenses		**(6,585)**	(6,862)
Other operating expenses		**(131)**	(872)
Interest expense on bank borrowings			(7)
Statutory insurance levy		**(96)**	(85)
Total benefits, claims and expenses		**(67,303)**	(79,146)
Profit/(loss) before income tax expenses and minority interests	17	**9,503**	(263)
Income tax expenses	18	**(2,280)**	(1,180)
Profit/(loss) before minority interests		**7,223**	(1,443)
Minority interests		**(52)**	15
Profit/(loss) attributable to shareholders		**7,171**	(1,428)
Dividends			
Basic and diluted earnings/(losses) per share	20	**RMB0.27**	RMB(0.07)

Consolidated Balance Sheet

As at December 31, 2004

	Note	**2004**	2003
		RMB million	*RMB million*
ASSETS			
Investments			
Fixed maturity securities		**150,234**	70,604
Held-to-maturity securities, at amortised cost	*4.4*	**79,603**	
Non-trading securities, at estimated fair value	*4.2*	**69,791**	70,604
Trading securities, at estimated fair value		**840**	
Equity securities	*4.3*	**17,271**	10,718
Non-trading securities, at estimated fair value	*4.2*	**12,597**	5,550
Trading securities, at estimated fair value		**4,674**	5,168
Term deposits	*4.6*	**175,498**	137,192
Statutory deposits restricted	*4.7*	**4,000**	4,000
Policy loans		**391**	116
Securities purchased under agreements to resell	*4.8*	**279**	14,002
Cash and cash equivalents		**27,217**	42,616
		374,890	279,248
Other assets			
Accrued investment income	*9*	**5,084**	2,875
Premiums receivables	*10*	**3,912**	2,801
Reinsurance assets	*7*	**1,297**	997
Deferred policy acquisition costs	*6*	**32,787**	24,868
Property, plant and equipment, net of accumulated depreciation	*8*	**12,250**	12,008
Other	*11*	**3,451**	5,923
		58,781	49,472
Total assets		**433,671**	328,720

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	Note	2004	2003
		RMB million	*RMB million*
LIABILITIES AND EQUITY			
Liabilities			
Future life policyholder benefits		**117,301**	82,718
Policyholder contract deposits and other funds		**225,996**	154,731
Unearned premium reserves		**5,212**	5,382
Reserves for claims and claim adjustment expenses	*13*	**1,215**	814
Annuity and other insurance balances payable		**2,801**	638
Premiums received in advance		**2,447**	2,407
Policyholder dividends payable		**2,037**	1,916
Securities sold under agreements to repurchase	*14*		6,448
Other liabilities	*15*	**4,960**	6,891
Deferred tax liabilities	*18*	**4,371**	3,686
Statutory insurance fund	*16*	**429**	333
Total liabilities		**366,769**	265,964
Contingencies and commitments	*24, 25*		
Minority interests		**372**	320
Shareholders equity			
Share capital	*22*	**26,765**	26,765
Reserves	*23*	**31,573**	34,051
Retained earnings		**8,192**	1,620
Total shareholders equity		**66,530**	62,436
Total liabilities and equity		**433,671**	328,720

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Balance Sheet

As at December 31, 2004

	Note	**2004**	2003
		RMB million	*RMB million*
ASSETS			
Investments			
Fixed maturity securities		**149,950**	70,604
Held-to-maturity securities, at amortised cost	*4.4*	**79,603**	
Non-trading securities, at estimated fair value	*4.2*	**69,507**	70,604
Trading securities, at estimated fair value		**840**	
Equity securities	*4.3*	**17,271**	10,718
Non-trading securities, at estimated fair value	*4.2*	**12,597**	5,550
Trading securities, at estimated fair value		**4,674**	5,168
Term deposits	*4.6*	**175,498**	137,192
Statutory deposits restricted	*4.7*	**4,000**	4,000
Investment in subsidiary	*26*	**480**	480
Policy loans		**391**	116
Securities purchased under agreements to resell	*4.8*	**279**	14,002
Cash and cash equivalents		**26,578**	41,815
		374,447	278,927
Other assets			
Accrued investment income	*9*	**5,080**	2,875
Premiums receivables	*10*	**3,912**	2,801
Reinsurance assets	*7*	**1,297**	997
Deferred policy acquisition costs	*6*	**32,787**	24,868
Property, plant and equipment, net of accumulated depreciation	*8*	**12,245**	12,004
Other	*11*	**3,430**	5,916
		58,751	49,461
Total assets		**433,198**	328,388

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	Note	**2004**	2003
		RMB million	*RMB million*
LIABILITIES AND EQUITY			
Liabilities			
Future life policyholder benefits		**117,301**	82,718
Policyholder contract deposits and other funds		**225,996**	154,731
Unearned premium reserves		**5,212**	5,382
Reserves for claims and claim adjustment expenses	*13*	**1,215**	814
Annuity and other insurance balances payable		**2,801**	638
Premiums received in advance		**2,447**	2,407
Policyholder dividends payable		**2,037**	1,916
Securities sold under agreements to repurchase	*14*		6,448
Other liabilities	*15*	**4,937**	6,879
Deferred tax liabilities	*18*	**4,371**	3,686
Statutory insurance fund	*16*	**429**	333
Total liabilities		**366,746**	265,952
Contingencies and commitments	*24, 25*		
Shareholders equity			
Share capital	*22*	**26,765**	26,765
Reserves	*23*	**30,479**	32,972
Retained earnings		**9,208**	2,699
Total shareholders equity		**66,452**	62,436
Total liabilities and equity		**433,198**	328,388

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Consolidated Statement of Changes in Equity

For the year ended December 31, 2004

The Group	**Share capital**	**(Accumulated loss)/ retained earnings**	**Reserves**	**Total**
	RMB million	*RMB million*	*RMB million (Note 23)*	*RMB million*
As of January 1, 2003		(176,893)	1,430	(175,463)
Net loss		(1,428)		(1,428)
Appropriation to statutory reserve		(53)	53	
Unrealised loss, net of tax			(2,732)	(2,732)
Capital contribution by CLIC	20,000	179,994	17,358	217,352
Issue of shares	6,765		19,328	26,093
Share issue expenses			(1,386)	(1,386)
As of December 31, 2003	26,765	1,620	34,051	62,436
As of January 1, 2004	**26,765**	**1,620**	**34,051**	**62,436**
Net profit		**7,171**		**7,171**
Appropriation to statutory reserve		**(599)**	**599**	
Unrealised loss, net of tax			**(3,077)**	**(3,077)**
As of December 31, 2004	**26,765**	**8,192**	**31,573**	**66,530**

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Statement of Changes in Equity

For the year ended December 31, 2004

The Company	Share capital	(Accumulated loss)/ retained earnings	Reserves	Total
	RMB million	*RMB million*	*RMB million (Note 23)*	*RMB million*
As of July 1, 2003	20,000		17,533	37,533
Net Profit		2,752		2,752
Appropriation to statutory reserve		(53)	53	
Unrealised loss, net of tax			(2,556)	(2,556)
Issue of shares	6,765		19,328	26,093
Share issue expenses			(1,386)	(1,386)
As of December 31, 2003	26,765	2,699	32,972	62,436
As of January 1, 2004	**26,765**	**2,699**	**32,972**	**62,436**
Net Profit		**7,093**		**7,093**
Appropriation to statutory reserve		**(584)**	**584**	
Unrealised loss, net of tax			**(3,077)**	**(3,077)**
As of December 31, 2004	**26,765**	**9,208**	**30,479**	**66,452**

(11)

Postpaid Smart	2,086	1,893	193	10	1,491	1,401	90	6
Prepaid and Postpaid Blended	309	333	(24)	(7)	252	280	(28)	(10)

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

Prepaid service revenues consist mainly of charges for subscribers actual usage of their loads. Prepaid blended ARPU in the first nine months of 2007 was Php287, a decrease of 8%, compared to Php312 in the same period in 2006. The average outbound domestic and international voice as well as the average value-added services and inbound revenue per subscriber declined in the first nine months of 2007 compared to the same period in 2006, but were partly offset by an increase in the average text messaging revenue per subscriber. On a net basis, prepaid blended ARPU in the first nine months of 2007 was Php236, a decrease of 11%, compared to Php265 in the same period in 2006.

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

Gross monthly ARPU for postpaid subscribers increased by 10% to Php2,086 while net monthly ARPU increased by 6% to Php1,491 in the first nine months of 2007 as compared to Php1,893 and Php1,401 in the same period in 2006, respectively. Prepaid and postpaid monthly gross blended ARPU was Php309 in the first nine months of 2007, a decrease of 7%, compared to Php333 in the same period in 2006. Monthly net blended ARPU decreased by 10% to Php252 in the first nine months of 2007 as compared to Php280 in the same period in 2006.

Our quarterly prepaid and postpaid ARPUs for the nine months ended September 30, 2007 and 2006 were as follows:

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

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

We recognize a prepaid cellular subscriber as an active subscriber when that subscriber activates and uses the SIM card in the subscriber s handset, which contains pre-stored air time. The pre-stored air time, 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, All Text* or *Smart Connect*; and by receiving loads of Php2, Php5, Php10 and Php15 via *Pasa Load*, or through their handsets using *Smart Money*. Reloads have validity periods ranging from one day to two months, depending on the amount reloaded. A prepaid cellular subscriber is disconnected if the subscriber does not reload within four months after the full usage or expiry of the last reload. Our current policy is to recognize a prepaid subscriber as active only when the subscriber activates and uses the SIM card and reloads at least once during the month of initial activation or in the immediate succeeding month.

For Smart prepaid, the average monthly churn rate for the first nine months of 2007 and 2006 were 3.1% and 3.2%, respectively, while the average monthly churn rate for *Talk N Text* subscribers was 3.5% in the first nine months of 2007 and 2006.

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

Wireless Broadband, Satellite, VSAT and Other Services

Our revenues from wireless broadband, satellite, VSAT and other services consist 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 information and messaging services and service revenues generated from PLDT Global s subsidiaries. Gross revenues from these services for the first nine months of 2007 amounted to Php2,938 million, an increase of Php1,008 million, or 52%, from Php1,930 million in the same period in 2006 principally due to the growth in our wireless broadband business partially offset by lower satellite transponder rental revenues.

Smart Broadband offers a number of wireless broadband services and had 259,477 subscribers as at September 30, 2007 as compared to 92,922 in the same period in 2006. *SmartBro*, the fixed wireless broadband service of Smart linked to Smart s wireless broadband-enabled base stations, allows people to connect to the internet using an outdoor aerial antenna installed in a subscriber s home. Wireless broadband revenues contributed Php1,597 million in the first nine months of 2007, increasing by Php1,088 million, or 214%, from Php509 million in the same period in 2006.

We also offer *PLDT WeRoam*, a wireless broadband service, 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 this service are the inclusion of international roaming in key roaming countries all over the world and national WiFi roaming access. Principally targeted at the corporate market, this service had 12,239 subscribers as at September 30, 2007 compared to 8,000 subscribers as at September 30, 2006 and contributed Php92 million to our data revenues, increasing by 64% from Php56 million in the same period in 2006.

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 Php212 million, or 12%, to Php1,630 million in the first nine months of 2007 as compared to Php1,842 million in the same period in 2006 primarily due to a lower volume of postpaid handsets sold and a lower average revenue per handset and SIM-pack, partly offset by a higher volume of prepaid handsets and SIM-packs sold in the first nine months of 2007.

Other Income

All other income/gains such as rental income, gain on disposal of property and which do not fall under service and non-service revenues are included under this classification. Our wireless business segment generated other income of Php718 million in the first nine months of 2007, an increase of Php88 million, or 14%, as compared to Php630 million in the same period in 2006.

Expenses

Expenses associated with our wireless business in the first nine months of 2007 amounted to Php32,339 million, an increase of Php684 million, or 2%, from Php31,655 million in the same period in 2006. A significant portion of this increase was attributable to higher depreciation and amortization, rent and selling and promotions expenses partially offset by net financing gains. As a percentage of our total wireless revenues and other income, expenses associated with our wireless business accounted for 49% and 52% in the first nine months of 2007 and 2006, respectively.

Cellular business expenses accounted for 92% of our wireless business expenses, while wireless broadband, satellite, VSAT and other business expenses accounted for the remaining 8% of our wireless business expenses in the first nine months of 2007 and 2006.

The following table summarizes the breakdown of our wireless-related expenses for the nine months ended September 30, 2007 and 2006 and the percentage of each expense item to the total:

	Nine Months Ended September 30,					
					Increase (Decrease)	
	2007	**%**	**2006**	**%**	**Amount**	**%**
			(Unaudited)			
(in millions)						
Wireless services						
Depreciation and amortization	Php8,907	28	Php7,948	25	Php959	12
Rent	6,274	19	5,157	16	1,117	22
Compensation and benefits(1)	3,730	12	3,928	12	(198)	(5)
Cost of sales	3,443	11	3,600	11	(157)	(4)
Selling and promotions	2,836	9	2,032	7	804	40
Maintenance	2,635	8	2,688	9	(53)	(2)
Professional and other contracted services	1,632	5	1,332	4	300	23
Taxes and licenses	922	3	754	2	168	22
Communication, training and travel	773	2	632	2	141	22
Insurance and security services	564	2	620	2	(56)	(9)
Provisions	272	1	397	1	(125)	(31)
Amortization of intangible assets	124		236	1	(112)	(47)
Financing costs (gains)	(527)	(2)	1,845	6	(2,372)	(129)
Other expenses	754	2	486	2	268	55
Total	Php32,339	100	Php31,655	100	Php684	2

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

Depreciation and amortization charges increased by Php959 million, or 12%, to Php8,907 million in the first nine months of 2007, principally due to an increase in our depreciable asset base mainly transmission facilities, 3G and broadband networks, and broadband customer-deployed equipment.

Rent expenses increased by Php1,117 million, or 22%, to Php6,274 million on account of an increase in domestic fiber optic network, or DFON, facilities and transmission circuits leased by Smart from PLDT, as well as higher site rental expenses. As at September 30, 2007, we had 4,817 GSM cell sites and 7,401 base stations, compared with 4,365 GSM cell sites and 6,079 base stations as at September 30, 2006.

Compensation and benefits expenses decreased by Php198 million, or 5%, to Php3,730 million primarily due to lower accrued long-term incentive plan, or LTIP, benefit and MRP costs, partly offset by employees basic pay increase, higher accrued bonuses and other employee benefits of Smart. Smart and subsidiaries employee headcount increased by 20 to 5,294 in the first nine months of 2007 as compared to 5,274 in the same period in 2006. For further discussion on our LTIP, please see *Note 21 Employee Benefits* to the accompanying unaudited consolidated financial statements.

Cost of sales decreased by Php157 million, or 4%, to Php3,443 million due to lower average cost of handsets and SIMs. The breakdown of cost of sales for our wireless business for the nine months ended September 30, 2007 and 2006 is as follows:

	Nine Months Ended September 30,			
			Decrease	
	2007	**2006**	**Amount**	**%**
	(Unaudited)			
(in millions)				
Cost of cellular handsets and SIM-packs sold	Php3,321	Php3,454	(Php133)	(4)
Cost of satellite air time and terminal units	122	146	(24)	(16)
	Php3,443	Php3,600	(Php157)	(4)

Selling and promotion expenses increased by Php804 million, or 40%, to Php2,836 million due to higher advertising, promotion and commission expenses, partly offset by a decrease in printing cost of prepaid cards with the prevalence of e-loading.

Maintenance expenses decreased by Php53 million, or 2%, to Php2,635 million mainly due to lower repairs and maintenance costs for network facilities and IT software, and a decrease in fuel costs for power generation, partly offset by higher expenses for electricity consumption for cell sites.

Professional and other contracted services increased by Php300 million, or 23%, to Php1,632 million primarily due to higher expenses for contracted services, consultancy and technical services, market research and advisory fees.

Taxes and licenses increased by Php168 million, or 22%, to Php922 million primarily due to higher non-creditable input tax and the Philippine National Telecommunications Commission, or NTC, licenses and fees, partly offset by lower business-related taxes and licenses.

Communication, training and travel expenses increased by Php141 million, or 22%, to Php773 million mainly due to higher mailing and courier charges, and local travel expenses.

Insurance and security services decreased by Php56 million, or 9%, to Php564 million primarily due to the decrease in site security expenses and lower charges on insurance contracts.

Provisions decreased by Php125 million, or 31%, to Php272 million primarily due to a lower level of write-down of slow-moving handsets to net realizable values.

Amortization of intangible assets decreased by Php112 million, or 47%, to Php124 million mainly due to intangible assets relating to technology application arising from the acquisition of Wolfpac which was fully amortized by the end of 2006.

We recognized net financing gains of Php527 million in the first nine months of 2007 as compared to a net financing costs of Php1,845 million in the same period in 2006 due to lower accretion on financial liabilities due to the settlement of Piltel s debt complemented by the appreciation of the Philippine peso to the U.S. dollar in 2007, partly offset by lower interest income and capitalized interest. The breakdown of our financing costs (gains) for our wireless business for the nine months ended September 30, 2007 and 2006 is as follows:

	Nine Months Ended September 30,			
			Change	
	2007	**2006**	**Amount**	**%**
	(Unaudited)			
(in millions)				
Interest on loans and related items	Php1,205	Php1,274	(Php69)	(5)
Accretion on financial liabilities net	665	2,887	(2,222)	(77)
Financing charges	37	33	4	12
Dividends on preferred stock subject to mandatory redemption	14	113	(99)	(88)
Gain on derivative transactions net	(48)	(24)	(24)	100
Capitalized interest	(124)	(205)	81	(40)
Interest income	(860)	(911)	51	(6)
Foreign exchange gains net	(1,416)	(1,322)	(94)	7
	(Php527)	Php1,845	(Php2,372)	(129)

Other expenses increased by Php268 million, or 55%, to Php754 million primarily due to various business and operational-related expenses.

Provision for Income Tax

Provision for income tax increased by Php8,045 million, or 262%, to Php11,121 million in the first nine months of 2007 from Php3,076 million in the same period in 2006. In the first nine months of 2007, the effective tax rate for our wireless business was 33% as compared to 11% in the same period in 2006 mainly due to the recognition of deferred tax assets of Piltel in 2006.

Net Income

Our wireless business segment recorded a net income of Php22,947 million in the first nine months of 2007, a decrease of Php2,810 million, or 11%, over Php25,757 million registered in the same period in 2006 on account of higher provision for income tax largely due to Piltel s recognition of deferred tax assets in 2006.

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 the first nine months of 2007 totaled Php36,242 million, a decrease of Php387 million, or 1%, from Php36,629 million in the same period in 2006.

The following table summarizes revenues from our fixed line business for the nine months ended September 30, 2007 and 2006 by service segment:

	Nine Months Ended September 30,					
					Increase (Decrease)	
	2007	**%**	**2006**	**%**	**Amount**	**%**
			(Unaudited)			
(in millions)						
Fixed line services:						
Service Revenues						
Local exchange	Php11,889	33	Php12,862	35	(Php973)	(8)
International long distance	6,685	19	7,434	20	(749)	(10)
National long distance	4,864	13	5,117	14	(253)	(5)
Data and other network	11,180	31	9,420	26	1,760	19
Miscellaneous	1,046	3	1,068	3	(22)	(2)
	35,664	99	35,901	98	(237)	(1)

Non-Service Revenues	119		71		48	68
Other Income	459	1	657	2	(198)	(30)
Total Fixed Line Revenues and Other Income	Php36,242	100	Php36,629	100	(Php387)	(1)

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 nine months ended September 30, 2007 and 2006:

	Nine Months Ended September 30,		Increase (Decrease)	
	2007	**2006**	**Amount**	**%**
	(Unaudited)			
Total local exchange service revenues (in millions)	Php11,889	Php12,862	(Php973)	(8)

Number of fixed line subscribers	1,751,468	1,747,357	4,111	
Postpaid	1,454,678	1,443,893	10,785	1
Prepaid	296,790	303,464	(6,674)	(2)
Number of fixed line employees	8,057	9,110	(1,053)	(12)
Number of fixed line subscribers per employee	217	192	25	13

Revenues from our local exchange service decreased by Php973 million, or 8%, to Php11,889 million in the first nine months of 2007 from Php12,862 million in the same period in 2006. The decrease was primarily due to the appreciation of the peso which required us to make downward adjustments in our monthly local service rates and the change in subscriber base mix in favor of prepaid subscribers with lower average revenue per user. The percentage contribution of local exchange revenues to our total fixed line service revenues decreased to 33% in the first nine months of 2007 as compared to 36% in the same period in 2006.

Initially intended as an affordable alternative telephone service for consumers under difficult economic conditions, our prepaid fixed line services now form an important part of our overall churn and credit risk exposure management and subscriber retention strategy. PLDT currently has three prepaid fixed line services: *Teletipid* and *Telesulit,* both funded by consumable prepaid cards, and the *Telepwede*, which is funded by e-loads (available at Smart or PLDT e-load retailers). *Telepwede* subscribers are charged Php115 to receive incoming calls and can reload for as low as Php30 to make outgoing calls. Local call rates are made more affordable at Php2 per call, unlimited. Upon the launch of *Telepwede*, PLDT stopped offering *Teletipid* and *Telesulit* to new subscribers. PLDT is constrained to discontinue *Teletipid* and *Telesulit* as they run on an old technology platform which has now become obsolete and such platform will be fully retired by May 1, 2008. Last day of reloading was set last November 1, 2007 allowing subscribers ample time to consume their account balances and complete the maximum account life up to May 1, 2008. Subscribers of *Teletipid* and *Telesulit* were advised via print ads, direct mailers and call outs of their option to upgrade to *Telepwede* or to regular PLDT postpaid.

In March 2007, PLDT launched the PLDT Landline Plus, a fixed wireless service where subscribers to the service benefit from a text-capable home phone. This service is initially offered outside Metro Manila with the phone unit at Php2,400 and a monthly service fee of Php600 and Php1,000 for residential and business subscribers, respectively. As at September 30, 2007, there were a total of 13,250 PLDT Landline Plus subscribers.

Pursuant to a currency exchange rate adjustment, or CERA, mechanism authorized by 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 the first nine months of 2007, we implemented five downward adjustments and one upward adjustment in our monthly local service rates, while there were six downward adjustments and three upward adjustments in the same period in 2006. The average Philippine peso to U.S. dollar rate factored in our monthly local service rates in the first nine months of 2007 was Php48.30 to US$1.00, compared to an average of Php52.03 to US$1.00 in the same period in 2006. This change in the average peso-to-dollar rate translated to a peso appreciation of 7%, which resulted in a net decrease of approximately 7% in our average monthly local service rates in the first nine months of 2007. In its letter dated July 16, 2007, the NTC has approved our request to use annual average exchange rates as our basis in CERA computation instead of the currently used monthly averages. Accordingly, effective August 18, 2007, our CERA computation is based on the average Philippine peso to U.S. dollar exchange rate of Php49.76 covering the period July 2006 to June 2007.

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 nine months ended September 30, 2007 and 2006:

	Nine Months Ended September 30,			
			Increase (Decrease)	
	2007	**2006**	**Amount**	**%**
	(Unaudited)			
Total international long distance service revenues (in millions)	Php6,685	Php7,434	(Php749)	(10)
Inbound	5,506	6,220	(714)	(11)
Outbound	1,179	1,214	(35)	(3)
International call volumes (in million minutes, except call ratio)	1,702	1,582	120	8
Inbound	1,493	1,442	51	4
Outbound	209	140	69	49
Inbound-outbound call ratio	7.1:1	10.3:1		

Our total international long distance service revenues decreased by Php749 million, or 10%, to Php6,685 million in the first nine months of 2007 from Php7,434 million in the same period in 2006 primarily due to the peso appreciation and a decrease in average termination rates for inbound calls mitigated by an increase in call volumes. The percentage contribution of international long distance service revenues to our total fixed line service revenues decreased to 19% in the first nine months of 2007 from 21% in the same period in 2006.

Our revenues from inbound international long distance service decreased by Php714 million, or 11%, to Php5,506 million due to the appreciation of the Philippine peso to the U.S. dollar coupled with a decrease in average rate per minute due to the change in call mix with more traffic terminating to cellular operators where the net revenue kept by us is lower. These decreasing effects were partially offset by an increase in inbound traffic volume by 51 million minutes to 1,493 million minutes in the first nine months of 2007. The appreciation of the Philippine peso to the U.S. dollar with average exchange rates of Php47.53 in the first nine months of 2007 and Php52.19 in the same period in 2006 contributed to the decrease in our inbound international long distance revenues in peso terms, since settlement charges for inbound calls are billed in U.S. dollars or in special drawing rights, an established method of settlement among international telecommunications carriers using values based on a basket of foreign currencies that are translated into pesos at the time of billing.

Our revenues from outbound international long distance service decreased by Php35 million, or 3%, to Php1,179 million in the first nine months of 2007 primarily due to a decline in average revenue per minute as a result of a lower average collection rate with the introduction of low-rate services such as *PLDT ID-DSL* and *Budget Card*, and the peso appreciation in 2007, which more than offset the increase in outbound international call volumes in 2006.

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 nine months ended September 30, 2007 and 2006:

	Nine Months Ended September 30,			
			Decrease	
	2007	2006	Amount	%
	(Unaudited)			
Total national long distance service revenues (in millions)	Php4,864	Php5,117	(Php253)	(5)
National long distance call volumes (in million minutes)	1,652	1,688	(36)	(2)

Our national long distance service revenues decreased by Php253 million, or 5%, to Php4,864 million in the first nine months of 2007 from Php5,117 million in the same period in 2006 primarily due to a decrease in call volumes coupled with a lower average revenue per minute in the first nine months of 2007. The percentage contribution of national long distance revenues to our fixed line service revenues accounted for 14% in the first nine months of 2007 and 2006.

Data and Other Network Services

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

The following table shows information about our data and other network service revenues for the nine months ended September 30, 2007 and 2006:

	Nine Months Ended September 30,			
			Increase (Decrease)	
	2007	2006	Amount	%
	(Unaudited)			
Data and other network service revenues (in millions)	Php11,180	Php9,420	Php1,760	19
Number of DSL broadband subscribers	229,534	118,679	110,855	93
Number of *PLDT Vibe* narrowband subscribers	268,984	294,778	(25,794)	(9)

In the first nine months of 2007, our data and other network services posted revenues of Php11,180 million, an increase of Php1,760 million, or 19%, from Php9,420 million in the same period in 2006 primarily due to increases in leased lines, IP-based and switched-based data services, particularly Diginet and DFON rental, and *PLDT DSL* mitigated by lower *PLDT Vibe* services. The percentage contribution of this service segment to our fixed line service revenues increased to 31% in the first nine months of 2007 from 26% in the same period in 2006.

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

DSL contributed revenues of Php2,764 million in the first nine months of 2007, an increase of Php432 million, or 19%, from Php2,332 million in the same period in 2006 primarily due to an increase in the number of subscribers. *DSL* reached 229,534 subscribers as at September 30, 2007 compared with 118,679 subscribers in the same period in 2006. *DSL* offers a number of packages with maximum speeds ranging from 88 kbps to 5 Mbps depending on the plan.

PLDT Vibe revenues decreased by Php82 million, or 28%, to Php206 million in the first nine months of 2007 from Php288 million in the same period in 2006 primarily due to lower number of plan subscribers as well as the declining usage of Vibe prepaid. The declining number of Vibe plans and regular monthly users for Vibe prepaid may be attributed to the migration from Vibe dial-up to *DSL* which is now priced more competitively. As at September 30, 2007, *PLDT Vibe* registered users totaled 268,984, of which 76,122 were exclusive postpaid users, 187,263 were exclusive prepaid users, and 5,599 were both postpaid and prepaid users. As at September 30, 2006, *PLDT Vibe* registered users totaled 294,778, of which 111,137 were exclusive postpaid users, 168,815 were exclusive prepaid users, and 14,826 were both postpaid and prepaid users.

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

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

On October 17, 2007, PLDT, with its robust and reliable nationwide telecommunications network, teamed up with Intel to offer the Simplified Networks on Auto Pilot, or SNAP, a turn-key and cost-effective IT networking solution that can help increase profitability and competitiveness. For a flat monthly fee arrangement, SNAP handles a company s IT requirements which includes the latest Intel processors and hardware components, server solutions, technical support and broadband connectivity.

Diginet, our domestic private leased line service, has been providing Smart s increasing fiber optic and leased line data requirements. Diginet revenues increased by Php841 million, or 20%, to Php5,118 million in the first nine months of 2007 as compared to Php4,277 million in the same period in 2006 mainly due to Smart s DFON rental of Php3,833 million and Php3,011 million in the first nine months of 2007 and 2006, respectively.

Miscellaneous

Miscellaneous service revenues are derived mostly from directory advertising and facilities management and rental fees. In the first nine months of 2007, these revenues decreased by Php22 million, or 2%, to Php1,046 million from Php1,068 million in the same period in 2006 mainly due to a decline in facilities management fees, mitigated by an increase in rental income owing to higher co-location charges. The percentage contribution of miscellaneous service revenues to our total fixed line service revenues was 3% in the first nine months of 2007 and 2006.

Non-service Revenues

Non-service revenues increased by Php48 million, or 68%, to Php119 million in the first nine months of 2007 from Php71 million in the same period in 2006 primarily due to higher 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 the first nine months of 2007, our fixed line business segment registered a decrease in other income of Php198 million, or 30%, to Php459 million from Php657 million in the same period in 2006 mainly due to lower income from disposal of assets and various materials.

Expenses

Expenses related to our fixed line business totaled Php30,264 million in the first nine months of 2007, a decrease of Php5,718 million, or 16%, as compared to Php35,982 million in the same period in 2006. The decrease was primarily due to lower depreciation and amortization, selling and promotion expenses, and financing costs partially offset by higher professional and other contracted services, taxes and licenses, and compensation and benefits.

The following table shows the breakdown of our total fixed line-related expenses for the nine months ended September 30, 2007 and 2006 and the percentage of each expense item to the total:

	Nine Months Ended September 30,					
					Increase (Decrease)	
	2007	**%**	**2006**	**%**	**Amount**	**%**
			(Unaudited)			
(in millions)						
Fixed line services:						
Depreciation and amortization	Php9,330	31	Php15,248	42	(Php5,918)	(39)
Compensation and benefits(1)	7,879	26	7,519	21	360	5
Financing costs	4,386	15	5,331	15	(945)	(18)
Maintenance	2,730	9	2,442	7	288	12
Professional and other contracted services	1,243	4	682	2	561	82
Rent	1,205	4	1,202	3	3	
Provisions	857	3	478	1	379	79
Selling and promotions	831	3	1,345	4	(514)	(38)
Taxes and licenses	728	2	491	2	237	48
Insurance and security services	330	1	388	1	(58)	(15)
Communication, training and travel	319	1	369	1	(50)	(14)
Cost of sales	118		113		5	4
Other expenses	308	1	374	1	(66)	(18)
Total	Php30,264	100	Php35,982	100	(Php5,718)	(16)

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

Depreciation and amortization charges decreased by Php5,918 million, or 39%, to Php9,330 million due to higher additional depreciation charges recognized by PLDT in 2006 on certain properties and equipment affected by our NGN roll-out. In the first nine months of 2007, we recognized additional depreciation of Php1,100 million relating to Piltel s equipment that are also affected by the NGN roll-out.

Compensation and benefits expenses increased by Php360 million, or 5%, to Php7,879 million primarily due to the effect of collective bargaining agreement-related increases in salaries and benefits, and an increase in pension benefits and MRP costs, partially offset by the lower costs of LTIP. For further discussion on our LTIP, please see *Note 21 Employee Benefits* to the accompanying unaudited consolidated financial statements.

Financing costs decreased by Php945 million, or 18%, to Php4,386 million largely due to lower interest on loans and related items and lower hedge costs. These were partially offset by higher loss on derivative transactions and lower interest income. The breakdown of financing costs for our fixed line business for the nine months ended September 30, 2007 and 2006 is as follows:

	Nine Months Ended September 30,			
			Change	
	2007	**2006**	**Amount**	**%**
		(Unaudited)		
(in millions)				
Interest on loans and related items	Php3,800	Php4,826	(Php1,026)	(21)
Hedge costs	908	1,090	(182)	(17)
Loss on derivative transactions	353	175	178	102
Accretion on financial liabilities net	130	156	(26)	(17)
Financing charges	1	11	(10)	(91)
Interest income	(238)	(373)	135	(36)
Capitalized interest	(275)	(223)	(52)	23
Foreign exchange gains net	(293)	(331)	38	(11)
	Php4,386	Php5,331	(Php945)	(18)

Maintenance expenses increased by Php288 million, or 12%, to Php2,730 million primarily due to higher maintenance costs for domestic cable and wire facilities as more operating and maintenance-related restorations were incurred in the first nine months of 2007 as compared to the same period in 2006.

Professional and other contracted services increased by Php561 million, or 82%, to Php1,243 million primarily due to PLDT s higher consultancy service fees coupled with higher contracted services.

Rent expenses increased by Php3 million to Php1,205 million due to an increase in pole rental charges and higher office and building rentals, partially offset by the decrease in transponder lease and domestic leased circuit charges.

Provisions increased by Php379 million, or 79%, to Php857 million primarily due to higher provision of doubtful accounts as a result of higher than anticipated uncollectible receivables complemented by higher provision for assessments in the first nine months of 2007 compared to the same period in 2006.

Selling and promotion expenses decreased by Php514 million, or 38%, to Php831 million primarily as a result of a collective effort in efficient media spending in relation to various products and services, partially offset by higher public relations expense.

Taxes and licenses increased by Php237 million, or 48%, to Php728 million, mainly on account of higher business-related taxes.

Insurance and security services decreased by Php58 million, or 15%, to Php330 million primarily due to lower premiums on property all-risk, industrial all-risk and industrial fire insurance.

Communication, training and travel expenses decreased by Php50 million, or 14%, to Php319 million due to the decrease in mailing and courier charges, and local and foreign travel.

Cost of sales increased by Php5 million, or 4%, to Php118 million due to the higher computer-bundled sales in relation to our DSL promotion and *WeRoam* subscriptions.

Other expenses decreased by Php66 million, or 18%, to Php308 million due to lower various business and operational-related expenses.

Provision for Income Tax

Provision for income tax amounted to Php1,980 million in the first nine months of 2007 as compared to Php60 million in the same period in 2006 primarily due to higher taxable income as a result of lower depreciation in 2007.

Net Income

In the first nine months of 2007, our fixed line business segment contributed a net income of Php3,998 million, an increase of Php3,411 million, or 581%, as compared to Php587 million in the same period in 2006 mainly as a result of a 16% decrease in fixed line-related expenses, particularly depreciation and amortization partially offset by a slight decrease in our service revenues.

Information and Communications Technology

Revenues and Other Income

Our ICT business provides BPO, call center, internet and online gaming, data center and other services.

On April 16, 2007, SPi acquired, through a wholly-owned US subsidiary, 100% of Springfield Service Corporation, or Springfield, for an aggregate purchase price of US$35 million, or Php1,664 million, plus possible future earn-out payments with an aggregate fair value at acquisition date of Php962 million. Springfield is one of the largest players in the medical billing and revenue cycle management market. As at September 30, 2007, SPi s total investment in Springfield amounted to Php2,685 million, including fair value of possible future earn-out payments of Php960 million and incidental costs of Php59 million, see *Note 11 Goodwill and Intangible Assets* to the accompanying unaudited financial statements for related discussion.

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

In the first nine months of 2007, our ICT business generated revenues of Php7,643 million, an increase of Php3,497 million, or 84%, from Php4,146 million in the same period in 2006. This increase was largely due to the consolidation of the SPi Group and Level Up! and the continued increase of our call center revenues.

The following table summarizes revenues from our ICT business for the nine months ended September 30, 2007 and 2006 by service segment:

	Nine Months Ended September 30,					
					Increase (Decrease)	
	2007	**%**	**2006**	**%**	**Amount**	**%**
			(Unaudited)			
(in millions)						
Service Revenues						
BPO	Php3,989	52	Php930	23	Php3,059	329
Call center	2,357	31	1,920	46	437	23
Internet and online gaming	686	9	561	14	125	22
*Vitro*ä data center	311	4	287	7	24	8
Others	73	1	90	2	(17)	(19)
	7,416	97	3,788	92	3,628	96
Non-service Revenues						
Point Product Sales	200	3	339	8	(139)	(41)
Other Income	27		18		9	50

Equity share in net income of associates			1		(1)	(100)
Total ICT Revenues and Other Income	Php7,643	100	Php4,146	100	Php3,497	84

Service Revenues

Service revenues generated by our ICT segment amounted to Php7,416 million in the first nine months of 2007, an increase of Php3,628 million, or 96%, as compared to Php3,788 million in the same period in 2006 primarily as a result of the consolidation of the SPi Group and Level Up! and the continued growth of our call center business.

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 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 corporations, international law firms, corporate counsels and government agencies;

- conversion services of medical record/data from handwritten or speech format to electronic format and patient scheduling, coding and compliance assistance, consulting and specialized reporting services; and

- revenue cycle management services for U.S. medical facilities.

We provide our BPO services primarily through the SPi Group, which ePLDT acquired on July 11, 2006. BPO contributed revenues of Php3,989 million in the first nine months of 2007, an increase of Php3,059 million, or 329%, from Php930 million in the same period in 2006 primarily from SPi Group services, and accounted for 54% and 25% of total service revenues of our ICT business in the first nine months of 2007 and 2006, respectively.

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 Ventus, 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 addition, Infocom, through its Customer Service Outsourcing Group, handles PLDT group s nationwide technical helpdesk operations.

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 relating to our call center business increased by Php437 million, or 23%, to Php2,357 million in the first nine months of 2007 from Php1,920 million in the same period in 2006 primarily due to the expansion of our facilities. In total, we own and operate approximately 5,800 seats with 5,010 customer service representatives, or CSRs, as at September 30, 2007 compared to approximately 5,130 seats with 4,010 CSRs as at September 30, 2006. In 2006, *ePLDT Ventus* launched two new sites bringing our total call center site count to seven as at September 30, 2007.

Call center revenues accounted for 32% and 51% of total service revenues of our ICT business in the first nine months of 2007 and 2006, respectively.

Internet and online gaming

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, and community access of computers and desktop publishing based on actual usage, 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;

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

Revenues from our internet and online gaming businesses increased by Php125 million, or 22%, to Php686 million in the first nine months of 2007 from Php561 million in the same period in 2006 primarily due to the consolidation of Level Up! in May 2006 which resulted in an increase in revenues by Php27 million, and an increase in Infocom s revenues by Php60 million. Our internet and online gaming business revenues accounted for 9% and 15% of total service revenues of our ICT business in the first nine months of 2007 and 2006, 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 the first nine months of 2007, *Vitro*ä contributed revenues of Php311 million, an increase of Php24 million, or 8%, from Php287 million in the same period in 2006 primarily due to an increase in co-location revenues and server hosting. *Vitro*ä revenues accounted for 4% and 8% of service revenues of our ICT business in the first nine months of 2007 and 2006, 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 ICT segment decreased by Php17 million, or 19%, to Php73 million in the first nine months of 2007 from Php90 million in the same period in 2006.

Please refer to *Note 9 Investments in Associates* to the accompanying unaudited consolidated financial statements for further discussion on ePLDT s investments.

Non-service Revenues

Non-service revenues consist of sales generated from reselling certain software licenses, server solutions, networking products, storage products and data security products. In the first nine months of 2007, non-service revenues generated by our ICT business decreased by Php139 million, or 41%, to Php200 million as compared to Php339 million in the same period in 2006 primarily due to lower revenues from sales of 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 ICT business increased by Php9 million, or 50%, to Php27 million in the first nine months of 2007 as compared to Php18 million in the same period in 2006 primarily due to *Vitro* s collection of interest charges for overdue receivables from Stradcom Corporation.

Equity Share in Net Income of Associates

ePLDT s equity share in net income of associates amounted to Php1 million in the first nine months of 2006 due to ePLDT s share in the earnings of its unconsolidated investee companies.

Expenses

Expenses associated with our ICT business totaled Php7,709 million in the first nine months of 2007, an increase of Php3,581 million, or 87%, from Php4,128 million in the same period in 2006 primarily due to the consolidation of the SPi Group and Level Up! resulting to an increase in compensation and benefits, professional and other contracted services, and depreciation and amortization. As a percentage of our ICT revenues, expenses related to our ICT business were 101% and 100% for the first nine months of 2007 and 2006, respectively.

The following table shows the breakdown of our total ICT-related expenses for the nine months ended September 30, 2007 and 2006 and the percentage of each expense item to the total:

	Nine Months Ended September 30,					
					Increase (Decrease)	
	2007	%	2006	%	Amount	%
			(Unaudited)			

(in millions)						
ICT services:						
Compensation and benefits(1)	Php3,984	52	Php1,738	42	Php2,246	129
Professional and other contracted services	938	12	416	10	522	125
Depreciation and amortization	715	9	463	11	252	54
Rent	495	6	356	9	139	39
Maintenance	380	5	258	6	122	47
Communication, training and travel	365	5	170	4	195	115
Selling and promotions	194	3	205	5	(11)	(5)
Cost of sales	184	2	293	7	(109)	(37)
Amortization of intangible assets	162	2	19	1	143	753
Taxes and licenses	66	1	43	1	23	53
Insurance and security services	34	1	21	1	13	62
Provisions	15		(3)		18	600
Financing costs (gains)	(2)		54	1	(56)	(104)
Other expenses	179	2	95	2	84	88
Total	Php7,709	100	Php4,128	100	Php3,581	87

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

Compensation and benefits increased by Php2,246 million, or 129%, to Php3,984 million largely due to the increased number of employees and corresponding salaries and employee benefits resulting from the expansion of our call center business and the consolidation of the SPi Group and Level Up! in 2006.

Professional and other contracted services increased by Php522 million, or 125%, to Php938 million primarily due to higher consultancy fees and subcontracted services incurred by the SPi Group related to its BPO services.

Depreciation and amortization charges increased by Php252 million, or 54%, to Php715 million primarily due to an increase in the depreciable asset base in relation to the expansion of our call center business and the consolidation of the SPi Group in July 2006.

Rent expenses increased by Php139 million, or 39%, to Php495 million primarily due to higher office space rentals and leased circuits from other carriers incurred by our call center business, the SPi Group and Level Up!.

Maintenance expenses increased by Php122 million, or 47%, to Php380 million primarily due to higher maintenance costs for new call center facilities plus higher electricity charges for *Vitro*TM and the consolidation of the SPi Group and Level Up!.

Communication, training and travel expenses increased by Php195 million, or 115%, to Php365 million primarily due to the increased cost of phone lines, bandwidth and information system charges, coupled with the increase in local travel costs, mailing and courier charges and freight and hauling charges incurred by our call center and BPO businesses.

Selling and promotion expenses decreased by Php11 million, or 5%, to Php194 million mainly due to the SPi Group s lower advertising and marketing spending.

Cost of sales decreased by Php109 million, or 37%, to Php184 million primarily due to lower software and hardware sales.

Amortization of intangible assets increased by Php143 million to Php162 million in relation to the acquisition of the SPi Group and Level Up!. See *Note 11 Goodwill and Intangible Assets* to the accompanying unaudited consolidated financial statements for further discussion.

Taxes and licenses increased by Php23 million, or 53%, to Php66 million primarily due to the consolidation of the SPi Group and higher business-related taxes.

Insurance and security services increased by Php13 million, or 62%, to Php34 million primarily due to higher premium costs and an increase in the value of assets insured.

Provisions increased by Php18 million, or 600%, to Php15 million mainly due to anticipated uncollectible accounts.

Financing gains amounted to Php2 million in the first nine months of 2007 primarily due to a gain on derivative transactions; no similar transaction was recorded in the same period in 2006. This was partially offset by higher accretion on financial liabilities particularly on interest expense on contingent consideration.

Other expenses increased by Php84 million, or 88%, to Php179 million mainly due to higher business-related costs, such as office supplies.

Benefit from Income Tax

Benefit from income tax amounted to Php73 million in the first nine months of 2007 primarily due to the corresponding deferred tax effect of the amortization of intangible assets in relation to the acquisition of the SPi Group and Level Up!, as compared to Php5 million in the same period in 2006.

Net Income

In the first nine months of 2007, our ICT business segment registered a net income of Php7 million as compared to Php23 million in the same period in 2006 mainly as a result of an 87% increase in ICT expenses mainly from the consolidation of the SPi Group, partly offset by the 84% increase in ICT-related revenues mainly from the consolidation of the SPi Group and increased contribution of our call center business.

Liquidity and Capital Resources

The following table shows our consolidated cash flows for the nine months ended September 30, 2007 and 2006 as well as our consolidated capitalization and other selected financial data as at September 30, 2007 and December 31, 2006:

	Nine Months Ended September 30,	
	2007	**2006**
	(Unaudited)	
(in millions)		
Cash Flows		
Net cash provided by operating activities	Php55,499	Php56,146
Net cash used in investing activities	19,557	25,261
Capital expenditures	*14,529*	*16,872*
Net cash used in financing activities	43,980	41,763
Net decrease in cash and cash equivalents	8,399	11,399

	September 30, 2007	**December 31, 2006**
(in millions)	(Unaudited)	(Audited)
Capitalization		
Long-term portion of interest-bearing financial liabilities net of current portion:		
Long-term debt	Php57,273	Php63,769
Obligations under capital lease	26	106
Preferred stock subject to mandatory redemption		1,369

	57,299	65,244
Current portion of interest-bearing financial liabilities:		
Notes payable	487	201
Long-term debt maturing within one year	6,965	16,184
Obligations under capital lease maturing within one year	911	924
Preferred stock subject to mandatory redemption	1,114	
	9,477	17,309
Total interest-bearing financial liabilities	66,776	82,553
Total equity	103,692	104,523
	Php170,468	Php187,076
Other Financial Data		
Total assets	Php227,971	Php241,892
Property, plant and equipment - net	159,288	164,190
Cash and cash equivalents	8,471	16,870

As at September 30, 2007, our consolidated cash and cash equivalents totaled Php8,471 million. Principal sources of consolidated cash and cash equivalents in the first nine months of 2007 were cash flows from operating activities amounting to Php55,499 million and drawings from Smart s, PLDT s and ePLDT s debt facilities aggregating Php5,429 million. These funds were used principally for dividend payments of Php28,394 million, capital outlays of Php14,529 million, total debt principal payments of Php16,294 million, interest payments of Php4,423 million and short-term investments of Php3,553 million.

Operating Activities

Our consolidated net cash flows from operating activities decreased by Php647 million, or 1%, to Php55,499 million in the first nine months of 2007 from Php56,146 million in the same period in 2006. A significant portion of our cash flow is generated by our wireless business, which contributed approximately 60% of our total revenues and other income in the first nine months of 2007 and 2006. Revenues from our fixed line and ICT services accounted for 33% and 7%, respectively, of our total revenues and other income in the first nine months of 2007 compared to 36% and 4%, respectively, in the same period in 2006.

Cash flows from operating activities of our wireless business amounted to Php34,502 million in the first nine months of 2007, an increase of Php4,620 million, or 15%, compared to Php29,882 million in the same period in 2006. The increase in our wireless business segment s cash flows from operating activities was primarily due to the decrease in our working capital requirements owing to the settlement of various payables in 2006. Likewise, cash flows from operating activities of our fixed line business increased to Php18,825 million due to lower working capital requirements in the first nine months of 2007, compared to Php15,476 million in the same period 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 September 30, 2007.

Until April 2006, Smart was subject to loan covenants that restricted its ability to pay dividends, redeem preferred shares, make distributions to PLDT or otherwise provide funds to PLDT or any associate without the consent of its lenders. Smart was able to obtain waivers from Finnvera and certain of its lenders for all dividend payments made by Smart to PLDT up to March 2006. Dividend 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. Cash dividends paid by Smart to PLDT for the nine months ended September 30, 2007 and 2006 amounted to Php26,927 million and Php20,600 million, respectively.

On September 17, 2007, Piltel paid cash dividends to various preferred shareholders in the aggregate amount of Php2,746 million, of which Php2,734 million was paid to PLDT.

Investing Activities

Net cash used in investing activities amounted to Php19,557 million in the first nine months of 2007, a decrease of Php5,704 million, or 23%, compared to Php25,261 million in the same period in 2006. This was primarily a net result of: (1) the increase in short-term investments by Php3,594 million in the first nine months of 2007 mainly due to Smart s increased investment in money market placements with over 90 days maturity; (2) a decrease in capital expenditures by Php2,343 million; and (3) lower investment acquisition by Php8,437 million. However, we expect capital expenditures to be higher in the last quarter of 2007.

Our consolidated capital expenditures in the first nine months of 2007 totaled Php14,529 million, a decrease of Php2,343 million, or 14%, from Php16,872 million in the same period in 2006 primarily due to Smart s and ePLDT s lower capital spending. Smart's capital spending of Php6,981 million in the first nine months of 2007 was used primarily to further upgrade its core, access and transmission network facilities, expand its wireless broadband facilities and develop IT platforms for new businesses. PLDT's capital spending of Php7,118 million was principally used to finance the expansion and upgrade of its submarine cable facilities, fixed line data and IP-based network services. ePLDT and its subsidiaries capital spending of Php394 million was primarily used to fund its continued call center expansion. The balance represented other subsidiaries capital spending. Consolidated capital expenditures in the first nine months of 2006 amounted to Php16,872 million, of which Php9,163 million, Php6,881 million and Php737 million were attributable to Smart, PLDT and ePLDT, respectively.

Financing Activities

On a consolidated basis, we used net cash of Php43,980 million for financing activities, net of loan drawings by Smart, in the first nine months of 2007, an increase of Php2,217 million, or 5%, compared to Php41,763 million in the same period in 2006. The net cash used in financing activities was mainly utilized for debt repayments, interest payments, and dividend payments distributed to PLDT common and preferred stockholders.

Debt Financing

Additions to our consolidated long-term debt in the first nine months of 2007 totaled Php5,429 million mainly from Smart's drawings related to the financing of its network expansion projects. Payments in respect of principal and interest of our total debt amounted to Php16,294 million and Php4,423 million, respectively, in the first nine months of 2007, of which Php11,343 million and Php3,256 million were attributable to PLDT, respectively.

The following table shows our long-term debt, including current portion, as at September 30, 2007 and December 31, 2006:

	September 30,	**December 31,**	**Increase (Decrease)**	
	2007	**2006**	**Amount**	**%**
	(Unaudited)	(Audited)		
(in millions)				
U.S. Dollar Debt:				
Export Credit Agencies-Supported Loans	Php9,321	Php14,981	(Php5,660)	(38)
Fixed Rate Notes	30,410	40,971	(10,561)	(26)
Term Loans	15,399	18,611	(3,212)	(17)
Satellite Acquisition Loans	1,342	2,083	(741)	(36)
	56,472	76,646	(20,174)	(26)
Philippine Peso Debt:				
Peso Fixed Rate Corporate Notes	4,988	808	4,180	517
Term Loans	2,778	2,499	279	11
	7,766	3,307	4,459	135
	Php64,238	Php79,953	(Php15,715)	(20)

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

Our long-term debt decreased by Php15,715 million, or 20%, to Php64,238 million as at September 30, 2007, largely due to debt amortizations and prepayments in line with our efforts to reduce overall debt level, and also due to the appreciation of the peso. The debt levels of Mabuhay, ePLDT, PLDT and Smart decreased by 36%, 35%, 27% and 2% to Php1,342 million, Php37 million, Php38,036 million and Php24,824 million, respectively, as at September 30, 2007.

On May 22, 2007, PLDT signed loan agreements with The Philippine American Life and General Insurance Company for Php400 million and The Philam Bond Fund, Inc. for Php20 million to refinance their respective participations in the Ten-Year Note under the Php1,270 million Peso Fixed Rate Corporate Notes which were repaid on June12, 2007.

Both loans will mature on June 12, 2014.

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

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. This loan facility was drawn in full on October 10, 2007. Please see *Note 17 Interest-bearing Financial Liabilities Long-term Debt* to the accompanying unaudited 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 September 30, 2007 are as follows:

Year	**US$ Loans**		**Peso Loans**	**Total**
(Unaudited)		(in millions)		
2007(1)	US$40	Php1,803	Php139	Php1,942
2008	147	6,608	558	7,166
2009	263	11,830	570	12,400
2010	71	3,183	568	3,751
2011	15	668	568	1,236
2012 and onwards	830	37,335	5,384	42,719
	US$1,366	Php61,427	Php7,787	Php69,214

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(1) October 1, 2007 through December 31, 2007.

Approximately Php26,495 million principal amount of our consolidated outstanding long-term debt as at September 30, 2007 is scheduled to mature over the period from 2007 to 2011. Of this amount, Php13,317 million was attributable to PLDT, Php11,800 million to Smart and the remainder to Mabuhay Satellite and ePLDT.

Debt Covenants

Our debt instruments contain restrictive covenants, including covenants that could prohibit us from paying dividends on common stock under certain circumstances, and require us to comply with specified financial ratios and other financial tests, calculated in conformity with Philippine Financial Reporting Standards, at relevant measurement dates, principally at the end of each quarterly period. We have complied with all of our maintenance financial ratios as required under our loan covenants and other debt instruments.

Please see *Note 17 Interest-bearing Financial Liabilities Debt Covenants* to the accompanying unaudited 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 currently intend to gradually increase our dividend payout ratio as we improve our leverage ratios. For 2006, our dividend payout ratio was 60% of 2006 earnings per share, excluding the special dividend discussed below, which we intend to increase to 70% in 2007.

On August 7, 2007, we declared a special dividend of Php40 per share attributable to our 2006 earnings. This special dividend is an incremental dividend payout representing approximately 25% of our 2006 earnings per share. As a result of such special dividend declaration, our total dividend payments attributable to our 2006 earnings increased to Php140 per share, inclusive of the regular dividends paid out of our 2006 earnings aggregating Php100 per share.

The following table sets forth the dividend declaration, on PLDT s common stock pertaining to 2006 and 2007 earnings:

		Date		Amount	
Earnings	**Approved**	**Record**	**Payable**	**Per share**	**Total**
					(in millions)
2006	August 8, 2006	August 21, 2006	September 21, 2006	Php50	Php9,379
2006	March 6, 2007	March 20, 2007	April 20, 2007	50	9,429
2006	August 7, 2007	August 24, 2007	September 24, 2007	40	7,548
				Php140	Php26,356
2007	August 7, 2007	August 24, 2007	September 24, 2007	Php60	Php11,322

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
Moody s Investor Service, or Moody s	Foreign Currency Senior Unsecured Debt Rating	Ba2	Stable
	Local Currency Corporate Family Rating	Baa2	Stable
Fitch Ratings, or Fitch	Long-term Foreign Currency Rating	BB+	Stable
	Long-term Local Currency Rating	BB+	Stable
	Long-term Foreign Currency Issuer Default Rating, or IDR	BB+	Stable
	Long-term Local Currency Issuer Default Rating	BBB	Stable
	National Long-term Rating	AAA(ph1)	Stable

On August 14, 2007, Fitch upgraded PLDT s long-term local currency IDR to BBB from BBB- with a stable outlook and at the same time affirmed PLDT s long-term foreign currency IDR of BB+ with a stable outlook, PLDT s global bonds and senior notes at BB+ . The rating action recognizes PLDT s sustained strengthening financial profile through 2006 and the first half of 2007, with a strong positive free cash flow generation enabling significant reductions in both gross and net debt levels. The upgrade also reflects our sustained strong operating performance and its pre-eminent position in the Philippine telecommunications sector.

On May 31, 200 7, Moody s upgraded our local currency corporate family rating to Baa2 with a stable outlook from Baa3. At the same time, Moody s affirmed our foreign currency senior unsecured debt rating at Ba2 with a stable outlook. This rating action concluded the review for possible upgrade that Moody s commenced on April 11, 2007. The upgrade reflects the continued improvement in our financial profile and the consolidation of our strong operating performance.

Equity Financing

PLDT raised Php74 million and Php57 million from the exercise by certain officers and executives of stock options in the first nine months of 2007 and 2006, respectively.

Cash dividend payments in the first nine months of 2007 amounted to Php28,394 million compared to Php14,847 million paid to preferred and common shareholders in the same period in 2006. As at September 30, 2007, there were 189 million PLDT common shares outstanding compared to 188 million common shares outstanding as at September 30, 2006.

Contractual Obligations and Commercial Commitments

Contractual Obligations

The following table discloses our unaudited consolidated contractual obligations outstanding as at September 30, 2007:

		Payments Due by Period			
	Total	**Within 1 year**	**2-3 years**	**4-5 years**	**After 5 years**
			(Unaudited)		
(in millions)					
Long-term debt (1)	Php69,214	Php7,073	Php17,617	Php16,861	Php27,663
Long-term lease obligations:					
Operating lease	3,511	620	1,241	827	823
Capital lease	1,441	1,414	26	1	
Unconditional purchase obligations(2)	796	71	45	242	438
Other long-term obligations	1,205	1,205			
Total contractual obligations	Php76,167	Php10,383	Php18,929	Php17,931	Php28,924

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

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

Long-term Debt

For a discussion of our long-term debt, see *Note 17 Interest-bearing Financial Liabilities* to the accompanying unaudited 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 10 to 25 years expiring at various dates. As at September 30, 2007, PLDT s aggregate remaining obligation under these contracts amounted to approximately Php4 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 September 30, 2007, PLDT s aggregate remaining obligation under this agreement was approximately Php20 million.

Other Long-term Operating Lease Obligations. The PLDT Group has various long-term lease contracts for periods ranging from two to ten years covering certain offices, warehouses, cell sites telecommunication equipment locations and various office equipment. In particular, Smart has lease obligations amounting to Php3,181 million as at September 30, 2007 in respect of office and cell site rentals with over 3,000 lessors nationwide, PLDT has lease obligations amounting to Php78 million as at September 30, 2007 in respect of office and lot rentals with over 175 lessors nationwide, ePLDT has lease obligations amounting to Php183 million as at September 30, 2007 in respect of certain office space rentals and PLDT Global has lease obligations amounting to Php45 million as at September 30, 2007 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 unaudited consolidated financial statements.

Unconditional Purchase Obligations

Air Time Purchase Agreement with AIL. PLDT was a party to a Founder National Service Provider, or NSP, ATPA, entered into with AIL in March 1997, which was amended in December 1998 (as amended, the Original ATPA), under which PLDT was granted the exclusive right to sell AIL services as NSP in the Philippines. In exchange, the Original ATPA required PLDT to purchase from AIL a minimum of US$5 million worth of air time (the Minimum Air Time Purchase Obligation) annually over ten years commencing January 1, 2002 (the Minimum Purchase Period), the purported date of commercial operations of Garuda I Satellite. In the event that AIL s aggregate billed revenue is less than US$45 million in any given year, the Original ATPA also required PLDT has to make supplemental air time purchase payments not to exceed US$15 million per year during the Minimum Purchase Period (the Supplemental Air Time Purchase Obligation).

After lengthy negotiations including a collaboration arrangement with Inmarsat, AIL and ACeS signed a term sheet (Banks Term Sheet) in September 2006 (as amended in October 2006, November 2006 and February 2007) with the majority of AIL s bank creditors. The Banks Term Sheet was used as the basis for negotiations amongst the parties to amend the Amended Credit Agreement. Under the Banks Term Sheet, a majority of the banks agreed, subject to the satisfaction of certain conditions, among other things to amend the Original ATPA as set forth in an attachment to the Banks Terms Sheet and to restructure AIL s indebtedness. For further discussion please see *Note 20 Related Party Transactions* to the accompanying unaudited consolidated financial statements.

As at September 30, 2007, PLDT s aggregate remaining minimum obligation under the amended ATPA was approximately Php796 million.

Other Long-term Obligations

Mandatory Conversion and Purchase of Shares. As discussed in *Note 17 Interest-bearing Financial Liabilities*, as at September 30, 2007, PLDT had issued a total of 3 million shares of Series V Convertible Preferred Stock, 5 million shares of Series VI Convertible Preferred Stock and 4 million shares of Series VII Convertible Preferred Stock in exchange for a total of 58 million shares of Series K Class I Convertible Preferred Stock of Piltel, pursuant to the debt restructuring plan of Piltel adopted in June 2001. As at September 30, 2007, 2,687,490 shares of Series V Convertible Preferred Stock, 4,588,860 shares of Series VI Convertible Preferred Stock and 3,842,000 shares of Series VII Convertible Preferred Stock had been voluntarily converted to PLDT common shares. As at September 30, 2007, 33,950 shares of Series V and 706,244 shares of Series VI Convertible Preferred Stocks remained outstanding.

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

The aggregate value of the put option based on outstanding shares as at September 30, 2007 was Php1,205 million which is puttable on June 4, 2008, if all of the outstanding shares of Series V and VI Convertible Preferred Stocks were mandatorily converted and all the common shares were put to PLDT at that time. The market value of the underlying common shares was Php2,154 million, based on the market price of PLDT common shares of Php2,910 per share as at September 30, 2007.

Please refer to *Note 17 Interest-bearing Financial Liabilities Preferred Stock Subject to Mandatory Redemption* to the accompanying unaudited consolidated financial statements for further discussion.

Commercial Commitments

As at September 30, 2007, our outstanding commercial commitments, in the form of letters of credit, amounted to Php1,846 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

The revaluation of our foreign-currency denominated assets and liabilities as a result of the appreciation or depreciation of the Philippine peso is recognized as foreign exchange gains or losses as at the balance sheet date. The extent of foreign exchange gains or losses is largely dependent on the amount of foreign currency debt and hedges we carry. While a certain percentage of our revenues are either linked to or denominated in U.S. dollars, most of our indebtedness and related interest expense, a substantial portion of our capital expenditures and a portion of our operating expenses are denominated in foreign currencies, mostly in U.S. dollars. As such, a strengthening or weakening of the Philippine peso against the U.S. dollar will decrease or increase in Philippine peso terms both the principal amount of our unhedged foreign currency-denominated debts and the related interest expense, our foreign currency-denominated capital expenditures and operating expenses as well as our U.S. dollar linked and U.S. dollar denominated revenues. In addition, many of our financial ratios and other financial tests are affected by the movements in the Philippine peso to U.S. dollar exchange rate.

To manage our foreign exchange risks, stabilize cash flows, and improve investment and cash flow planning, we enter into forward foreign exchange contracts, currency swap contracts, currency option contracts and other hedging products aimed at reducing and/or managing the adverse impact of changes in foreign exchange rates on our operating results and cash flows. However, these hedges do not cover all of our exposure to foreign exchange risks. Specifically, we use forward foreign exchange contracts, currency swap contracts, foreign currency option contracts to manage the foreign exchange risks 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 foreign currency option contracts, and fixed to floating coupon only swap agreements. We accounted for these instruments as either cash flow hedges, wherein changes in the fair value are recognized as cumulative translation adjustments in equity until when the hedged transaction affects the consolidated statement of income or when the hedging instrument expires, or transactions not designated as hedges, wherein changes in the fair value are recognized directly as income or expense for the period.

As at September 30, 2007, approximately 89% of our total consolidated debts was denominated in U.S. dollars. Consolidated foreign currency-denominated debt was reduced to Php56,472 million from Php81,850 million as at September 30, 2006. PLDT s outstanding long-term principal only currency swap contracts and foreign currency option contracts amounted to US$550 million and US$136 million, respectively, as at September 30, 2007. Consequently, the unhedged portion of consolidated debts amounts is approximately 45% or 38%, net of our U.S. dollar cash balances as at September 30, 2007.

For the nine months ended September 30, 2007, approximately 38% of our consolidated revenues are either denominated in U.S. dollars or are linked to the U.S. dollars. In this respect, the recent appreciation of the peso against the U.S. dollar reduced our revenues, and consequently, our cash flow from operations in peso terms.

The Philippine peso had appreciated by 8% against the U.S. dollar to Php44.974 to US$1.00 as at September 30, 2007, from Php49.045 to US$1.00 as at December 31, 2006. Likewise, as at September 30, 2006, the peso had appreciated by 5% to Php50.249 to US$1.00 from Php53.062 to US$1.00 as at December 31, 2005. As a result of the foreign exchange movements as well as the amount of our outstanding foreign currency debts and hedges, we recognized foreign exchange gains of Php1,662 million and Php1,601 million in the first nine months of 2007 and 2006, respectively.

For further discussions of these contracts, see *Note 24 Financial Assets and Liabilities Derivative Financial Instruments* to the accompanying unaudited 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 September 30, 2007, PLDT s outstanding interest rate swap contracts amounted to US$31 million. For further discussions of these contracts, see *Note 24 Financial Assets and Liabilities Derivative Financial Instruments* to the accompanying unaudited 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 the first nine months of 2007 was 2.6%, compared to 6.8% in the same period in 2006.

PART II OTHER INFORMATION

Sale and transfer of Piltel s Fixed Line Business to PLDT

On November 5, 2007, Piltel s Board of Directors approved the sale and transfer of Piltel s fixed line business to PLDT or any of its subsidiaries which provides fixed line service, subject to the execution of a definitive agreement and fulfillment of certain closing conditions including the procurement of the requisite regulatory approvals. The sale and transfer will allow Piltel to concentrate its resources on its wireless business. It will also bring together the PLDT Group s LEC businesses such that these LEC businesses can derive operating efficiencies while extending to Piltel s fixed line subscribers the opportunity to benefit from the upgrades being undertaken at PLDT. PLDT has been managing Piltel s fixed line business since July 2001 under a Facilities Management Agreement, or FMA

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

On November 6, 2007, PLDT commenced a solicitation of consents from holders of its outstanding 11.375% Notes due 2012, or the 2012 Notes, to effect certain proposed amendments relating to the limitation on restricted payments and limitation on dividends and a solicitation of consents from holders of its outstanding 10.5% Notes due 2009, or the 2009 Notes, and 8.35% Notes due 2017, or the 2017 Notes, to effect certain proposed amendments relating to the limitation on dividends.

Specifically, the proposed amendments, once effective, would give PLDT greater flexibility to make certain restricted payments, amend limitations on PLDT paying dividends or distributions, and reduce PLDT s permitted leverage ratios pursuant to the terms of the notes.

PLDT s key financial indicators including revenues, profitability and operating cash flows have improved over time compared to when the notes were issued. PLDT is focused on maintaining its market leadership, investing in new growth areas to boost its core telecommunications business and diversifying its revenue sources. PLDT is also focused on pursuing an efficient capital structure by adjusting its dividend and distribution policy to maintain an optimal level of cash on its balance sheet. PLDT believes that the existing Limitation on Restricted Payments and the existing Limitation on Dividends, constrain its ability to pursue these objectives. To demonstrate its continued commitment to maintaining a prudent capital structure, PLDT will simultaneously tighten its debt capacity.

Incorporation of SPi Global Solutions Corporation, or SPi Global

On October 5, 2007, the Philippine SEC approved the incorporation of SPi Global, a wholly-owned subsidiary of ePLDT. SPi Global will be the holding company of the BPO voice and non-voice businesses of ePLDT.

Related Party Transactions

a. Air Time Purchase Agreement between PLDT and AIL and Related Agreements

For a more detailed discussion on the ATPA, see *Contractual Obligations and Commercial Commitments Unconditional Purchase Obligations Air Time Purchase Agreement with AIL* .

b. Transactions with Major Stockholders, Directors and Officers

Transactions to which PLDT or any of its subsidiaries is a party, in which a director, key officer or owner of more than 10% of the outstanding common stock of PLDT, or any member of the immediate family of a director, key officer or owner of more than 10% of the outstanding common stock of PLDT had a direct or indirect material interest, as at September 30, 2007 (unaudited) and December 31, 2006 (audited) and for the nine months ended September 30, 2007 and 2006 (unaudited) are as follows:

Cooperation Agreement with First Pacific and certain affiliates, or the FP Parties, NTT Communications and DoCoMo In connection with the transfer by NTT Communications of approximately 12.6 million shares of PLDT s common stock to 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, limitation on competition, business cooperation, additional rights of DoCoMo, change in control and termination. See *Note 20 Related Party Transactions* to the accompanying unaudited consolidated financial statements for further details.

Integrated i-mode Services Package Agreement between DoCoMo and Smart An Integrated i-mode Services Package Agreement was entered into by Smart and DoCoMo on February 15, 2006, under which DoCoMo agreed to grant Smart, on an exclusive basis within the territory of the Philippines for a period of five years, an integrated i-mode services package including a non-transferable license to use the licensed materials and the i-mode brand, as well as implementation support and assistance and post-commercial launch support from DoCoMo. Pursuant to this agreement, Smart is required to pay an initial license fee and running royalty fees based on the revenue arising from i-mode subscription fees and data traffic. Outstanding obligation under this agreement amounted to Php53 million as at December 31, 2006. Smart has no outstanding obligation under this agreement as at September 30, 2007.

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 dated January 31, 2006.

Pursuant to the Advisory Services Agreement, DoCoMo will provide the services of certain key personnel in connection with certain aspects of the business of PLDT and Smart. Also, said agreement governs the terms and conditions of the appointments of such key personnel and the corresponding fees related thereto. Total fees under this agreement amounted to Php56 million and Php25 million for the nine months ended September 30, 2007 and 2006, respectively. Outstanding liability under this agreement amounted to Php18 million and Php32 million as at September 30, 2007 and December 31, 2006, respectively.

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 Php83 million and Php144 million for the nine months ended September 30, 2007 and 2006, respectively. PLDT s outstanding obligations under these agreements amounted to Php18 million as at September 30, 2007 and December 31, 2006.

Agreement between Smart and Asia Link B.V., or ALBV. Smart has an existing Technical Assistance Agreement with ALBV, a subsidiary of the First Pacific Group, for the latter s provision of technical support services and assistance in the operations and maintenance of cellular business for a period of five years, subject to renewal upon mutual agreement between the parties. The agreement provides for quarterly payments of technical service fees equivalent to 2% of the net revenues of Smart. In January 2004, the agreement was amended, reducing the technical service fees to be paid by Smart to ALBV to 1% of net revenues effective January 1, 2004. On February 18, 2004, Smart and ALBV entered into a renewal of the Technical Assistance Agreement extending the effectivity of the terms thereof to February 23, 2008. Furthermore, in view of the acquisition by Smart of ownership of 92.1% of the outstanding common stock of Piltel held by PLDT, the parties agreed to make the consolidated net revenues of Smart the basis for the computation of the 1% technical service fees payable by Smart to ALBV, effective January 1, 2005. Total service fees charged to operations under this agreement amounted to Php449 million and Php398 million for the nine months ended September 30, 2007 and 2006, respectively. As at September 30, 2007, Smart had advanced the payment of service fees to ALBV amounting to Php151 million. As at December 31, 2006, Smart had an outstanding liability to ALBV of Php128 million.

Smart also has an existing Services Agreement with ALBV for a period of 25 years starting January 1, 1999, which will automatically expire unless renewed by mutual agreement of both parties. Under the agreement, ALBV provides advice and assistance to Smart in sourcing capital equipment and negotiating with international suppliers, arranging international financing and other services therein consistent with and for the furtherance of the objectives of the services. Service agreement fees were paid for the whole 25-year period. Outstanding prepaid management fees as at September 30, 2007 and December 31, 2006 amounted to Php830 million and Php869 million, respectively. Financing service fee charged to operations amounted to Php38 million each for the nine months ended September 30, 2007 and 2006.

Agreements relating to insurance companies Gotuaco del Rosario and Associates, or Gotuaco, acts as the broker for certain insurance companies to cover certain insurable properties of the PLDT Group. Insurance premiums are remitted to Gotuaco and the broker s fees are settled between Gotuaco and the insurance companies. In addition, PLDT has an insurance policy with Malayan Insurance Co., Inc., or Malayan, wherein premiums are directly paid to

Malayan. Total insurance expenses under these agreements amounted to Php168 million and Php189 million for the nine months ended September 30, 2007 and 2006, respectively. Two directors of PLDT have direct/indirect interests 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 unaudited consolidated financial statements.

ANNEX AGING OF ACCOUNTS RECEIVABLE

The following table shows the aging of unaudited consolidated trade receivables as at September 30, 2007:

Type of Accounts Receivable	Total		Current	31-60 Days	61-90 Days		Over 91 Days
				(In Millions)			
I. Trade Receivables							
1. Retails subscribers	Php8,535		Php1,776	Php976	Php246		Php5,537
2. Foreign administrations	4,466		1,338	1,128	509		1,491
3. Corporate subscribers	7,443		767	981	490		5,205
4. Domestic carriers	1,858		444	98	98		1,218
5. Dealers and agents	2,348		1,694	94	148		412
Subtotal	Php24,650		Php6,019	Php3,277	Php1,491		Php13,863
II. Non-Trade Receivables	1,641						
		Less: Allowance for doubtful accounts				Less: Allowance for doubtful accounts	
Total	26,291						
Less: Allowance for doubtful accounts	16,046						
Total Receivables - net	**Php10,245**						

SIGNATURES

Pursuant to the requirements of the Securities Regulation Code, the registrant has duly caused this report for the third quarter of 2007 to be signed on its behalf by the undersigned thereunto duly authorized.

Registrant: **PHILIPPINE LONG DISTANCE TELEPHONE COMPANY**

Signature and Title: /s/ Napoleon L. Nazareno
Napoleon L. Nazareno
President and Chief Executive Officer

Signature and Title: /s/ Anabelle Lim-Chua
Anabelle Lim-Chua
Senior Vice President and Treasurer
(Principal Financial Officer)

Signature and Title: /s/ June Cheryl A. Cabal-Furigay
June Cheryl A. Cabal-Furigay
Vice President and Controller
(Principal Accounting Officer)

Date: November 6, 2007

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS AT SEPTEMBER 30, 2007 (UNAUDITED) AND DECEMBER 31, 2006 (AUDITED)

AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006 (UNAUDITED)

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
ASSETS		
Noncurrent Assets		
Property, plant and equipment - net (Notes 2, 3, 8 and 17)	**159,288**	164,190
Investments in associates (Notes 2, 9 and 17)	**1,343**	636
Investments-available-for-sale (Notes 2 and 24)	**142**	116
Investment in debt securities (Notes 2 and 24)	**268**	
Investment properties (Notes 2, 3 and 10)	**580**	587
Goodwill and intangible assets (Notes 2, 3 and 11)	**13,701**	12,214
Deferred income tax assets (Notes 2, 4 and 6)	**13,808**	19,658
Derivative financial assets (Notes 2 and 24)	**93**	434
Prepayments - net of current portion	**799**	843
Advances and refundable deposits - net of current portion (Notes 2 and 20)	**1,413**	1,066
Total Noncurrent Assets	**191,435**	199,744
Current Assets		
Cash and cash equivalents (Notes 2, 13 and 24)	**8,471**	16,870
Short-term investments (Notes 2 and 24)	**11,522**	8,327
Trade and other receivables (Notes 2, 3, 14 and 24)	**10,245**	10,158
Inventories and supplies (Notes 2 and 15)	**1,641**	1,230
Derivative financial assets (Notes 2 and 24)	**80**	47
Current portion of prepayments	**4,385**	5,360
Current portion of advances and refundable deposits (Notes 2 and 20)	**192**	156
Total Current Assets	**36,536**	42,148
TOTAL ASSETS	**227,971**	241,892
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 - 441,819,482 shares as at September 30, 2007 and 442,375,057 shares as at December 31, 2006	**4,418**	4,424
Common stock, Php5 par value, authorized - 234,000,000 shares; issued and outstanding - 188,708,152 shares as at September 30, 2007 and 188,434,695 shares as at December 31, 2006	**944**	942
Stock options issued (Note 21)	**10**	40
Equity portion of convertible preferred stock (Note 17)	**9**	9
Capital in excess of par value	**66,998**	66,574
Retained earnings (Note 7)	**30,614**	32,784

Cumulative translation adjustments (Note 24)	**(1,223)**	(1,796)
Total Equity Attributable to Equity Holders of PLDT	**101,770**	102,977
Minority interest	**1,922**	1,546
Total Equity	**103,692**	104,523

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (*continued*)

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

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
Noncurrent Liabilities		
Interest-bearing financial liabilities - net of current portion (Notes 2, 8, 17, 22 and 24)	**57,299**	65,244
Deferred income tax liabilities (Notes 2, 4 and 6)	**523**	402
Derivative financial liabilities (Notes 2 and 24)	**6,800**	6,872
Pension and other employee benefits (Notes 2, 3 and 21)	**3,855**	2,982
Customers deposits	**2,210**	2,204
Other noncurrent liabilities (Notes 2, 3, 8, 14 and 18)	**8,885**	7,581
Total Noncurrent Liabilities	**79,572**	85,285
Current Liabilities		
Accounts payable (Notes 2 and 24)	**12,042**	8,634
Accrued expenses and other current liabilities (Notes 2, 3, 17, 19, 20 and 21)	**15,933**	19,102
Unearned revenues (Note 2)	**3,334**	3,274
Derivative financial liabilities (Notes 2 and 24)	**15**	108
Provisions for assessments (Notes 20, 22 and 23)	**474**	446
Current portion of interest-bearing financial liabilities (Notes 2, 8, 17, 22 and 24)	**9,477**	17,309
Dividends payable (Notes 2, 7, 17 and 24)	**1,068**	773
Income tax payable (Notes 2 and 6)	**2,364**	2,438
Total Current Liabilities	**44,707**	52,084
TOTAL EQUITY AND LIABILITIES	**227,971**	241,892

See accompanying Notes to Unaudited Consolidated Financial Statements.

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(in million pesos, except per share amounts)

	Nine Months Ended September 30,		**Three Months Ended September 30,**	
	2007	**2006**	**2007**	**2006**
	(Unaudited)			
INCOME				
Service revenues (Note 4)	**100,470**	92,003	**33,449**	31,364
Non-service revenues (Notes 4 and 5)	**1,860**	2,160	**543**	696
Equity share in net income of associates (Note 4)		1		(2)
Other income (Note 4)	**1,138**	1,236	**685**	900
	103,468	95,400	**34,677**	32,958
EXPENSES				
Depreciation and amortization (Notes 4 and 8)	**18,952**	23,659	**6,076**	8,175
Compensation and benefits (Notes 5 and 21)	**15,589**	13,184	**5,736**	5,568
Maintenance (Note 20)	**5,299**	4,890	**1,857**	1,604
Financing costs (Notes 5, 8, 17 and 24)	**3,857**	7,230	**679**	1,096
Selling and promotions	**3,855**	3,558	**1,357**	1,098
Cost of sales (Notes 5, 20 and 22)	**3,745**	4,006	**1,111**	1,402
Professional and other contracted services (Notes 5 and 20)	**3,468**	2,227	**1,143**	987
Rent (Note 22)	**2,168**	1,769	**757**	622
Taxes and licenses (Note 23)	**1,715**	1,288	**427**	374
Communication, training and travel	**1,307**	1,038	**421**	365
Provisions (Notes 3, 5, 14, 15, 20, 22 and 23)	**1,144**	872	**414**	102
Insurance and security services (Note 20)	**872**	973	**286**	313
Amortization of intangible assets (Note 11)	**286**	255	**105**	115
Equity share in net losses of associates	**17**		**9**	
Other expenses (Note 20)	**1,214**	953	**310**	265
	63,488	65,902	**20,688**	22,086
INCOME BEFORE INCOME TAX	**39,980**	29,498	**13,989**	10,872
PROVISION FOR INCOME TAX (Notes 2, 4 and 6)	**13,028**	3,131	**4,312**	145
NET INCOME FOR THE PERIOD	**26,952**	26,367	**9,677**	10,727
ATTRIBUTABLE TO:				
Equity holders of PLDT	**26,506**	25,744	**9,505**	10,439
Minority interest	**446**	623	**172**	288
	26,952	26,367	**9,677**	10,727
Earnings Per Common Share (Note 7)				

Basic	**138.71**	138.71	**49.76**	55.69
Diluted	**138.27**	138.58	**49.63**	55.58

See accompanying Notes to Unaudited Consolidated Financial Statements.

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(in million pesos)

	Preferred Stock	**Common Stock**	**Stock Options Issued**	**Equity Portion of Convertible Preferred Stock**	**Capital in Excess of Par Value**	**Retained Earnings**	**Cumulative Translation Adjustments**	**Equity Attributable to Equity Holders of the Parent**	**Minority Interest**	**Total Equity**
Balances at January 1, 2006	4,433	904	67	49	53,918	12,583	1,253	73,207	1,162	74,369
Income for the period						25,744		25,744	623	26,367
Foreign currency translation differences (Note 24)							(69)	(69)	(32)	(101)
Net gains on available-for-sale financial assets (Note 24)							5	5		5
Net losses on cash flow hedges (Note 24)							(1,862)	(1,862)		(1,862)
Total income and expense for the period recognized directly to equity							(1,926)	(1,926)	(32)	(1,958)
Total income and expense for the period						**25,744**	**(1,926)**	**23,818**	**591**	**24,409**
Cash dividends						**(14,779)**		**(14,779)**		**(14,779)**
Issuance of capital stock net (Note 16)	**(6)**	**36**		**(40)**	**11,846**			**11,836**		**11,836**
Exercised shares			**(24)**		**81**			**57**		**57**
Minority interest									**8**	**8**
Balances at September 30, 2006 (Unaudited)	**4,427**	**940**	**43**	**9**	**65,845**	**23,548**	**(673)**	**94,139**	**1,761**	**95,900**

Balances at January 1, 2007	4,424	942	40	9	66,574	32,784	(1,796)	102,977	1,546	104,523
Income for the period						26,506		26,506	446	26,952
Foreign currency translation differences (Note 24)							(935)	(935)	(44)	(979)
Net gains on available-for-sale financial assets) (Note 24)							31	31		31
Net gains on cash flow hedges (Note 24)							1,477	1,477		1,477
Total income and expense for the period recognized directly to equity							573	573	(44)	529
Total income and expense for the period						**26,506**	**573**	**27,079**	**402**	**27,481**
Cash dividends (Note 7)						**(28,676)**		**(28,676)**	**(12)**	**(28,688)**
Issuance of capital stock net (Note 16)	**(6)**	**1**			**321**			**316**		**316**
Exercised shares (Note 21)		**1**	**(30)**		**103**			**74**		**74**
Minority interest									**(14)**	**(14)**
Balances at September 30, 2007 (Unaudited)	**4,418**	**944**	**10**	**9**	**66,998**	**30,614**	**(1,223)**	**101,770**	**1,922**	**103,692**

See accompanying Notes to Unaudited Consolidated Financial Statements.

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in million pesos)

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before income tax	**39,980**	29,498
Adjustments for:		
Depreciation and amortization (Notes 4 and 8)	**18,952**	23,659
Interest on loans and related items - net of capitalized interest (Note 5)	**4,630**	5,685
Provision for doubtful accounts (Notes 3 and 5)	**1,054**	697
Accretion on financial liabilities - net (Note 5)	**834**	3,045
Amortization of intangible assets (Note 11)	**286**	255
Loss on derivative transactions - net (Notes 5 and 24)	**207**	151
Write-down of inventories to net realizable values (Note 5)	**62**	189
Provisions for assessments (Note 5)	**28**	(14)
Equity share in net losses (income) of associates (Note 4)	**17**	(1)
Dividends on preferred stock subject to mandatory redemption (Note 5)	**14**	113
Interest income (Note 5)	**(1,112)**	(1,297)
Foreign exchange gains - net (Note 5)	**(1,662)**	(1,601)
Others	**(204)**	(624)
Operating income before working capital changes	**63,086**	59,755
Decrease (increase) in:		
Trade and other receivables	**(1,637)**	(1,406)
Inventories and supplies	**(376)**	202
Prepayments	**1,165**	571
Advances and refundable deposits	**(35)**	1,238
Increase (decrease) in:		
Accounts payable	**3,586**	(3,360)
Accrued expenses and other current liabilities	**1,829**	1,086
Unearned revenues	**25**	398
Pension and other employee benefits	**(4,105)**	3,262
Net cash generated from operations	**63,538**	61,746
Income taxes paid	**(8,039)**	(5,600)
Net cash provided by operating activities	**55,499**	56,146
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to property, plant and equipment	**(14,130)**	(16,444)
Proceeds from disposal of property, plant and equipment	**533**	792
Interest paid - capitalized to property, plant and equipment (Notes 5 and 8)	**(399)**	(428)

Payments for purchase of investments - net of cash acquired (Note 11)	**(2,287)**	(10,724)
Proceeds from disposal of investment properties	**3**	26
Decrease (increase) in short-term investments	**(3,553)**	41
Decrease in investments in notes receivable		90
Increase in investment in debt securities	**(264)**	
Decrease in investments-held-for-sale	**5**	
Interest received	**901**	1,184
Decrease (increase) in advances and refundable deposits	**(366)**	202
Net cash used in investing activities	**(19,557)**	(25,261)

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (*continued*)

(in million pesos)

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited)	
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from availment of long-term debt (Note 17)	**5,429**	5,011
Payments of long-term debt (Note 17)	**(16,207)**	(23,366)
Payments of debt issuance costs	**(14)**	(21)
Proceeds from notes payable	**360**	129
Payments of notes payable	**(87)**	(64)
Payments of obligations under capital lease	**(146)**	(145)
Interest paid - net of capitalized portion	**(4,423)**	(5,281)
Settlements of derivatives	**(857)**	(1,778)
Cash dividends paid	**(28,394)**	(14,847)
Proceeds from issuance of capital stock	**74**	59
Redemption of shares	**(14)**	
Increase (decrease) in:		
Customers deposits	**14**	12
Other noncurrent liabilities	**285**	(1,472)
Net cash used in financing activities	**(43,980)**	(41,763)
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**(361)**	(521)
NET DECREASE IN CASH AND CASH EQUIVALENTS	**(8,399)**	(11,399)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	**16,870**	30,059
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**8,471**	18,660

See accompanying Notes to Unaudited Consolidated Financial Statements.

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Corporate Information

The Philippine Long Distance Telephone Company, or PLDT, or Parent Company, was incorporated under the old Corporation Law of the Philippines (Act 1459, as amended) on November 28, 1928, following the merger of four telephone companies under common U.S. ownership. Under its amended Articles of Incorporation, PLDT s corporate term is currently limited through 2028. In 1967, effective control of PLDT was sold by 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, and its Philippine and other affiliates, or collectively the First Pacific Group, acquired a significant interest in PLDT. On March 24, 2000, NTT Communications Corporation, or NTT Communications, through its wholly-owned subsidiary NTT Communications Capital (UK) Ltd., or NTTC-UK, became PLDT s strategic partner with approximately 15% economic and voting interest in the issued and outstanding common stock of PLDT. Simultaneous with NTT Communications investment in PLDT, we acquired 100% of Smart Communications, Inc., or Smart. On March 14, 2006, NTT DoCoMo, Inc., or DoCoMo, acquired from NTT Communications approximately 7% of PLDT s outstanding common shares held by NTT Communications with NTT Communications retaining ownership of approximately 7% of PLDT s common shares. On February 28, 2007, Metro Pacific Asset Holdings, Inc., a Philippine affiliate of First Pacific completed the acquisition of an additional interest of approximately 46% in Philippine Telecommunications Investment Corporation, or PTIC, a shareholder of PLDT. This additional investment in PTIC represents an attributable interest of approximately 6.4% of the issued common shares of PLDT and thereby raised First Pacific Group s beneficial ownership to approximately 28% of PLDT s shares of common stock as at that date.

The common shares of PLDT are listed and traded on the Philippine Stock Exchange, or PSE. On October 19, 1994, an American Depositary Receipt, or ADR, facility was established, pursuant to which Citibank N.A., as the 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. Effective
February 10, 2003, PLDT appointed JP Morgan Chase Bank as successor depositary for PLDT s ADR facility. The ADSs are listed on the New York Stock Exchange, or NYSE, in the United States and are traded on the NYSE under the symbol PHI . As at December 31, 2006, there were a total of over 37 million ADSs outstanding.

Until recently, the ADSs were also listed on the NYSE Arca. However, on December 18, 2006, PLDT issued a notice of its intent to voluntarily delist its ADSs from NYSE Arca, after determining that doing so is in the best interest of PLDT and its stockholders as it would eliminate the duplicative administrative burdens and costs inherent in dual listing on both the NYSE and NYSE Arca. The actual delisting from the NYSE Arca became effective on February 12, 2007.

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.

2. Summary of Significant Accounting Policies and Practices

Basis of Preparation

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

Our unaudited consolidated financial statements include, in our opinion, adjustments consisting only of normal recurring adjustments, necessary to present fairly the results of operations for the interim periods. The results of operations for the nine months ended September 30, 2007 are not necessarily indicative of the results of operations that may be expected for the full year.

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

Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year except that we have adopted the following new and amendments to existing Philippine Accounting Standards, or PAS, PFRS and Philippine Interpretations of International Financial Reporting Interpretations Committee, or IFRIC, during the year. Our adoption of these new and revised standards and interpretations did not have any effect on our financial statements. Our adoption, however, gave rise to additional disclosures on the following:

- IFRIC 7 Applying the Restatement Approach under PAS 29, Financial Reporting in Hyperinflationary Economies;
- IFRIC 8 Scope of PFRS 2, Share-based Payment;
- IFRIC 9 Reassessment of Embedded Derivatives;
- IFRIC 10 Interim Financial Reporting and Impairment;
- PAS 1 Amendments Presentation of Financial Statements Capital Disclosures; and
- PFRS 7 Financial Instruments Disclosures.

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

IFRIC 7, Applying the Restatement Approach under PAS 29, Financial Reporting in Hyperinflationary Economies **.** The Interpretation requires that when a country becomes hyperinflationary, PAS 29 must be applied as if the country had always been hyperinflationary and it provides guidance on calculating deferred taxes and comparatives. As we do not operate in a hyperinflationary economy, this standard has had no impact on our unaudited consolidated financial statements.

IFRIC 8, Scope of PFRS 2, Share-based Payment **.** The Interpretation clarifies that PFRS 2 applies to share-based payment transactions in which the entity cannot specifically identify some or all of the goods or services received. If the value of the identifiable consideration received (if any) appears to be less than the fair value of the equity instruments granted or the liability incurred, this is an indication of other consideration (i.e., unidentifiable goods or services) has been (or will be) received which should be measured in accordance with PFRS 2. The adoption has had no significant impact on our unaudited consolidated financial statements as at September 30, 2007.

***IFRIC 9, Reassessment of Embedded Derivatives*.** The Interpretation clarifies when an entity should reassess whether an embedded derivative needs to be separated from the host contract after the initial hybrid contract is recognized. It concludes that reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. The adoption has had no significant impact on our unaudited consolidated financial statements as at September 30, 2007.

***IFRIC 10, Interim Financial Reporting and Impairment*.** The Interpretations states that any such impairment losses recognized in an interim financial statement must not be reversed in subsequent interim or annual financial statements. The adoption has had no significant impact on our unaudited consolidated financial statements as at September 30, 2007.

***Amendments to PAS 1, Presentation of Financial Statements Capital Disclosures*.** This amendment requires us to include new disclosures to enable users of the financial statements to evaluate our objectives, policies and processes for managing capital. The adoption has had no significant impact on our unaudited consolidated financial statements as at September 30, 2007 except for additional disclosures as required by the standard.

***PFRS 7, Financial Instruments Disclosures*.** This introduces new disclosures to improve information about our consolidated financial statements and the nature and extent of risks arising from financial instruments. The revised disclosures on financial instruments provided by this standard are included on our unaudited consolidated financial statements.

Basis of Consolidation

Our unaudited 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	Philippines	Internet broadband distributor		100.0
Wolfpac Mobile, Inc., or Wolfpac	Philippines	Mobile applications developer and service provider		100.0
Pilipino Telephone Corporation, or Piltel	Philippines	Cellular and fixed line services		92.1
Telesat, Inc., or Telesat	Philippines	Satellite communications services	100.0	

AceS Philippines Cellular Satellite Corporation, or AceS Philippines	Philippines	Satellite information and messaging 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, or ICT				
ePLDT, Inc., or ePLDT	Philippines	Information and communications infrastructure for Internet-based services, e-commerce, call centers and IT-related services	100.0	
SPi Technologies, Inc., or SPi, and Subsidiaries	Philippines	Business process outsourcing, or BPO, services		100.0
ePLDT Ventus, Inc., or Ventus	Philippines	Call center 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
Infocom Technologies, Inc., or Infocom	Philippines	Internet services		99.6
netGames, Inc., or netGames	Philippines	Publisher of online games		80.0
Digital Paradise, Inc., or Digital Paradise, (formerly Netopia Computer Technologies, Inc.)	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 fully consolidated from the date when control is transferred to the PLDT Group and cease to be consolidated from the date when control is transferred out of the PLDT Group.

We prepare our unaudited 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, Level Up!, Mabuhay Satellite, Maratel, BCC, Digital Paradise, Digital Paradise Thailand, netGames, Infocom, and Airborne Access, not held by the PLDT Group.

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, is aimed to strengthen ePLDT s online gaming business in the Philippines. Post-closing conditions were completed on April 30, 2006. In August 2006, the Shareholders Agreement and Share Purchase Agreement between ePLDT and Level Up! were amended to reflect the removal of earn-out and price adjustment provisions thereby fixing the acquisition for 60% 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 s Acquisition of CyMed, Inc., or CyMed

On August 11, 2006, SPi in turn acquired a 100% 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.

SPi s Acquisition of Springfield Service Corporation, or Springfield

On April 16, 2007, SPi acquired, through a wholly-owned US subsidiary, 100% of Springfield for an aggregate purchase price of US$35 million, or Php1,664 million, plus possible future earn-out payments with an aggregate fair value at acquisition date of Php962 million. Springfield is one of the largest players in the medical billing and revenue cycle management market. As at September 30, 2007, SPi s total investment in Springfield amounted to Php2,685 million, including fair value of possible future earn-out payments of Php960 million and incidental costs of Php59 million, see *Note 11 Goodwill and Intangible Assets* for related discussion.

Piltel s Equity Restructuring

On April 20, 2007, the Philippine Securities and Exchange Commission, or Philippine SEC, approved Piltel s request to undergo equity restructuring to eliminate its deficit as at December 31, 2006 amounting to Php22,251 million against its additional paid-in capital. The equity restructuring was approved by Piltel s Board of Directors on March 5, 2007.

Incorporation of SPi Global Solutions Corporation, or SPi Global

On October 5, 2007, the Philippine SEC approved the incorporation of SPi Global, a wholly-owned subsidiary of ePLDT. SPi Global will be the holding company of the BPO voice and non-voice businesses of ePLDT.

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 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. Our unaudited consolidated statement 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 unaudited consolidated statements 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 Translations

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 recognized in the consolidated statement 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 period 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 reporting 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 period. 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 the cumulative translation adjustments recognized in equity relating to subsidiaries are recognized in the consolidated statement of income.

Property, Plant and Equipment

Property, plant and equipment, except for land, 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 period 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 statement 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 substantially available for their intended use.

Borrowing Costs

Borrowing costs are capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset. Capitalization of borrowing costs commences when the activities 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 period 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, plant 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

Investment properties are initially measured at cost including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met; and excludes the costs of day to day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at fair value, which 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 statement of income in the period in which they arise.

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

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

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

Business Combinations and Goodwill

Business combinations are accounted for using the purchase method of accounting. This involves recognizing identifiable assets (including previously unrecognized intangible assets) and liabilities (including contingent liabilities and excluding future restructuring) of 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 statement 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 period 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 statement 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 statement of income when the asset is derecognized.

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

Impairment of Non-Financial Assets

We assess at each reporting period 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 the fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded subsidiaries or other available fair value indicators.

Impairment losses of continuing operations are recognized in the consolidated statement of income in those expense categories consistent with the function of the impaired asset, except for property previously revalued where the revaluation was taken to equity. In this case, the impairment is also recognized in equity up to the amount of any previous revaluation.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, we make an estimate of recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset s recoverable amount since the last impairment loss was recognized. If this is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior periods. Such reversal is recognized in the consolidated statement of income. After such a reversal, the depreciation charged is adjusted in future periods to allocate the asset s revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

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

Goodwill

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount of the cash-generating unit (group of cash-generating units) to which goodwill has been allocated, an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods.

Intangible Assets

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash generating unit level, as appropriate.

Investments in Associates

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

Research and Development Costs

Research and development costs are expensed as incurred.

Cash and Cash Equivalents

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

Trade and Other Receivables

Trade and other receivables are stated at face value, net of allowance for any doubtful accounts.

Allowance for Doubtful Accounts

The PLDT Group s accounting policy in evaluating any impairment of receivable is discussed under impairment of financial assets section of this Note. Consequently, allowance for doubtful accounts is maintained at a level considered adequate to provide for uncollectible receivables. The level of allowance is based on historical collections, write-off experience, current economic trends, changes in our customer payment terms and other factors that may affect our ability to collect payments. An evaluation of the receivables, designed to identify potential charges to the allowance, is performed on a continuous basis during the period.

Subscribers. Full allowance is provided for receivables from permanently disconnected subscribers. Permanent disconnections are made after a series of collection steps following non-payment by subscribers. Such permanent disconnections generally occur within 105 days from the date of payment was due. Partial allowance is provided for active subscribers based on the historical loss experience and aging profile of the receivable.

Traffic settlement receivables net. Full allowance is provided for carrier accounts which are considered over-due and after a review of the status of settlement with other carriers.

Inventories and Supplies

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

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

Interest-bearing Financial Liabilities

All loans and borrowings are initially recognized at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method.

Gains and losses are recognized in the consolidated statement of income when the liabilities are derecognized as well as through the amortization process.

Convertible Preferred Stock

Peso-denominated

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

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

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

Foreign currency-denominated

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

Provisions

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

Retirement Benefits

Defined Benefit Pension

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

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

Upon our adoption of *PAS 19, Employee Benefits ,* in 2004, we opted to amortize our transition liabilities for the three years until December 31, 2006, see *Note 21 Employee Benefits*.

Defined Contribution Plans

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

Share-Based Payment Transactions

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

Equity-settled transactions

The cost of equity-settled transactions with employees is measured by reference to the fair value of the stock options at the date at which they are granted. Fair value is determined using an option-pricing model, further details of which are set forth in *Note 21 Employee Benefits*. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of PLDT (market conditions).

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

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

Where the terms of an equity-settled award are modified, an expense, at a minimum, is recognized as if the terms had not been modified. An expense is recognized for any increase in the value of the transactions as a result of the modification, as measured at the date of modification.

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

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

Cash-settled transactions

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

Leases

The determination of whether an arrangement contains a lease is based on the substance of the arrangement at the inception date of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset. A reassessment is made after the inception date of the lease only if the following criteria apply: (1) there is a change in the contractual terms, other than a renewal or extension of the arrangement; (2) a renewal option is exercised or an extension is granted, unless the term of the renewal or extension was initially included in the lease term; (3) there is a change in the determination of whether fulfillment is dependent on a specified asset; or (4) there is a substantial change to the asset.

Where a reassessment is made, lease accounting commences or ceases, as the case may be, from the date when the change in circumstances gives rise to the reassessment for scenarios (1), (3) or (4) and at the date of renewal or extension period for scenario (2).

For arrangements entered into prior to January 1, 2005, the date of inception is deemed to be January 1, 2005 in accordance with the transitional requirements of *IFRIC 4, Determining Whether an Arrangement Contains a Lease* .

Lease obligations having provisions for bargain purchase options, or ownership transfer at the end of the lease term, or a lease term equal to 75% or more of the estimated economic life of the leased property, or lease obligations where the present value at the beginning of the lease term of the minimum lease payments (excluding executory costs and taxes to be paid or paid by the lessor and including any profit thereon) equals or exceeds 90% of the fair value of the leased property, are capitalized. The related obligations are recognized as liabilities at fair value. Minimum lease payments are allocated between the finance charges and reduction of the lease liability so as to achieve a constant periodic rate of interest on the remaining balance of the liability.

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

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

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are deferred and amortized on a straight-line method over the lease term on the same bases as the lease income. Operating lease payments are recognized as an expense in the consolidated statement of income on a straight-line basis over the lease term. For income tax reporting purposes, expenses that should have been incurred under a lease agreement are considered as deductible expenses.

Revenue Recognition

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

Service revenues

Subscriptions

We provide telephone and data communication services under prepaid and postpaid payment arrangements. Revenues, including fees for installation and activation, are accrued upon subscription.

Air time, traffic and value-added services

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

Business Process Outsourcing, or BPO

Where applicable, supplemental revenues are recognized depending on service levels or achievement of certain performance measurement targets. We recognize these supplemental revenues only after it has achieved the required measurement targets. When these service levels or performance measurement targets are not achieved, we grant service credits as a reduction in fees. Advance customer receipts that have not been recognized as revenue in accordance with its stated policies are recorded as advances from customers and presented as a liability in the consolidated balance sheet. If the fee is not fixed or determinable, revenue is not recognized on those arrangements until the customer payment is received. For arrangements requiring specific customer acceptance, revenue recognition is deferred until the earlier of the end of the deemed acceptance period or until a written notice of acceptance is received from the customer. Revenue on services rendered to customers whose ability to pay is in doubt at the time of performance of services is also not recorded. Rather, revenue is recognized from these customers as payment is received.

Incentives

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

Non-service revenues

Handset and equipment sales

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

Interest income

Interest income is recognized as it accrues on a time proportion basis taking into account the principal amount outstanding and the effective interest rate.

Income Taxes

Current income tax

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

Deferred income tax

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

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

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

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

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

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

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

Earnings Per Common Share, or EPS

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

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

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

If the required dividends to be declared on each series of convertible preferred shares divided by the number of equivalent common shares, assuming such convertible preferred shares are converted to common shares, would decrease the basic EPS, then such convertible preferred shares would be deemed

dilutive. As such, the diluted EPS will be calculated by dividing consolidated net income attributable to common shareholders (consolidated net income, adding back any dividends and/or other charges recognized in the period related to the dilutive convertible preferred shares classified as liability, less dividends on non-dilutive preferred shares except for dividends on preferred stock subject to mandatory redemption) by the weighted average number of common shares including the common share equivalent arising from the conversion of the dilutive convertible preferred shares.

Investments and Other Financial Assets and Liabilities

Financial assets and liabilities within the scope of *PAS 39, Financial Instruments: Recognition and Measurement ,* *a*re classified as either financial assets and liabilities at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets, as appropriate. We determine the classification of our financial assets and liabilities after initial recognition and, where allowed and appropriate, re-evaluates this designation at each balance sheet date. When financial assets and liabilities are recognized initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable to transaction costs. The fair value of investments that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm s length market transactions; reference to the current market value of another instrument which is substantially the same; discounted cash flow analysis or other valuation models.

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

Financial assets and liabilities at fair value through profit or loss

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

Financial assets and liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments or a financial guarantee contract. Gains or losses on investments or liabilities held for trading are recognized in profit and loss.

Where a contract contains one or more embedded derivatives, the entire hybrid contract may be designated as a financial asset and financial liability at fair value through profit or loss, except where the embedded derivative does not significantly modify the cash flows or it is clear that separation of the embedded derivative is prohibited.

Financial assets and liabilities may be designated at initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets and liabilities or recognizing gains or losses on them on a different basis; or (ii) the assets and liabilities are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial assets and liabilities contains an embedded derivative that would need to be separately recorded.

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets which carry fixed or determinable payments and fixed maturities and which we have the positive intention and ability to hold to maturity. After initial measurement, held-to-maturity investments are measured at amortized cost in the consolidated balance sheet. This cost is computed as the amount initially recognized minus principal repayments, plus or minus the cumulative amortization using the effective interest rate method of any difference between the initially recognized amount and the maturity amount, less allowance for impairment. This calculation includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate method, transaction costs and all other premiums and discounts. Gains and losses are recognized in the consolidated statement of income when the investments are derecognized or impaired, as well as through the amortization process.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, loans and receivables are subsequently carried at amortized cost in the consolidated balance sheet using the effective interest rate method less any allowance for impairment. Amortized cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate method and transaction costs. Gains and losses are recognized in the consolidated statement of income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial measurement, available-for-sale financial assets are measured at fair value in the consolidated balance sheet with unrealized gain or loss being recognized directly in equity in the cumulative translation adjustments except when the financial asset is impaired. When the investment is disposed of, the cumulative gain or loss previously recorded in equity is recognized in the consolidated statement of income. Interest earned or paid on the investments is reported as interest income or expense using the effective interest rate method. Dividends earned on investments are recognized in the consolidated statement of income when the right of payment has been established.

We consider whether a contract contains an embedded derivative, when the entity first becomes a party to it. The embedded derivatives are separated from the host contract which is not measured at fair value through profit or loss when the analysis shows that the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract.

Impairment of Financial Assets

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

Assets carried at amortized cost

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

We first assess whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

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

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

Available-for-sale financial assets

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

Derecognition of Financial Assets and Liabilities

Financial assets

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

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

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

Financial liabilities

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

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

Derivative Financial Instruments and Hedging

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

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

The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of long-term currency swaps, foreign currency options and interest rate swap contracts is determined by reference to market values for similar instruments.

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

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

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

Fair value hedges

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

For fair value hedges relating to items carried at amortized cost, the adjustment to carrying value is amortized through the consolidated statement of income over the remaining term to maturity. Any adjustment to the carrying amount of a hedged financial instrument for which the effective interest rate method is used is amortized through the consolidated statement of income.

Amortization may begin as soon as an adjustment exists, beginning no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged.

If the hedge item is derecognized, the unamortized fair value is recognized immediately in the consolidated statement of income.

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

Cash flow hedges

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

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

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

Hedges of a net investment

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

New Accounting Standards Subsequent to September 2007

Following are the new PFRS and IFRIC, which will be effective subsequent to September 30, 2007:

***IFRIC 11, PFRS 2, Group and Treasury Share Transactions*.** This will become effective for annual periods beginning on or after March 31, 2007. This Interpretation addresses issues whether transactions should be accounted for as equity-settled or as cash-settled under PFRS 2 and issues the concerning share-based payment arrangement involving entities within the same group.

***IFRIC 12, Service Concession Arrangements*.** This will become effective on January 1, 2008. This interpretation, which covers contractual arrangements arising from entities providing public services, is not relevant to our current operations.

PFRS 8, Operating Segments**.** The standard is effective beginning January 1, 2009 and will replace PAS 14 and adopts a management approach to reporting segment information. The requirements of this standard will be included on our consolidated financial statements when the standard is adopted.

We expect that the adoption of the pronouncements listed above will have no significant impact on our consolidated financial statements in the period of our initial application.

3. Management s Use of Judgments, Estimates and Assumptions

The preparation of our unaudited consolidated financial statements in conformity with PFRS requires us to make judgments, estimates and assumptions that affect the reported amounts of our assets and liabilities and disclosure of contingent assets and liabilities at the date of our unaudited consolidated financial statements, and the reported amounts of revenues and expenses during the period reported and related notes. In preparing our unaudited consolidated financial statements, we have made our best judgments, estimates and assumptions of certain amounts, giving due consideration to materiality. We believe the following represents a summary of these significant judgments, estimates and assumptions and related impacts and associated risks to our unaudited consolidated financial statements.

Estimating useful lives of property, plant and equipment

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

Total carrying values of property, plant and equipment, net of accumulated depreciation and amortization amounted to Php159,288 million and Php164,190 million as at September 30, 2007 and December 31, 2006, respectively, see *Note 8 Property, Plant and Equipment*.

Goodwill and intangible assets

Purchase accounting requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair market values of the acquiree s identifiable assets and liabilities at the acquisition date. It also requires the acquiree to recognize goodwill. Our business acquisitions have resulted in goodwill and intangible assets, which are subject to periodic impairment test and amortization, respectively, see *Note 11 Goodwill and Intangible Assets*.

Total carrying values of goodwill and intangible assets as at September 30, 2007 and December 31, 2006 amounted to Php13,701 million and Php12,214 million, respectively. We have no impairment losses recognized for the nine months ended September 30, 2007 and 2006.

Asset impairment

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

Determining the fair values of property, plant and equipment, investments and intangible assets, which requires the determination of future cash flows expected to be generated from the continued use and ultimate disposition of such assets, requires us to make estimates and assumptions that can materially affect our unaudited consolidated financial statements. Future events could cause us to conclude that property, plant and equipment, investments and intangible assets associated with an acquired business are impaired. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

The preparation of estimated future cash flows involves significant judgments and estimations. While we believe that our assumptions are appropriate and reasonable, significant changes in our assumptions may materially affect our assessment of recoverable values and may lead to future additional impairment charges under PFRS. We have no impairment losses recognized for the nine months ended
September 30, 2007 and 2006.

Investment properties

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

Total carrying values of investment properties as at September 30, 2007 and December 31, 2006 amounted to Php580 million and Php587 million, respectively, see *Note 10 Investment Properties*.

Realizability of deferred income taxes

We review the carrying amounts of deferred income tax assets at each balance sheet date and reduce these to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred income tax assets to be utilized. Our assessment on the recognition of deferred income tax assets on deductible temporary differences is based on the forecasted taxable income of the subsequent reporting periods. This forecast is based on our past results and future expectations on revenues and expenses. As management believes, it will have no sufficient future taxable income to utilize the benefits of deductible temporary differences. However, there is no assurance that we will generate sufficient taxable income to allow all or part of our deferred income tax assets to be utilized.

Total unrecognized deferred income tax assets as at September 30, 2007 and December 31, 2006 amounted to Php322 million and Php299 million, respectively, see *Note 6 Income Tax*.

Determination of fair values of financial assets and liabilities

We carry certain of our financial assets and liabilities at fair value, which requires extensive use of accounting estimates and judgments. In addition, certain liabilities acquired through debt exchange and restructuring are required to be carried at fair value at the time of the debt exchange and restructuring, see *Note 24 Financial Assets and Liabilities*. While significant components of fair value measurement were determined using verifiable objective evidence (i.e., foreign exchange rates, interest rates, volatility rates), the amount of changes in fair value would differ if we utilized a different valuation methodology. Any change in fair value of these financial assets and liabilities would directly affect our consolidated statement of income and equity.

Total fair value of financial assets and liabilities as at September 30, 2007 amounted to Php30,822 million and Php90,922 million, respectively, while the total fair value of financial assets and liabilities as at December 31, 2006 amounted to Php35,952 million and Php106,301 million, respectively, see *Note 24 Financial Assets and Liabilities*.

Estimating allowance for doubtful accounts

We estimate the allowance for doubtful accounts related to our trade receivables based on two methods. The amounts calculated using each of these methods are combined to determine the total amount we reserve. We evaluate specific accounts where we have information that certain customers are unable to meet their financial obligations. In these cases, we use judgment based on the best available facts and circumstances, including but not limited to, the length of our relationship with the customer and the customer s current credit status based on third party credit reports and known market factors, to record specific reserves for customers against amounts due in order to reduce our receivables to amounts that we expect to collect. These specific reserves are re-evaluated and adjusted as additional information received affects the amounts estimated. Full allowance is provided for receivables from permanently disconnected subscribers and carriers. Such permanent disconnections generally occur within 105 days from the date of payment was due. Partial allowance is provided for active subscribers and carriers based on the age status of receivables.

The amounts and timing of recorded expenses for any period would differ if we made different judgments or utilized different estimates. An increase in our allowance for doubtful accounts would increase our recorded operating expenses and decrease our current assets.

Provision for doubtful accounts amounted to Php1,054 million and Php697 million for the nine months ended September 30, 2007 and 2006, respectively. Trade and other receivables, net of allowance for doubtful accounts, amounted to Php10,245 million and Php10,158 million as at September 30, 2007 and December 31, 2006, respectively, see *Note 5 Income and Expenses* and *Note 14 Trade and Other Receivables*.

Asset retirement obligations

Asset retirement obligations are recognized in the period in which they are incurred if a reasonable estimate of fair value can be made. This requires an estimation of the cost to restore/dismantle on a per square meter basis, depending on the location, and is based on the best estimate of the expenditure required to settle the obligation at the balance sheet date, discounted using a pre-tax rate that reflects the current market assessment of the time value of money and, where appropriate, the risk specific to the liability. Total provision for asset retirement obligations amounted to Php909 million and Php831 million as at September 30, 2007 and December 31, 2006, respectively, see *Note 8 Property, Plant and Equipment* and *Note 18 Other Noncurrent Liablities*.

Revenue recognition

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

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

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

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

Estimation of pension cost and other retirement benefits

The determination of our obligation and cost for pension and other retirement benefits is dependent on our selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in *Note 21 Employee Benefits* and include, among other things, discount rates, expected returns on plan assets and rates of compensation increases. In accordance with PFRS, actual results that differ from our assumptions are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceed 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. While we believe that our assumptions are reasonable and appropriate, significant differences in our actual experience or significant changes in our assumptions may materially affect our pension and other retirement obligations.

Unrecognized net actuarial loss as at September 30, 2007 and December 31, 2006 amounted to Php4,561 million and Php4,657 million, respectively. The accrued benefit cost as at September 30, 2007 and December 31, 2006 amounted to Php2,651 million and Php2,888 million, respectively, see *Note 21 Employee Benefits*.

Share-based payment transactions

Our LTIP grants share appreciation rights, or SARs, to our eligible key executives and advisors. Under the LTIP, we recognize the services we receive from the eligible key executives and advisors, and our liability to pay for those services, as the eligible key executives and advisors render services during the vesting period. We measure our liability, initially and at each reporting date until settled, at the fair value of the SARs, by applying an option valuation model, taking into account the terms and conditions on which the SARs were granted, and the extent to which the eligible key executives and advisors have rendered service to date. We recognize any changes in fair value at each reporting date until settled, in the results of operations for the period. The assumptions and estimates are described in *Note 21 Employee Benefits* and include, among other things, annual stock volatility, risk free interest rate, remaining life, and the fair value of common stock. While management believes that the assumptions and estimates used are reasonable and appropriate, significant differences in our actual experience or significant changes in the assumptions may materially affect the stock compensation costs charged to operations. The fair value of the LTIP recognized as an expense for the nine months ended
September 30, 2007 (under the 2007 to 2009 LTIP) and 2006 (under the 2004 to 2006 LTIP) amounted to Php1,100 million and Php2,677 million, respectively. As at September 30, 2007 and December 31, 2006, total LTIP liability amounted to Php1,175 million and Php5,030 million, respectively, see
Note 5 Income and Expenses and *Note 21 Employee Benefits*.

Legal contingencies

We are currently involved in various legal proceedings. Our estimate of the probable costs for the resolution of these claims has been developed in consultation with outside counsel handling our defense in these matters and is based upon an analysis of potential results. We currently do not believe these proceedings will have a material adverse effect on our unaudited consolidated financial statements. It is possible, however, that future results of operations could be materially affected by changes in our estimates or in the effectiveness of our strategies relating to these proceedings, see *Note 23 Provisions and Contingencies.*

Determination of functional currency

Based on the economic substance of the underlying circumstances relevant to the PLDT Group, the functional and presentation currency of the PLDT Group (except for 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 statement 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 period such 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 reporting currency of the PLDT Group at the rate of exchange prevailing at the balance sheet date and its income and expenses are translated at the weighted average exchange rate for the period. 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 is recognized in the consolidated statement of income.

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

4. Segment Information

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

We have organized our business into three main segments:

- Wireless - wireless telecommunications services provided through our cellular service providers namely, Smart and Piltel; Smart Broadband, our wireless broadband provider; Wolfpac, our wireless content operator; Mabuhay Satellite, ACeS Philippines and 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: ClarkTel, SubicTel, Maratel, Piltel, BCC, PLDT Global and SNMI, which together account for approximately 3% of our consolidated fixed line subscribers; and

• ICT - information and communications infrastructure and services for internet applications, internet protocol-based solutions and multimedia content delivery provided by PLDT s subsidiary ePLDT; BPO provided services by SPi Group (consolidated on July 11, 2006); call center services provided under the umbrella brand name *ePLDT Ventus*, include Ventus, Parlance and Vocativ; internet access and online gaming services provided by ePLDT s subsidiaries, namely, Infocom, Digital Paradise, Digital Paradise Thailand, netGames, Airborne Access and Level Up!; and e-commerce and IT-related services provided by other investees of ePLDT, as described in *Note 9 Investments in Associates*.

Transfer prices between business segments are set on an arm s-length basis in a manner similar to transactions with third parties. Segment revenue, segment expense and segment result include transfers between business segments. These transfers are eliminated in consolidation.

The segment assets as at September 30, 2007 and December 31, 2006 and results of operations of our reportable segments for the nine months ended September 30, 2007 and 2006 are as follows:

	Wireless	Fixed Line	ICT	Inter-segment Transactions	Total
			(in million pesos)		
As at and for the nine months ended September 30, 2007 (Unaudited)					
Income					
Service revenues	64,059	35,664	7,416	(6,669)	100,470
Non-service revenues	1,630	119	200	(89)	1,860
Other income	718	459	27	(66)	1,138
Segment income	66,407	36,242	7,643	(6,824)	103,468
Result					
Income (loss) before income tax	34,068	5,978	(66)		39,980
Provision for (benefit from) income tax	11,121	1,980	(73)		13,028
Net income for the period	22,947	3,998	7		26,952
Assets and liabilities					
Segment assets	82,559	172,848	19,456	(60,700)	214,163
Deferred income tax assets	1,113	12,545	150		13,808
Total assets	83,672	185,393	19,606	(60,700)	227,971
Segment liabilities	47,379	79,822	6,067	(9,512)	123,756
Deferred income tax liabilities			523		523
Total liabilities	47,379	79,822	6,590	(9,512)	124,279
Other segment information					
Capital expenditures	7,085	7,049	395		14,529

Depreciation and amortization	8,907	9,330	715		18,952
Provisions	272	857	15		1,144
Interest on loans and related items - net of capitalized interest	1,081	3,525	24		4,630
Interest income	860	238	14		1,112
As at December 31, 2006 (Audited) and for the nine months ended September 30, 2006 (Unaudited)					
Income					
Service revenues	58,016	35,901	3,788	(5,702)	92,003
Non-service revenues	1,842	71	339	(92)	2,160
Equity share in net income of associates			1		1
Other income	630	657	18	(69)	1,236
Segment income	60,488	36,629	4,146	(5,863)	95,400
Result					
Income before income tax	28,833	647	18		29,498
Provision for (benefit from) income tax	3,076	60	(5)		3,131
Net income for the period	25,757	587	23		26,367
Assets and liabilities					
Segment assets	86,905	184,096	17,431	(66,198)	222,234
Deferred income tax assets	4,991	14,608	59		19,658
Total assets	91,896	198,704	17,490	(66,198)	241,892
Segment liabilities	48,751	91,192	3,396	(6,372)	136,967
Deferred income tax liabilities	6		396		402
Total liabilities	48,757	91,192	3,792	(6,372)	137,369
Other segment information					
Capital expenditures	9,152	6,983	737		16,872
Depreciation and amortization	7,948	15,248	463		23,659
Provisions	397	478	(3)		872
Interest on loans and related items - net of capitalized interest	1,069	4,603	13		5,685
Interest income	911	373	13		1,297

5. Income and Expenses

Non-service Revenues

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Sale of computers, cellular handsets and SIM-packs	**1,749**	1,913
Point-product sales	**111**	247
	1,860	2,160

Compensation and Benefits

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Salaries and benefits	**12,723**	9,643
Pension (Note 21)	**1,180**	760
Incentive plan (Notes 3 and 21)	**1,100**	2,677
Manpower rightsizing program	**586**	104
	15,589	13,184

Financing Costs

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Interest on loans and related items	**5,029**	6,113
Hedge costs (Note 24)	**908**	1,090
Accretion on financial liabilities net (Notes 2, 17 and 24)	**834**	3,045
Loss on derivative transactions net (Notes 2 and 24)	**207**	151
Financing charges	**38**	44

Dividends on preferred stock subject to mandatory redemption (Note 7)	**14**	113
Capitalized interest (Notes 2 and 8)	**(399)**	(428)
Interest income	**(1,112)**	(1,297)
Foreign exchange gains net (Notes 17 and 24)	**(1,662)**	(1,601)
	3,857	7,230

Interest expense for short-term borrowing for the nine months ended September 30, 2007 and 2006 amounted to Php23 million and Php10 million, respectively.

Cost of Sales

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Cost of computers, cellular handsets and SIM-packs sold	**3,439**	3,567
Cost of point-product sales	**184**	293
Cost of satellite air time and terminal units (Notes 20 and 22)	**122**	146
	3,745	4,006

Professional and Other Contracted Services

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Technical and consultancy fees (Note 20)	**1,979**	1,306
Contracted services	**1,265**	711
Legal and audit fees	**129**	158
Others	**95**	52
	3,468	2,227

Provisions

	Nine Months Ended September 30, 2007	2006
	(Unaudited) (in million pesos)	
Doubtful accounts (Notes 3 and 14)	**1,054**	697
Write-down of inventories to net realizable values (Note 15)	**62**	189
Assessments (Notes 20, 22 and 23)	**28**	(14)
	1,144	872

6. Income Tax

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

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Net assets	**13,808**	19,658
Net liabilities	**(523)**	(402)

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

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)

	(in million pesos)	
Net assets		
Net operating loss carryover, or NOLCO	**6,555**	4,983
Accumulated provision for doubtful accounts	**4,662**	4,746
Unearned revenues	**2,620**	2,076
Derivative financial instruments	**1,968**	1,878
Pension and other employee benefits	**1,151**	2,568
Unamortized past service pension costs	**1,018**	871
Asset impairment	**933**	5,432
Provision for unrealized assets	**639**	732
Leases	**333**	304
Accumulated write-down of inventories to net realizable values	**294**	321
Asset retirement obligation net of capitalized asset	**226**	191
Unrealized foreign exchange losses	**143**	2,632
Executive stock option plan	**31**	106
Excess of fair value over cost of investment properties	**(78)**	(77)
Preferred stock subject to mandatory redemption	**(84)**	(109)
Intangible assets and fair value adjustments on assets acquired	**(332)**	(391)
Capitalized taxes and duties	**(393)**	(446)
Capitalized foreign exchange differential	**(822)**	(988)
Gain on debt exchange and debt restructuring transactions	**(1,378)**	(1,650)
Undepreciated capitalized interest charges	**(4,300)**	(4,607)
Others	**622**	1,086
	13,808	19,658
Net liabilities		
Unearned revenues	**(1)**	(1)
Excess of fair value over cost of investment properties	**(68)**	(38)
Intangible assets and fair value adjustments on assets required	**(454)**	(357)
Unrealized foreign exchange gains		(6)
	(523)	(402)

Provision for corporate income tax consists of:

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Current	**7,271**	7,222
Deferred	**5,757**	(4,091)
	13,028	3,131

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

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Provision for corporate income tax at the applicable statutory tax rates	**13,993**	10,324
Tax effects of:		
Non-deductible expenses	**256**	65
Equity share in net loss of investees	**6**	
Income subject to lower tax rate	**(386)**	(176)
Income subject to final tax	**(398)**	(433)
Income not subject to tax	**(443)**	(1,095)
Net movement in deferred income tax		(5,554)
Actual provision for corporate income tax	**13,028**	3,131

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

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

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

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

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

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

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

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

mySecureSign, Inc., or mSSI, is a wholly-owned subsidiary of ePLDT and is registered with the BOI as a new IT service firm in the field of services related to public key infrastructure on a pioneer status. Under such registration, mSSI enjoys, among other incentives, a six-year ITH from August 1, 2001 or the actual start of commercial operations, whichever comes first. mSSI started commercial operations on January 1, 2002.

Ventus is registered with the BOI as a new IT export service firm in the field of customer interaction center on a pioneer status. Under this registration, Ventus is entitled to certain tax incentives such as an ITH for six years starting March 2005. In relation to this, Ventus is required to comply with specific terms and conditions stated in the BOI registration.

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

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

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

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

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

Smart Broadband has three registered activities with the BOI on a pioneer status, namely: (i) a new operator of telecommunications systems (inter-exchange carrier for data services); (ii) new information technology service firm in the field of providing internet services; and (iii) a new operator of telecommunications facilities (nationwide broadband wireless access). Under the terms of these registrations, Smart Broadband is entitled to certain tax and non-tax incentives which include, among other things, an ITH for six years from February 2001, August 2001 and July 2005, respectively.

The first two registered activities (new operator of telecommunications systems and new information technology service firm in the field of providing internet services) have expired in February 2007 and September 2007, respectively. The remaining registered activity, which is the new operator of telecommunications facilities (nationwide broadband wireless access) will expire in August 2011.

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

Consolidated tax incentives that we availed for the nine months ended September 30, 2007 and 2006 amounted to Php377 million and Php157 million, respectively.

On May 24, 2005, the president of the Philippines signed into law Republic Act No. 9337, or R.A. 9337, amending certain sections of the National Internal Revenue Code, which took effect on November 1, 2005. R.A. 9337, among others, introduced the following changes:

a. The regular corporate income tax rate for domestic corporations and resident/non-resident foreign corporations increased from 32% to 35% effective November 1, 2005 and will be reduced to 30% effective January 1, 2009.

b. The VAT rate increased from 10% to 12% effective February 1, 2006.

c. The input VAT on capital goods should be spread evenly over the estimated useful life or sixty months, whichever is shorter, if the acquisition cost, excluding the VAT component thereof, exceeds Php1 million.

Our deferred income tax assets have been recorded to the extent that such deferred income tax assets are expected to be utilized against sufficient future taxable profit. We had unrecognized deferred income tax assets of Php322 million and Php299 million largely pertaining to asset impairment as at September 30, 2007 and December 31, 2006, respectively.

Our unaudited consolidated unutilized NOLCO as at September 30, 2007 is as follows:

Year Incurred	**Year Expiring**	**(in million pesos)**
2004	2007	15
2005	2008	8,742
2006	2009	5,600
2007	2010	4,379
		18,736
Tax benefit		6,558

Unrecognized deferred income tax assets from NOLCO as at September 30, 2007 (Unaudited)	(3)
	6,555

Our unaudited consolidated MCIT as at September 30, 2007 is as follows:

Year Incurred	**Year Expiring**	**(in million pesos)**
2005	2008	484
2006	2009	499
2007	2010	532
		1,515

7. Earnings Per Common Share

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

	Nine Months Ended September 30,			
	2007		2006	
	Basic	**Diluted**	Basic	Diluted
	(Unaudited) (in million pesos)			
Consolidated net income attributable to equity holders of PLDT	**26,506**	**26,506**	25,744	25,744
Dividends on preferred shares	**(341)**	**(341)**	(342)	(37)
Dividends on dilutive preferred stock subject to mandatory redemption charged to interest expense for the period		**13**		
Accretion of preferred stock subject to mandatory redemption		**106**		
Foreign exchange gain on preferred stock subject to mandatory redemption		**(98)**		
Consolidated net income applicable to common shares	**26,165**	**26,186**	25,402	25,707
	(in thousands, except per share amounts)			
Outstanding common shares at beginning of period	**188,435**	**188,435**	180,789	180,789
Effect of issuance of common shares during the period	**197**	**197**	2,342	2,342
Average incremental number of shares under ESOP during the period		**41**		92
Common shares equivalent of preferred shares deemed dilutive:				

Preferred Stock Series A to EE (Note 16)				2,284
Preferred Stock Series VI (Note 17)		**706**		
Weighted average number of common shares for the period	**188,632**	**189,379**	183,131	185,507
Earnings per common share	**Php138.71**	**Php138.27**	Php138.71	Php138.58

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

Dividends Declared For The Nine Months Ended September 30, 2007

	Date			**Amount**	
Class	**Approved**	**Record**	**Payable**	**Per Share**	**Total** (in million pesos)
Preferred Stock Subject to Mandatory Redemption					
Series V	March 6, 2007	March 20, 2007	April 15, 2007	Php4.675	
	June 12, 2007	June 28, 2007	July 15, 2007	4.675	
	September 14, 2007	September 28, 2007	October 15, 2007	4.675	
Series VI	March 6, 2007	March 20, 2007	April 15, 2007	US$0.09925	4
	June 12, 2007	June 28, 2007	July 15, 2007	0.09925	3
	September 14, 2007	September 28, 2007	October 15, 2007	0.09925	3
Charged to income					10
10% Cumulative Convertible Preferred Stock					
Series CC	January 30, 2007	February 28, 2007	March 30, 2007	Php1.00	17
Series DD	January 31, 2007	February 15, 2007	February 28, 2007	1.00	2
Series EE	March 27, 2007	April 26, 2006	May 31, 2007	1.00	
Series A, I, R, W, AA and BB	July 10, 2007	August 1, 2007	August 31, 2007	1.00	129
Series B, F, Q, V and Z	August 7, 2007	September 3, 2007	September 28, 2007	1.00	91
Series E, K, O and U	September 14, 2007	October 4, 2007	October 31, 2007	1.00	44
Series C, D, J, T and X				1.00	57

	September 14, 2007	October 14, 2007	November 27, 2007		
					340
Cumulative Non-Convertible Redeemable Preferred Stock					
Series IV*	January 30, 2007	February 23, 2007	March 15, 2007	Php	12
	May 8, 2007	May 25, 2007	June 15, 2007		13
	July 10, 2007	August 9, 2007	September 15, 2007		12
					37
Common Stock					
Regular Dividend	March 6, 2007	March 20, 2007	April 20, 2007	Php50.00	9,429
	August 7, 2007	August 24, 2007	September 24, 2007	60.00	11,322
Special Dividend	August 7, 2007	August 24, 2007	September 24, 2007	40.00	7,548
					28,299
Charged to retained earnings					28,676

** Dividends are declared based on total amount paid up*

Dividends Declared After September 30, 2007

	Date			Amount	
Class	**Approved**	**Record**	**Payable**	**Per Share**	**Total** (in million pesos)
Cumulative Non-convertible Redeemable Preferred Stock					
Series IV*	November 6, 2007	November 23, 2007	December 15, 2007	Php	12
10% Cumulative Convertible Preferred Stock					
Series G, N, P and S	November 6, 2007	December 6, 2007	December 28, 2007	Php1.00	27
					39

** Dividends are declared based on total amount paid up*

8. Property, Plant and Equipment

This account consists of:

	Cable and wire facilities	Central office equipment	Cellular facilities	Buildings	Vehicles, furniture, and other network equipment	Communications satellite	Information origination and termination equipment	Land and land improvements	Property under construction	T
						(in million pesos)				
cember 31, 2006 (Audited)										
	112,621	84,604	64,423	20,376	31,039	9,834	9,140	2,685	12,686	3
ulated iation and zation	(46,594)	(58,292)	(32,889)	(6,235)	(25,461)	(7,678)	(5,800)	(269)		(18
ok value	66,027	26,312	31,534	14,141	5,578	2,156	3,340	2,416	12,686	1
months Ended September 30, 2007 (Unaudited)										
ok value at ing of period	66,027	26,312	31,534	14,141	5,578	2,156	3,340	2,416	12,686	1
ons/Transfers	2,876	2,075	1,337	203	1,362		1,539	2	5,093	
als/Retirements	(137)	(46)	(47)	(8)	(41)			(14)	(27)	
ation nces charged y to cumulative tion nents	(2)	(4)		(10)	(5)	(274)			(10)	
sition through ss combination		(1)		13	163					
sifications	868	(156)	3,407	6	938		(1,750)		(3,300)	
ciation and zation (Note 4)	(4,997)	(3,900)	(5,366)	(874)	(2,569)	(427)	(816)	(3)		(1
ok value at end od	64,635	24,280	30,865	13,471	5,426	1,455	2,313	2,401	14,442	1
tember 30, 2007 (Unaudited)										
	115,236	86,301	67,001	20,567	32,739	9,098	8,149	2,672	14,442	3
ulated iation and zation	(50,601)	(62,021)	(36,136)	(7,096)	(27,313)	(7,643)	(5,836)	(271)		(19
ok value	64,635	24,280	30,865	13,471	5,426	1,455	2,313	2,401	14,442	1

Substantially all our telecommunications equipment is purchased from outside the Philippines. Our significant sources of financing for such purchases are foreign loans requiring repayment in currencies other than Philippine pesos, principally in U.S. dollars, see *Note 17 Interest-bearing Financial Liabilities*. Interest, using an average capitalization rate of 10%, and net foreign exchange losses capitalized to property, plant and equipment qualified as borrowing costs for the nine months ended
September 30, 2007 and 2006 were as follows:

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Interest	**399**	428
Foreign exchange loss (gains)	**(63)**	239

As at September 30, 2007 and December 31, 2006, the undepreciated capitalized net foreign exchange losses which qualified as borrowing costs amounted to Php2,064 million and Php2,646 million, respectively.

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

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

We recognized additional depreciation charge of Php1,100 million and Php5,823 million for the nine months ended September 30, 2007 and 2006, respectively, due to a change in the estimated useful lives of certain of our network assets owing to continuing network upgrade and expansion.

Asset Impairment Review

Piltel carries out annual impairment tests on its fixed line assets based on the net present value, or NPV, of future cash flows from the continued use of these assets. For the impairment review in 2006, a discount factor of 6.25% on a pre-tax basis was used for both E.O. 109 and RTS business, applied on cash flow projections from 2007 until such year when the bulk of assets are fully depreciated. Cash flow assumptions for E.O. 109 averaged Php64 million per year from 2007 to 2017 and for RTS averaged Php271 million per year from 2007 to 2013. The resulting NPV of the total cash flow projections was higher than the carrying value of both the E.O. 109 and RTS assets.

Management believes that due to Mabuhay Satellite s difficulty in generating cash flows with the satellite nearing its end-of-life and other events affecting its business, Mabuhay Satellite s Agila II transponder is considered impaired. This impairment review is based on the NPV of future cash flows from the continued use of this asset using the discount factor of 10% as applied on cash flow projections from 2007 until 2010. An impairment loss of Php1,391 million was applied to the carrying value of this satellite as at December 31, 2006 and included in the accumulated depreciation and amortization account in the unaudited consolidated balance sheet as at September 30, 2007 and December 31, 2006.

Property, plant and equipment include the following amounts for capitalized leases as at September 30, 2007 and December 31, 2006:

	September 30, 2007 (Unaudited)			December 31, 2006 (Audited)		
	Central office equipment	**Vehicles, furniture and other network equipment**	**Total**	Central office equipment	Vehicles, furniture and other network equipment	Total
	(in million pesos)					
Cost	**354**	**1,187**	**1,541**	354	1,183	1,537
Less accumulated depreciation	**327**	**1,088**	**1,415**	310	950	1,260
	27	**99**	**126**	44	233	277

The following table summarizes all changes to the liabilities on asset retirement obligations as at September 30, 2007 and December 31, 2006:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Asset retirement obligations at beginning of period	**831**	752
Accretion expenses	**62**	87
Additional liability recognized during the period	**21**	45

Settlement of obligations	**(5)**	(53)
Asset retirement obligations at end of period (Notes 3 and 18)	**909**	831

9. Investments in Associates

This account consists of:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
ACeS International Limited	**1,614**	1,614
Mabuhay Space Holdings Limited	**859**	937
Blue Ocean Wireless	**724**	
Philweb Corporation	**712**	712
Stradcom International Holdings, Inc.	**616**	616
BayanTrade Dotcom, Inc.	**97**	97
ePDS, Inc.	**6**	6
	4,628	3,982
Less accumulated impairment losses and equity share in net losses of associates	**3,285**	3,346
	1,343	636

Investment of ACeS Philippines in ACeS International Limited, or AIL

As at September 30, 2007 and December 31, 2006, ACeS Philippines had a 36.99% and 20% investment in AIL, respectively, a company incorporated under the laws of Bermuda. AIL owns the Garuda I Satellite and the related system control equipment in Batam, Indonesia.

AIL has incurred recurring significant operating losses, negative operating cash flows, and significant levels of debt. The financial condition of AIL was partly due to the National Service Providers , or NSPs, inability to generate the amount of revenues originally expected as the growth in subscriber numbers has been significantly lower than budgeted. These factors raise substantial doubt about AIL s ability to continue as a going concern. On this basis, we recognized a full impairment provision in respect of our investment in AIL amounting to Php1,614 million in 2003.

For further details as to the contractual relationships in respect of AIL, see *Note 20 Related Party Transactions*.

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

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

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

In accordance with the settlement agreement, Mabuhay Satellite and SS/L shall proceed to dissolve the joint venture under a separate agreement, for which each of the parties will receive title over a number of transponders owned by the joint venture in proportion to their respective interests. On the basis of the joint venture dissolution, we recognized an impairment provision in respect of our investment in MSHL of Php431 million in 2004.

Investment of Smart in Blue Ocean Wireless, or BOW

On August 3, 2007, Smart has agreed to acquire a 30% equity interest in Blue Ocean Wireless, or BOW, a Dublin-based company delivering GSM communication capability for the merchant maritime sector. Total acquisition cost amounted to US$15.9 million, or Php724 million, of which Php601 million was paid in cash and Php123 million will be paid in kind. BOW provides the world s first GSM network on the seas through Altobridge, a patented GSM platform that supports full voice and text services, thus providing an important complementary service to Smart s prepaid wireless satellite phone service, *SMARTLink*.

Investment of ePLDT in Philweb Corporation, or Philweb

In May 2006, ePLDT subscribed newly issued common shares of Philweb, an internet-based online gaming company, equivalent to 20% of the total outstanding capital stock of Philweb at a price of Php0.020 per share or an aggregate amount of Php502 million. Of the total subscription price, Php427 million was paid by ePLDT on the closing date. The portion of the unpaid subscription price amounting to Php25 million will be paid by ePLDT at the same time as the Philweb majority stockholders pay the remaining unpaid portion of the subscription pursuant to a general call on subscription to be made by Philweb s board of directors. The balance of Php50 million will be paid upon the lapse of certain post-closing price adjustment periods. The unpaid subscription of Php75 million was recorded as part of accrued expenses and other current liabilities in the unaudited balance sheet.

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

Philweb is primarily engaged in internet-based online gaming, through its appointment as Principal Technology Service Provider under the Marketing Consultancy Agreement for Internet Sports Betting and Internet Casino with the Philippine Amusement and Gaming Corporation, or PAGCOR. As of the end of September 2007, Philweb offers Internet Sports Betting in over 239 PAGCOR Internet Sports Betting Stations and over 60 Internet Casino Stations nationwide. As at September 30, 2007, the market value of ePLDT s investments in Philweb amounted to Php1,741 million.

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

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

In 2007, Stradcom Corporation entered into a Lenders Agreement for the issuance of Asset-Backed Bonds amounting to Php1.6 billion intended for debt refinancing and general corporate purposes, including working capital and investments.

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

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

In September 2005, ePLDT received 4,794,615 bonus warrants from BayanTrade which entitles ePLDT to purchase 2,794,615 common shares at a price of Php0.50 per share at any time on or before August 31, 2010. We did not account for the value of bonus warrants because the value is not material.

Investment of ePLDT in ePDS, Inc., or ePDS

On June 30, 2003, ePLDT signed a joint venture agreement with DataPost Pte Ltd., or DataPost, a subsidiary of Singapore Post, and G3 Worldwide ASPAC, or Spring, pursuant to which the parties formed ePDS, a bills printing company which does laser printing and enveloping services for statements, bills and invoices, and other value-added services for companies in the Philippines. ePLDT has a 50% interest in ePDS, while DataPost has a 30% interest. Spring, the largest international mail services provider, owns the remaining 20%. ePDS has an initial paid-up capital of Php11 million.

In October 2005, ePDS Board of Directors approved the declaration of a 100% stock dividend on its common stock equivalent to Php11 million. The stock dividends were issued from the increase in authorized capital stock of ePDS which was approved by the Philippine SEC in June 2006.

Summarized Financial Information of Equity Investees

The following table presents summarized financial information in conformity with PFRS for equity investees for which we have significant influence as at September 30, 2007 and December 31, 2006 and for the nine months ended September 30, 2007 and 2006.

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Noncurrent assets	**1,458**	1,333

Current assets	**914**	1,122
Capital deficiency	**(8,935)**	(9,618)
Noncurrent liabilities	**10,251**	10,029
Current liabilities	**1,056**	2,044

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited)	
	(in million pesos)	
Revenues	**726**	624
Revenues less cost of revenues	**431**	483
Expenses	**601**	390
Net loss	**(170)**	(321)

10. Investment Properties

	September 30, 2007	December 31, 2006
	(Unaudited)	(Audited)
	(in million pesos)	
Balance at beginning of period	**587**	701
Disposals	**(7)**	(112)
Net loss from fair value adjustments		(2)
Balance at end of period (Note 3)	**580**	587

Investment properties are stated at fair values, which have been determined based on the latest valuations performed by an independent firm of appraisers, which is an industry specialist in valuing these types of investment properties. The valuation undertaken was based on an open market value, supported by a market evidence in which assets could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm s-length transaction at the date of valuation, in accordance with international valuation standards.

11. Goodwill and Intangible Assets

Movements in goodwill and intangible assets during the periods are as follows:

	September 30, 2007 (Unaudited)			December 31, 2006 (Audited)		
	Goodwill	**Intangible assets**	**Total**	Goodwill	Intangible assets	Total
	(in million pesos)					
Cost:						
Balance at beginning of period	**10,137**	**3,456**	**13,593**	1,942	1,991	3,933
Additions during the period	**2,266**	**338**	**2,604**	8,498	1,540	10,038
Translation adjustments	**(725)**	**(120)**	**(845)**	(303)	(75)	(378)
Balance at end of period	**11,678**	**3,674**	**15,352**	10,137	3,456	13,593
Accumulated amortization and impairment:						
Balance at beginning of period	**438**	**941**	**1,379**	438	446	884
Amortization during the period		**286**	**286**		450	450
Translation adjustments		**(14)**	**(14)**		(5)	(5)
Impairment during the period					50	50
Balance at end of period	**438**	**1,213**	**1,651**	438	941	1,379
Net balance (Note 3)	**11,240**	**2,461**	**13,701**	9,699	2,515	12,214

In relation to SPi s acquisition of Springfield, the fair value of Springfield s net assets, determined provisionally, was assessed to be equal to its book value, which resulted in goodwill amounting to

Php2,266 million. Intangible assets pertaining to Springfield s customer relationship and customer contracts were initially determined at Php338 million with estimated useful life of five and ten years, respectively. Valuation of intangible assets by independent appraiser is ongoing which is expected to be completed by fourth quarter of 2007.

Other intangible assets consist of:

		September 30, 2007 (Unaudited)			December 31, 2006 (Audited)		
		Gross		**Net**	Gross		Net
	Estimated Useful Lives	**Carrying Amount**	**Accumulated Amortization**		Carrying Amount	Accumulated Amortization	
		(in million pesos)					
Customer list	**1 10 years**	**1,551**	**347**	**1,204**	1,332	195	1,137
Spectrum	**15 years**	**1,205**	**248**	**957**	1,205	187	1,018
	4 years	**600**	**504**	**96**	601	471	130

Technology application Licenses	**5**	**17 years**	**318**	**114**	**204**	318	88	230
			3,674	**1,213**	**2,461**	3,456	941	2,515

As at December 2006, ePLDT has provided an impairment in value of its intangible assets in Level Up! amounting to Php50 million, representing a write-down of such intangible assets to recoverable amounts using the value-in-use approach. The impairment was a result of projected decline on revenues related to certain license agreements. Market value-in-use was based on the discounted cash flow projections using the most recent financial forecast approved by our management.

The future amortization of other intangible assets as at September 30, 2007 are as follows:

	(in million pesos)
2007(1)	49
2008	418
2009	403
2010	365
2011	296
2012 and onwards	930
Balance at end of period	2,461

(1) October 1, 2007 through December 31, 2007

Impairment Testing of Goodwill

Goodwill from Acquisition of Smart Broadband

The test for recoverability of Smart s goodwill was applied to an asset group, representing the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities.

Although revenue streams may be segregated between Smart and Smart Broadband through subscribers availing themselves of their respective cellular and wireless broadband services, the cost items and cash flows are difficult to carve out, largely due to the significant portion of shared and common-used networks/platforms. In the case of Smart Broadband, it provides broadband wireless access to its subscribers using Smart s cellular base stations, fiber optic and

IP backbone. With the common use of wireless assets with Smart in providing wireless services, the lowest asset group for Smart Broadband for which cash flows could be clearly identified from other groups of assets will be Smart s wireless business segment.

Our wireless business segment has been our largest revenue and cash flow contributor since 2003. As such, there is no impairment of our wireless business segment. As at December 31, 2006, the recoverable amount of this segment is determined on the basis of value in use calculations using cash flow projections based on the financial budgets approved by Smart s Management covering a 5-year period from 2007 to 2011. The pre-tax discount rate applied to cash flow projections is 10.6% and cash flows beyond the 5-year period are determined using a 2.5% growth rate that is the same as the long-term average growth rate for the telecommunications industry.

The calculation of value in use for Smart s wireless business segment was based on the following assumptions: (a) usage revenues for 2007 were based on the annualized actual year-to-date results available at the time the budget was prepared in 2006; (b) usage revenues were assumed to grow at an average rate of 5% per annum from 2007 to 2011; (c) average capital expenditures per year were assumed at Php8.6 billion from 2007 to 2011; (d) the discount rate used was the weighted average cost of capital; and (e) the growth rate used for cash flows beyond the budget period was based on published industry research.

Annual update in the impairment testing will be completed at year-end.

Goodwill from Acquisition of SPi and its Subsidiary, CyMed

The goodwill acquired through the SPi and CyMed transactions was allocated for impairment testing to each of the cash generating units of those businesses namely: healthcare, litigation and publishing.

As at December 31, 2006, we determined that there would be no impairment loss recognized for each of the cash generating units since the recoverable amount exceeded the carrying amount of the individual assets. The recoverable amount of goodwill was determined using the value in use approach. Value in use was based on the cash flow projections of the most recent financial budgets/forecasts approved by management, which management believes are reasonable and are management s best estimate of the range of economic conditions that will exist over the remaining useful life of the asset.

In determining the appropriate discount rate to be applied, our weighted average cost of capital was used and adjusted for the difference in currency and specific risks associated with the assets or business of a cash-generating unit.

Management assessed the reasonableness of the assumptions by examining the causes of differences between actual 2006 cash flow and budgeted/projected cash flows, with a particular emphasis on the observed trends towards the last quarter of 2006.

Annual update in the impairment testing will be completed at year-end.

12. Notes Receivable

Investment of ePLDT in Debt Securities of Technology Support Services, Inc., or TSSI (formerly First Advance Multi-Media Entertainment Corp., or FAME)

On June 1, 2004, ePLDT and FAME entered into an agreement whereby ePLDT granted a seven-year zero-coupon loan to FAME amounting to US$3.1 million. Based on agreement, upon maturity of the loan, which is at the end of seven years from issuance, ePLDT may require FAME to redeem or pay the loan at a redemption value amounting to US$6.1 million. At any time during the life of the outstanding loan, ePLDT may convert the loan into 20% of the total outstanding capital stock of FAME.

On August 20, 2004, FAME changed its corporate name to TSSI.

On September 14, 2004, ePLDT entered into a second agreement with TSSI whereby ePLDT granted another seven-year zero coupon loan to TSSI amounting to US$3.1 million with the same terms and features as the first loan. As at September 30, 2007 and December 31, 2006, the aggregate loans of ePLDT to TSSI amounted to Php346 million.

TSSI has been incurring losses from the start of operations due to delays in its projects. On this basis, we recognized a full impairment provision in respect of our notes receivable from TSSI amounting to Php346 million in December 2006.

13. Cash and Cash Equivalents

This account consists of:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Cash on hand and in banks	**2,986**	3,416
Temporary cash investments	**5,485**	13,454
	8,471	16,870

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

14. Trade and Other Receivables

This account consists of receivables from:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Customers and carriers	**24,650**	25,349
Others (Notes 20, 22 and 23)	**1,641**	1,579
	26,291	26,928
Less allowance for doubtful accounts	**16,046**	16,770
	10,245	10,158

Movements in the allowance for doubtful accounts are as follows:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Balance at beginning of period	**16,770**	18,525
Provisions for the period (Notes 3 and 5)	**1,054**	736
Translation adjustments	**(39)**	(24)
Write-offs	**(1,739)**	(1,813)
Reversals		(654)
Balance at end of period	**16,046**	16,770

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

Sale of receivables under the RPD amounted to US$4 million, or Php167 million, and US$4 million, or Php213 million, for the nine months ended September 30, 2007 and 2006, respectively. Loss on sale of receivables under the RPD amounted to US$1 million, or Php6 million, and US$1 million, or Php22 million, for the nine months ended September 30, 2007 and 2006, respectively.

15. Inventories and Supplies

This account consists of:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Terminal and cellular phone units:		
At net realizable value	**808**	556
At cost	**933**	719
Spare parts and supplies:		

At net realizable value	**684**	514
At cost	**1,527**	1,397
Others:		
At net realizable value	**149**	160
At cost	**150**	161
At lower of cost or net realizable value	**1,641**	1,230

16. Equity

The movement of PLDT s capital accounts as at December 31, 2006 and September 30, 2007 are as follows:

	Preferred Stock Php10 par value per share				**Common Stock** Php5 par value per share	
	Series A to EE	**IV**	**Total Preferred Stock**			
			No. of Shares	**Amount**	**No. of Shares**	**Amount**
			(in millions)			
Authorized			823	Php8,230	234	Php1,170
Outstanding						
Balance at January 1, 2006	407	36	443	Php4,433	181	Php904
Conversion	(1)		(1)	(11)	7	38
Issuance				2		
Balance at December 31, 2006 (Audited)	406	36	442	Php4,424	188	Php942
Balance at January 1, 2007	406	36	442	Php4,424	188	Php942
Conversion	(1)		(1)	(7)		1
Issuance				1	1	1
Balance at September 30, 2007 (Unaudited)	405	36	441	Php4,418	189	Php944

Preferred Stock

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

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

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

In case of any other reclassification or change of outstanding shares of Common Stock, or in case of any consolidation or merger of PLDT with or into another corporation, the Board of Directors shall make such provisions, if any, for adjustment of the minimum conversion price and the sales price utilized in calculating the conversion price as the Board of Directors, in its sole discretion, shall be deemed appropriate.

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

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

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

On October 24, 2005, PLDT issued to JPMorgan, as depositary, and to the holders of the Series III Convertible Preferred Stock a notice of mandatory conversion of all of its outstanding 4,616,200 shares of Series III Convertible

Preferred Stock into shares of PLDT Common Stock. The conditions for mandatory conversion under the terms of the Series III Preferred Stock have been satisfied, including:
(i) that the average closing price of PLDT s ADSs for the 30-day period ending seven days prior to the date in which notice of the mandatory conversion was given was above US$29.19 a share; (ii) that there were no dividends in arrears on any shares of the Series III Convertible Preferred Stock; and (iii) that PLDT had sufficient distributable reserves to pay the fixed preferential dividends on the shares of Series III Convertible Preferred Stock, calculated down to and including the mandatory conversion date.

In November 2005, PLDT issued 710,891 shares of common stock on account of the voluntary conversion of 415,023 shares of Series III Convertible Preferred Stock.

As at December 19, 2005, as a result of PLDT s issuance of a notice of mandatory conversion, all of the outstanding shares of Series III Convertible Preferred Stock were voluntarily and mandatorily converted into shares of PLDT Common Stock wherein each share of Series III Convertible Preferred Stock was converted into 1.7129 shares of Common Stock. A total of 7,907,032 shares of PLDT s Common Stock were issued as a result of the voluntary and mandatory conversions of all of the Series III Convertible Preferred Stock.

The Series IV Cumulative Non-Convertible Redeemable Preferred Stock earns cumulative dividends at an annual rate of 13.5% based on the paid-up subscription price. It is redeemable at the option of PLDT at any time one year after subscription and at the actual amount paid for such stock, plus accrued dividends. On February 26, 2002, the Board of Directors called for the payment of a portion of the balance of the subscription price of the Series IV Cumulative Non-Convertible Redeemable Preferred Stock amounting to Php72 million, which was paid on March 5, 2002. On March 22, 2002, PLDT redeemed 60 million shares out of the 360 million subscribed shares of its Series IV Cumulative Non-Convertible Preferred Stock and paid Php72 million, representing the redemption price plus unpaid dividends up to the date of redemption.

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

17. Interest-bearing Financial Liabilities

This account consists of the following:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Long-term portion of interest-bearing financial liabilities - net of current portion:		
Long-term debt (Note 24)	**57,273**	63,769
Obligations under capital lease (Notes 8 and 24)	**26**	106
Preferred stock subject to mandatory redemption (Note 24)		1,369
	57,299	65,244
Current portion of interest-bearing financial liabilities:		
Notes payable	**487**	201
Long-term debt maturing within one year (Note 24)	**6,965**	16,184
Obligations under capital lease maturing within one year (Notes 8 and 24)	**911**	924
Preferred stock subject to mandatory redemption (Note 24)	**1,114**	
	9,477	17,309

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

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Long-term debt	**4,976**	5,953
Obligations under capital lease (Notes 8 and 24)	**504**	540
Preferred stock subject to mandatory redemption	**91**	260
Total unamortized debt discount at end of period (Note 24)	**5,571**	6,753

The following table describes all changes to unamortized debt discount as at September 30, 2007 and December 31, 2006.

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Unamortized debt discount at beginning of period	**6,753**	13,347
Additions during the period	**15**	48
Settlements and conversions during the period	**(42)**	(2,733)
Revaluations during the period	**(357)**	(595)
Accretion during the period charged to interest expense (Notes 5 and 24)	**(798)**	(3,314)
Unamortized debt discount at end of period (Note 24)	**5,571**	6,753

Long-term Debt

Long-term debt consists of:

Description	Interest Rates	September 30, 2007 (Unaudited)		December 31, 2006 (Audited)	
		(in millions)			
U.S. Dollar Debt:					
Export Credit Agencies-Supported Loans:					
Kreditanstalt für Wiederaufbau, or KfW	5.65% - 7.58% and US$ LIBOR + 0.55% - 2.5% in 2007 and 2006	**US$153**	**Php6,896**	US$201	Php9,877
Finnvera, Plc, or Finnvera	US$ LIBOR + 0.05% in 2007 and 7.53% - 7.75% and US$ LIBOR + 0.05% in 2006	**49**	**2,219**	69	3,381
Nippon Export and Investment Insurance of Japan, or NEXI	US$ LIBOR + 1% in 2007 and in 2006			25	1,215
Others	6.60% and US$ LIBOR + 0.15% - 0.65% and GOVCO s cost + 0.20% in 2007 and 5.83% - 6.6% and US$ LIBOR + 0.15% - 1.60% and GOVCO s Cost + 0.20% in 2006	**5**	**206**	10	508
		207	**9,321**	305	14,981
Fixed Rate Notes	7.85% - 11.375% in 2007 and 2006	**676**	**30,410**	835	40,971
Term Loans:					
Debt Exchange Facility	2.25% and US$ LIBOR + 1% in 2007 and 2006	**184**	**8,288**	176	8,615
GSM Network Expansion Facilities	4.49% - 4.70% and US$ LIBOR + 0.815% in 2007 and 4.49% - 4.70% and US$ LIBOR + 0.815% - 3.25% in 2006	**154**	**6,944**	194	9,509
Others	US$ LIBOR + 0.40% and 6% - 10% in 2007 and US$ LIBOR + 0.40% - 3.625% and 1.75% - 10% in 2006	**4**	**167**	10	487
Satellite Acquisition Loans	5.66% and US$ LIBOR + 1.75% - 2.75% in 2007 and 2006	**30**	**1,342**	42	2,083
		US$1,255	**56,472**	US$1,562	76,646
Philippine Peso Debt:					
Peso Fixed Rate Corporate Notes	5.625% - 15% in 2007 and 15% - 15.816% in 2006		**4,988**		808
Term Loans:					
Secured Term Loans	7.09%, MART1 + 5.70% and 90-day PHILBOR + 3% in 2007 and 7.09% 15% and 90-day		**6**		11

	PHILBOR + 3% in 2006		
Other Unsecured Term Loans	6.125% and MART1 + 0.75% in 2007 and MART1 + 0.75% in 2006	**2,772**	2,488
		7,766	3,307
		64,238	79,953
Less portion maturing within one year		**6,965**	16,184
Total long-term debt		**Php57,273**	Php63,769

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

The scheduled maturities of our outstanding consolidated long-term debt at nominal values as at September 30, 2007 are as follows:

	U.S. Dollar Loans		**Php Loans**	**Total**
Year	**In U.S. Dollar**	**In Php**	**In Php**	**In Php**
		(in millions)		
2007(1)	40	1,803	139	1,942
2008	147	6,608	558	7,166
2009	263	11,830	570	12,400
2010	71	3,183	568	3,751
2011	15	668	568	1,236
2012 and onwards	830	37,335	5,384	42,719
	1,366	61,427	7,787	69,214

(1) October 1, 2007 through December 31, 2007

U.S. Dollar Debt:

Export Credit Agencies-Supported Loans

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

Kreditanstalt für Wiederaufbau, or KfW

KfW, a German state-owned development bank, is PLDT s largest single creditor. As at September 30, 2007, we owed US$153 million, or Php6,896 million, aggregate principal amount of debt to KfW, as follows:

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- US$113 million provided under various export credit agency-backed facilities, of which US$18 million was in connection with our expansion and service improvement programs, and US$95 million in connection with the US$149 million refinancing facility discussed below; and

- US$40 million provided for the 15% downpayment portion and credit facilities without guarantee/insurance cover from the export credit agencies, of which US$26 million was in connection with the US$149 million refinancing facility discussed in the following paragraphs.

On January 25, 2002, PLDT signed two loan agreements with KfW, which provided PLDT with a US$149 million facility to refinance in part the repayment installments under its existing loans from KfW due from January 2002 to December 2004. The facility is composed of a nine-year loan, inclusive of a three-year disbursement period and a two-year grace period during which no principal is payable. It partly enjoys the guarantee of HERMES, the export credit agency of the Federal Republic of Germany. We have drawn US$140 million, or Php6,295 million, under this facility as at September 30, 2007. PLDT waived further disbursements under this refinancing facility effective September 1, 2004. Thus, the undrawn portion of US$9 million was cancelled.

Of the amounts outstanding under these KfW loans, US$24 million will mature on various dates between October 1, 2007 and December 4, 2007, US$55 million will mature in 2008, US$43 million will mature in 2009 and US$31 million will mature in 2010. Principal amortizations on these loans are generally payable in equal semi-annual installments.

Finnvera, Plc, or Finnvera

As at September 30, 2007, US$50 million (US$49 million, net of unamortized discount of US$1 million), or Php2,249 million (Php2,219 million, net of unamortized discount of Php30 million), principal amount of Smart s debt was provided by various banks under an export credit agency-backed facility in connection with Smart s GSM expansion program. This facility is covered by a guaranty from Finnvera, the Finnish Export Credit Agency, for 100% of political and commercial risk for the refinancing facility of GSM Phases 5A and 5B. Other Finnvera-guaranteed GSM loan facilities were fully paid in the aggregate amount of US$17 million for GSM Phases 3 and 4 loan facilities on April 28, 2006.

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

Nippon Export and Investment Insurance of Japan, or NEXI

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

Other Export Credit Agency Supported Loans

PLDT has also obtained loans extended and/or guaranteed by other export credit agencies, including the Export-Import Bank of the United States, and the respective export credit agencies of France and Italy, in the aggregate outstanding principal amount of US$4 million, or Php173 million, as at September 30, 2007. Smart, likewise, obtained loans guaranteed by the export credit agencies of Norway and Italy with outstanding balance of US$1 million, or Php33 million, as at September 30, 2007. Of the amounts outstanding under these loans, US$4 million will mature on various dates between October 1, 2007 and December 15, 2007 and US$1 million will mature in 2008.

Fixed Rate Notes

PLDT has the following non-amortizing fixed rate notes outstanding as at September 30, 2007 and December 31, 2006:

Principal Amount	Interest Rate	Maturity Date	**September 30, 2007 (Unaudited)**		December 31, 2006 (Audited)	
			(in millions)			
US$300,000,000	8.350%	March 6, 2017	**US$296**	**Php13,326**	US$296	Php14,523
US$250,000,000	11.375%	May 15, 2012	**245**	**10,998**	244	11,963
US$135,886,000	10.500%		**135**	**6,086**	166	8,148

		April 15, 2009				
US$ 19,310,000	10.625%	May 15, 2007			19	941
US$110,068,000	7.850%	March 6, 2007			110	5,396
			US$676	**Php30,410**	US$835	Php40,971

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

On November 6, 2007, PLDT commenced a solicitation of consents from holders of its outstanding 11.375% Notes due 2012, or the 2012 Notes, to effect certain proposed amendments relating to the limitation on restricted payments and limitation on dividends and a solicitation of consents from holders of its outstanding 10.5% Notes due 2009, or the 2009 Notes, and 8.35% Notes due 2017, or the 2017 Notes, to effect certain proposed amendments relating to the limitation on dividends.

Specifically, the proposed amendments, once effective, would give PLDT greater flexibility to make certain restricted payments, amend limitations on PLDT paying dividends or distributions, and reduce PLDT s permitted leverage ratios pursuant to the terms of the notes.

PLDT s key financial indicators including revenues, profitability and operating cash flows have improved over time compared to when the notes were issued. PLDT is focused on maintaining its market leadership, investing in new growth areas to boost its core telecommunications business and diversifying its revenue sources. PLDT is also focused on pursuing an efficient capital structure by adjusting its dividend and distribution policy to maintain an optimal level of cash on its balance sheet. PLDT believes that the existing Limitation on Restricted Payments and the existing Limitation on Dividends, constrain its ability to pursue these objectives. To demonstrate its continued commitment to maintaining a prudent capital structure, PLDT will simultaneously tighten its debt capacity.

<u>*Term Loans*</u>

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

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

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

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

As at September 30, 2007, outstanding balance of these loans amounted to US$283 million (US$184 million, net of unamortized discount of US$99 million), or Php12,739 million (Php8,288 million, net of unamortized discount of Php4,451 million).

Interest for the above facilities is payable every quarter at a floating rate of three months US$ LIBOR plus 1.00% for the 2007 and 2008 facilities, and a fixed rate of 2.25% per annum for the 2014 facility. Furthermore, a portion of the 2014 facility amounting to US$144 million has a variable yield option whereby the creditors have an option to elect for an early repayment at a discount either in December 2007 at 52.5% of the relevant debt amount or in December 2008 at 57.5% of the relevant debt amount.

GSM Network Expansion Facilities

On September 13, 2004, Smart signed a US$104 million 5-year term loan facility to finance the related Phase 7 GSM Equipment and services. The facility was awarded to ABN AMRO Bank, Banque National de Paribas, Calyon, DBS Bank and Sumitomo Mitsui Banking Corporation as the Lead Arrangers with Finnish Export Credit, Plc as the Lender. The full amount of the facility was drawn on November 22, 2004, of which US$52 million remained outstanding as at September 30, 2007. The loan is payable over five years in ten equal semi-annual payments starting May 2005 with final repayment in November 2009.

On August 8, 2005, Smart signed a US$30 million commercial facility with NIB to partly finance the related Phase 8 GSM equipment and services contracts. The facility is a 5-year term loan payable semi-annually in ten equal installments commencing six months from the first drawdown date at a floating rate of US$ LIBOR plus 0.815% margin per annum. The facility was drawn on July 11, 2006 for the full amount of US$30 million at a floating interest of 6.445% (5.63% US$ LIBOR plus 0.815% per annum margin). The first installment payment commenced on

January 11, 2007. US$24 million amount remained outstanding as at September 30, 2007.

On August 10, 2005, Smart signed a loan facility for its GSM Phase 8 financing in the amount of US$70 million. The facility was awarded to the Bank of Tokyo Mitsubishi Ltd., Mizuho Corporate Bank Ltd., Standard Chartered Bank and Sumitomo Mitsui Banking Corporation as the Lead Arrangers, with FEC as the Lender. Smart opted to utilize only a total of US$67 million which was drawn on February 15, 2006 and March 13, 2006 for US$10 million and US$57 million, respectively. The undrawn balance of US$3 million was cancelled. The facility is a 5-year term loan payable in 10 equal semi-annual installments with final repayment on September 1, 2010. Interest is payable semi-annually at a fixed rate of 4.515% per annum. As at September 30, 2007, US$44 million remained outstanding.

On July 31, 2006, Smart signed a U.S. Dollar Term Loan Facility for US$44.2 million to partly finance the related Phase 9 GSM equipment and services contracts. The Lender is FEC with ABN AMRO Bank N.V., Standard Chartered Bank and Sumitomo Mitsui Banking Corporation and Mizuho Corporate Bank Ltd. as the Lead Arrangers. The facility is a 5-year term loan payable in 10 equal semi-annual installments commencing six months from the drawdown date at a CIRR Fixed rate of 4.05% per annum. The facility was drawn on November 10, 2006 for the full amount of US$44.2 million. The first installment commences on January 16, 2007 with final repayment on July 15, 2011. As at September 30, 2007, the US$35 million loan remains outstanding.

As at September 30, 2007, the aggregate outstanding balance of these loans amounted to US$155 million (US$154 million, net of unamortized discount of US$1 million), or Php6,981 million (Php6,944 million, net of unamortized discount of Php37 million).

Other Term Loan

On July 1, 2004, CyMed availed of a 5-year non-interest-bearing advance from certain of its officers to fund its operating expenses, including salaries and other incidental expenses. The outstanding balance of this loan as at September 30, 2007 amounted to US$1 million, or Php30 million, which is payable quarterly until July 31, 2009.

Undrawn Facility

On October 16, 2006, Smart signed a U.S. Dollar Term Loan Facility with Metropolitan Bank and Trust Company to finance the related Phase 9 GSM Facility for an amount of US$50 million. The facility is a five-year loan payable in 18 equal and consecutive quarterly installments commencing on the third quarter from the date of the first drawdown. Interest rate is floating at three-month US$ LIBOR plus 0.75% per annum margin. The loan facility was fully drawn on October 10, 2007.

Restructured Loans

On June 5, 2006, Piltel made a partial voluntary prepayment of principal under its Peso bank facility, US 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 million 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, US 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.

On March 30, 2007, Piltel paid the remaining convertible bonds with principal amount of US$0.7 million.

Satellite Acquisition Loans

Mabuhay Satellite has an existing Credit Agreement with the Export-Import Bank of the United States, or Ex-Im Bank, to finance a portion of the cost of purchasing the Agila II Satellite. In 2004, Ex-Im Bank approved, in principle, the re-profiling of Mabuhay Satellite s US$42 million debt with them by extending the maturity of the loan by 1½ years to July 15, 2007 and reducing the interest rate by 1% to 5.6%. The revised repayment terms have been approved by the majority of the local creditor banks. On July 16, 2007, the outstanding balance was fully paid in the amount of US$5 million (Php236 million).

Mabuhay Satellite also has an existing Omnibus Agreement with a syndicate of local banks, or the Banks, which includes issuance of irrevocable standby Letters of Credit in favor of Ex-Im Bank, as security under the Credit Agreement and a term loan to Mabuhay Satellite in the aggregate amount of US$30 million (Php1,342 million), which will mature on various dates from 2006 to 2009. The Omnibus Agreement was cancelled on July 16, 2007.

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

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

Philippine Peso Debt:

Php2,770 Million Peso Fixed Rate Corporate Notes

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

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

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

Php5 Billion Peso Fixed Rate Corporate Notes

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

Term Loans

Secured Term Loans

Php100 Million Term Loan Facility

On March 15, 2004, ePLDT entered into a three-year term loan facility with Asia United Bank amounting to Php100 million for the payment of its outstanding short-term bank loan facility and for other working capital requirements. The loan facility was fully drawn as at December 31, 2004. The loan is to be repaid in nine equal quarterly installments starting March 2005 with final repayment in March 2007. Interest on the loan is equivalent to 90-day PHIBOR plus 3% per annum payable quarterly in arrears. The loan is secured by a Mortgage Trust Indenture Agreement, or MTIA, dated March 15, 2004, with Asia United Bank Trust and Investments Group, on a parcel of land with a carrying value of Php279 million as at December 31, 2004. This loan was fully paid as at March 31, 2007.

Php149 Million Term Loan Facility

In January 2006, Vocativ, a wholly-owned call center subsidiary of ePLDT, partially prepaid Php89 million out of its outstanding five-year term loan facility of Php109 million with Asia United Bank for the payment of its additional capital expenditures and working capital requirements. Under the terms of the loan, principal payment is to be paid in 14 equal quarterly installments starting April 2006 with final repayment in July 2009. Interest on the loan is equivalent to 90-day PHIBOR plus 3% per annum payable quarterly in arrears. The loan is secured by a Mortgage Participation Certificate against the MTIA between ePLDT and Asia United Bank Corporation Trust and Investments Group dated March 15, 2004 on a parcel of land, which excludes the buildings and improvements. The remaining balance of Php20 million was pre-terminated in April 2006.

Unsecured Term Loans

Php2,500 Million Term Loan Facility

On August 14, 2006, Smart signed a Peso Term Loan Facility with Metropolitan Bank and Trust Company to finance the related Phase 9 GSM facility for an amount of Php2,500 million. The facility is a five-year loan payable in 18 equal consecutive quarterly installments commencing on the third quarter from the date of the first drawdown. Interest rate is floating at three-month MART plus 0.75% per annum margin. The facility was drawn on December 11, 2006 for the full amount of Php2,500 million at a floating interest of 6.0232% (5.2732% three-month MART1 plus 0.75% per annum margin). The first installment will commence on September 11, 2007 with final repayment on December 9, 2011. The outstanding balance of this loan as at September 30, 2007 amounted to Php2,361 million (Php2,352 million, net of unamortized discount of Php9 million).

Php400 Million and Php20 Million Refinancing Loans

On May 22, 2007, PLDT signed loan agreements with The Philippine American Life and General Insurance Company for Php400 million and The Philam Bond Fund, Inc. for Php20 million to refinance their respective participations in the Ten-Year Note under the Php1,270 million Peso Fixed Rate Corporate Notes which were repaid on June12, 2007. Interest is payable quarterly. Both loans will mature on June 12, 2014.

Debt Covenants

Our debt instruments contain restrictive covenants, including covenants that could prohibit us from paying dividends on common stock under certain circumstances, and require us to comply with specified financial ratios and other financial tests, calculated in conformity with PFRS, at relevant measurement dates, principally at the end of each quarterly period. We have complied with all of our maintenance financial ratios as required under our loan covenants and other debt instruments.

The principal factors that can negatively affect our ability to comply with these financial ratios and other financial tests are depreciation of the Philippine peso relative to the U.S. dollar, poor operating performance of PLDT and its consolidated subsidiaries, impairment or similar charges in respect of investments or other long-lived assets that may be recognized by PLDT and its consolidated subsidiaries and increases in our interest expenses. Interest expense may increase as a result of various factors including issuance of new debt, the refinancing of lower cost indebtedness by higher cost indebtedness, depreciation of the Philippine peso, the lowering of PLDT s credit ratings or the credit ratings of the Philippines, increase in reference interest rates, and general market conditions. Since approximately 89% of PLDT s total consolidated debts are denominated in foreign currencies, principally in U.S. dollars, many of these financial ratios and other tests are negatively affected by any weakening of the peso.

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

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

PLDT s debt instruments also contain customary and other default provisions that permit the lender to accelerate amounts due or terminate their commitments to extend additional funds under the debt instruments. These default provisions include: (a) cross-defaults and cross-accelerations that permit a lender to declare a default if PLDT is in default under another debt instrument; in some cases, the cross-default provision is triggered upon a payment or other default permitting the acceleration of PLDT s debt, whether or not the defaulted debt is accelerated. In other cases, the cross-default provision requires the defaulted loan to be accelerated. In some debt instruments, the cross-default provision will be triggered only if the principal amount of the defaulted indebtedness exceeds a threshold amount specified in these debt instruments; (b) failure by PLDT to meet certain financial ratio covenants referred to above; (c) the occurrence of any material adverse change in circumstances that a lender reasonably believes materially impairs PLDT s ability to perform its obligations under its debt instrument with the lender; (d) the revocation, termination or amendment of any of the permits or franchises of PLDT in any manner unacceptable to the lender; (e) the abandonment, termination or amendment of the project financed by a loan in a manner unacceptable to the lender; (f) the nationalization or sustained discontinuance of all or a substantial portion of PLDT s business; and (g) other typical events of default, including the commencement of bankruptcy, insolvency, liquidation or winding up proceedings by PLDT.

Smart s debt instruments contain certain restrictive covenants, including covenants that prohibit Smart from paying dividends, redeeming preferred shares, making contributions to PLDT or otherwise providing funds that require Smart to comply with specified financial ratios and other financial tests at semi-annual measurement dates. The loan facilities that contain restrictions in dividend payments and redemption of preferred stocks have been paid in April 2006. The financial tests under Smart s loan agreements include compliance with a debt to equity ratio of not more than 1.5:1.0, a debt to EBITDA ratio of not more than 3:1 and a debt service coverage ratio of not less than 1.5:1.0. As at September 30, 2007, Smart has maintained compliance with all of its financial covenants. The agreements also contain customary and other default provisions that permit the lender to accelerate amounts due under the loans or terminate their commitments to extend additional funds under the loans. These default provisions include: (a) cross-defaults and cross-accelerations that permit a lender to declare a default if Smart is in default under another loan agreement. These cross-default provisions are triggered upon a payment or other default permitting the acceleration of Smart debt, whether or not the defaulted debt is accelerated; (b) failure by Smart to comply with certain financial ratio covenants; (c) any reduction in PLDT s ownership of Smart s capital stock below 51% of the total of each class of issued shares; (d) any reduction in First Pacific s and Metro Pacific Corporation s collective direct and/or indirect ownership of PLDT s common stock below 17.5% of the total common stock outstanding or 17.5% of the voting power of PLDT s total common stock outstanding; and (e) the occurrence of any material adverse change in circumstances that the lender reasonably believes materially impairs Smart s ability to perform its obligations or impair guarantors ability to perform their obligations under its loan agreements.

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

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

Obligations Under Capital Lease

The future minimum payments for capitalized leases as at September 30, 2007 are as follows:

Year	(in million pesos)
2007	1,378
2008	50
2009	12
2010	1
Total minimum lease payments (Note 22)	1,441
Less amount representing interest	504
Present value of net minimum lease payments	937
Less obligations under capital lease maturing within one year (Notes 8 and 24)	911
Long-term portion of obligations under capital lease (Notes 8 and 24)	26

Municipal Telephone Projects

In 1993, PLDT entered into two lease agreements with the Philippine Department of Transportation and Communications, or DOTC, covering telecommunications facilities in the province of Bohol and Batangas established under the Municipal Telephone Act. Under these agreements, PLDT was granted the exclusive right to provide telecommunications management services, to expand services, and to promote the use of the DOTC-contracted facilities in certain covered areas for a period of 15 years. Title to the properties shall be transferred to PLDT upon expiration of the lease term. As at September 30, 2007, PLDT s aggregate remaining obligation under this agreement was approximately Php858 million. In case of cancellation, PLDT is liable to pay Php100 million under each of the two contracts as liquidated damages.

On June 1, 2004, PLDT served the DOTC a notice of termination of the lease agreement in respect of the telecommunications system in Bohol which state of deterioration, obsolescence and disrepair has made it impossible for PLDT to continue managing, operating, and maintaining the system. Since 2002, PLDT has been advising the DOTC of the need to review the viability of the system as PLDT has infused more than Php200 million for upgrades and maintenance to keep the system operable. Further, the enactment of Public Telecommunications Policy Act, or R.A. No. 7925, which negated the DOTC s warranty to grant PLDT the exclusive right to provide telecommunication services in the areas stipulated, prevented PLDT from achieving the originally projected profitability, thereby rendering it impossible for PLDT to continue fulfilling its obligation under the lease agreement. Although several discussions have been held since then, no mutually acceptable agreement has been reached. On June 30, 2004, the DOTC advised PLDT that the request for termination of the lease agreement in Bohol has been referred to the Department of Justice, or DOJ, as government agencies are required to refer all interpretation of contracts and agreements to the DOJ secretary as attorney-general of the national government. On May 5, 2005, PLDT received a letter from the DOTC stating that PLDT is in default for failure to remit to the DOTC the quarterly installments under the lease agreement. Due to the failure of the parties to amicably settle their dispute, on September 28, 2005, PLDT demanded that the dispute be referred to arbitration and that the parties agree on the composition of the arbitration committee. In response, the DOTC, in a letter dated October 17, 2005, informed PLDT that pursuant to Executive Order No. 269, Series of 2004, dated January 12, 2004, the existing communications programs and projects implemented by DOTC were transferred to the Commission on Information and Communications Technology, or CICT, and that the DOTC had forwarded to CICT PLDT s letter dated September 28, 2005. In a letter dated March 24, 2006, the CICT informed PLDT that the CICT poses no objection on PLDT s stated intentions and preference to refer the unresolved and outstanding issues to the Philippine Dispute Resolution Center, Inc., or PDRCI, per the arbitration clause of the lease agreement. On June 27, 2006, a Request for Arbitration dated June 1, 2006 was filed by PLDT with the PDRCI. On November 15, 2006, DOTC has filed its Answer to the said Request for Arbitration. After PDRCI took cognizance of the case, PLDT and DOTC filed their amended pleadings. DOTC filed a Supplemental Answer with Prayer for Interim Relief, which prayed for, among others, the remittance to DOTC of the amount PLDT allegedly deposited in a separate account for the benefit of the former.

On June 1, 2007, the PDRCI issued a Final Partial Award (On the Request for Interim Relief), granting DOTC s prayer. PLDT was ordered to release to DOTC the amount of Php149 million subject to the posting by DOTC of a surety bond. PLDT has taken issue with the Final Partial Award, or Award, and filed before the Court of Appeals a Petition for Review under Rule 43 of the Rules of Court to review the Award.

In the meantime, DOTC filed an Application/Motion for Confirmation of Final Partial Award before the Regional Trial Court of Mandaluyong, which is currently pending.

The Arbitration proceedings between DOTC and PLDT pertaining to lease agreement of the Bohol Telecommunications System continue to this day. As at September 30, 2007, the net book value of the telecommunications system in Bohol, including PLDT s additional capital expenditure relating to the telecommunications system, and corresponding capital lease obligation amounted to Php3 million and Php735 million, respectively.

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

Other Long-term Capital Lease Obligations

The PLDT Group has various long-term lease contracts for a period of three years covering various office equipment. In particular, PLDT, Smart and ePLDT have capital lease obligations in the aggregate amount of Php540 million as at September 30, 2007 in respect of office equipment.

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

Preferred Stock Subject to Mandatory Redemption

The movements of PLDT s preferred stock subject to mandatory redemption as at September 30, 2007 and December 31, 2006 are as follows:

	September 30, 2007 (Unaudited)			December 31, 2006 (Audited)			
	Series V	**Series VI**	**Total**	Series V	Series VI	Series VII	Total
	(in million pesos)						
Balance at beginning of period	**61**	**1,308**	**1,369**	272	6,321	5,381	11,974
Accretion	**8**	**106**	**114**	13	481	282	776
Revaluation		**(98)**	**(98)**		(241)	(120)	(361)
Conversion	**(17)**	**(254)**	**(271)**	(224)	(5,253)	(5,543)	(11,020)
Balance at end of period	**52**	**1,062**	**1,114**	61	1,308		1,369

As at September 30, 2007, PLDT had issued 3 million shares of Series V Convertible Preferred Stock, 5 million shares of Series VI Convertible Preferred Stock and 4 million shares of Series VII Convertible Preferred Stock in exchange for a total of 58 million shares of Series K Class I Convertible Preferred Stock of Piltel, pursuant to the debt restructuring plan of Piltel adopted in June 2001. As discussed below, as at December 31, 2006, all Series VII Convertible Preferred Stock had been converted. Shares of Series V and VI Convertible Preferred Stock are entitled to receive annual dividends of Php18.70 per share and US$0.397 per share, respectively. Each share of Series V and VI Convertible Preferred Stock is convertible at any time at the option of the holder into one PLDT common share. On the date immediately following the seventh anniversary of the issue date of the Series V and Series VI Convertible Preferred Stock, the remaining outstanding shares under these series will be mandatorily converted into PLDT common shares. Under a put option exercisable for 30 days, holders of common shares received, on mandatory conversion of the Series V and VI Convertible Preferred Stock, will be able to require PLDT to purchase such PLDT common shares for Php1,700 per share and US$36.132 per share, respectively.

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

The cost of each foreign currency component of the Convertible Preferred Stock Series VI and VII, was designated as a debt instrument with embedded call options. The fair value of the Convertible Preferred Stock was determined on the issue date, of which the fair value of embedded call options was bifurcated and accounted for separately, see *Note 2 Summary of Significant Accounting Policies and Practices* and *Note 24 Financial Assets and Liabilities*. The residual amount was assigned as liability components and recorded as Preferred Stock Subject to Mandatory Redemption and is included under the Interest-bearing Financial Liabilities account in the unaudited consolidated balance sheets.

The difference between the amount designated as liability components of the Series V, VI and VII Convertible Preferred Stock at issue date and the aggregate redemption value is accreted over the period up to the put option date using the effective interest rate method. Accretions added to Preferred Stock Subject to Mandatory Redemption and charged to interest for the nine months ended September 30, 2007 and 2006 amounted to Php114 million and Php739 million, respectively.

Preferred Stock Subject to Mandatory Redemption amounted to Php1,114 million and Php1,369 million as at September 30, 2007 and December 31, 2006, respectively, after revaluation of Series VI and VII Convertible Preferred Stock to the exchange rates at balance sheet dates and after giving effect to the above accretions, conversions and additional issuances. As at September 30, 2007 and December 31, 2006, 11,118,350 shares and 10,937,309 shares, respectively, of the Convertible Preferred Stock have been voluntarily converted into PLDT common shares. On August 18, 2006, all 3,842,000 shares of Series VII Convertible Preferred Stock have been voluntarily converted into PLDT common shares. The outstanding shares of Series V and VI Convertible Preferred Stock as at September 30, 2007 were 33,950 shares and 706,244 shares, respectively. The aggregate redemption value of the outstanding Series V and VI Convertible Preferred Stock amounted to Php1,205 million and Php1,629 million as at September 30, 2007 and December 31, 2006, respectively.

The corresponding dividends on these shares charged as interest expense amounted to Php14 million and Php113 million for the nine months ended September 30, 2007 and 2006, respectively.

Notes Payable

In 2006, SPi obtained unsecured dollar-denominated short-term notes payable from various local commercial banks amounting to US$4.09 million. In 2007, additional short-term unsecured dollar-denominated notes payable were obtained from various banks totaling US$4.8 million. Interest on the notes range from 6.9% to 7.5% of the outstanding balance per annum and the notes are payable within 90 to 360 days from the availment date. The outstanding balance of US$8.9 million, or Php400 million, as at September 30, 2007 will mature in various dates from

October 17, 2007 to August 8, 2008.

In 2006, Cymed obtained two-year interest bearing notes payable amounting to US$3.4 million from its previous shareholders. Interest on the notes payable is 6.2% per annum. The outstanding balance of US$1.6 million, or Php70 million, as at September 30, 2007 will mature in August 2008.

On June 1, 2007, SPi America LLC obtained short-term interest-bearing notes payable amounting to US$0.5 million, or Php22 million in payment for software license. The loan is payable within one year in four equal quarterly payments of principal and interest commencing on September 1, 2007. Interest on the loan is 5% per annum. The outstanding balance of US$0.4 million, or Php17 million, as at September 30, 2007 will mature in various dates from December 1, 2007 to June 1, 2008.

18. Other Noncurrent Liabilities

This account consists of:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Accrual of capital expenditures under long-term financing	**6,135**	5,646
Future earn-out payments (Note 2)	**999**	
Asset retirement obligations (Notes 3 and 8)	**909**	831
Unearned revenues	**5**	63
Prepayments received under receivable purchase facility (Note 14)		205
Others	**837**	836
	8,885	7,581

19. Accrued Expenses and Other Current Liabilities

This account consists of:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Accrued utilities and related expenses (Note 20)	**8,615**	8,078
Accrued employee benefits (Note 21)	**3,781**	7,474
Accrued interest and other related costs (Notes 17 and 20)	**1,609**	1,768
Accrued taxes and related expenses (Notes 22 and 23)	**856**	756
Payable in installment purchase of equity investment (Note 11)	**123**	
Others	**949**	1,026
	15,933	19,102

20. Related Party Transactions

a. Air Time Purchase Agreement between PLDT and AIL and Related Agreements

PLDT is a party to a Founder NSP Air Time Purchase Agreement, or ATPA, entered into with AIL in March 1997, which was amended in December 1998 (as amended, the Original ATPA), under which PLDT was granted the exclusive right to sell AIL services as national service provider, or NSP, in the Philippines. In exchange, the Original ATPA required PLDT to purchase from AIL a minimum of US$5 million worth of air time (the Minimum Air Time Purchase Obligation) annually over ten years commencing on January 1, 2002 (the Minimum Purchase Period), the purported date of commercial operations of the Garuda I Satellite. In the event that AIL s aggregate billed revenue was less than US$45 million in any given year, the Original ATPA also required PLDT to make supplemental air time purchase payments not to exceed US$15 million per year during the Minimum Purchase Period (the Supplemental Air Time Purchase Obligation).

Under the Original ATPA, the Minimum Air Time Purchase Obligation and the Supplemental Air Time Purchase Obligation terminated upon the earlier of (i) the expiration of the Minimum Purchase Period and (ii) the date on which all indebtedness incurred by AIL to finance the AIL System has been repaid. AIL indebtedness consists of: (1) loans with several financial institutions (the Banks) under the Credit Agreement dated March 12, 1997, as amended from time to time, including the amendment through the rescheduling agreement, dated September 30, 2002, which extended the principal repayment dates to agreed periods with the final maturity date on January 31, 2012 (collectively, the Amended Credit Agreement); and (2) amounts owing to MMOC under the Spacecraft Contract dated August 28, 1995, as amended on December 30, 1998.

AIL has incurred recurring significant operating losses, negative operating cash flows, and significant levels of debt. The financial condition of AIL was partly due to the NSPs inability to generate the amount of revenues originally expected as the growth in subscriber numbers has been significantly lower than budgeted.

On September 1, 2006, AIL, PT Asia Cellular Satellite, a 95% owned subsidiary of AIL, and Inmarsat Global Limited, or Inmarsat, reached an agreement to pool their resources to develop powerful and novel product and service offerings in the Asian region, founded on their respective mobile satellite communications networks, with (a) Inmarsat performing the role of satellite and network operator and wholesale product and services developer and (b) AIL performing the role of wholesale and retail distributor of products and services.

Inmarsat operates a constellation of geostationary satellites that extend mobile phone, fax and data communications to nearly every part of the world through the services it offers to end users through its established chain of distribution partners and satellite communications service providers.

On September 1, 2006, PLDT entered into a gateway services agreement with Inmarsat, under which PLDT committed to provide gateway infrastructure in Subic Bay up to a maximum amount of US$5 million. In exchange, PLDT will earn US$0.015 per minute for interconnection services to be provided to Inmarsat distribution partners for traffic going through the gateway facility in Subic Bay.

On September 1, 2006, AIL and PT Asia Cellular Satellite entered into a term sheet, as amended on October 20, 2006 and further amended on November 20, 2006 (the Bank Term Sheet), with a majority of the banks used as the basis for negotiations between the parties thereto with a view to enter into an agreement to further amend the Amended Credit Agreement with AIL s bank creditors. Under the Banks Term Sheet, a majority of the banks agreed, subject to satisfaction of certain conditions, among other things, to amend the Original ATPA as set forth in an attachment to the Banks Terms Sheet and to restructure AIL s indebtedness. Pursuant to the business collaboration arrangements between AIL and Inmarsat, on September 1, 2006, Inmarsat made the first payment of US$4 million to AIL which was used to pay principal and interest payable to the banks in accordance with the Banks Term Sheet.

On February 1, 2007, the parties to the Original ATPA entered into an amendment to the Original ATPA on substantially the terms attached to the Bank Terms Sheet (the Amended ATPA). Under the Amended ATPA, the Minimum Air Time Purchase Obligation was amended and replaced in its entirety with an obligation of PLDT (the Amended Minimum Air Time Purchase Obligation) to purchase from AIL a minimum of US$500,000 worth of air time annually over a period ending upon the earlier of (i) the expiration of the Minimum Purchase Period and (ii) the date on which all indebtedness incurred by AIL to finance the AIL System is repaid. Furthermore, the Amended ATPA unconditionally released PLDT from any obligations arising out of or in connection with the Original ATPA prior to the date of the Amended ATPA, except for obligations to pay for billable units used prior to such date. Moreover, pursuant to a letter of confirmation, dated February 1, 2007, the banks released and discharged PLDT and ACeS Philippines and their respective subsidiaries from any and all obligations and liabilities under the Original ATPA and related agreements.

Moreover, in accordance with the above contractual arrangements, ACeS Philippines acquired (i) from LMGT Holdings (ACeS), Inc., or LMGT, 50% of its equity interest in AIL for a consideration of US$0.75 million pursuant to a sale and purchase agreement entered into on February 1, 2007 and (ii) from Tera Global Investment Ltd., or TGIL, for a nominal consideration 50% of TGIL s interest in a promissory note issued by AIL, which 50% interest represents an aggregate amount of US$44 million, or the Transferred AIL Note, together with related security interests pursuant to sale agreement entered into on February 1, 2007. Immediately thereafter, a portion of the Transferred AIL Note was converted into shares of AIL and the balance was converted into non-interest bearing convertible bonds of AIL. As a result of these transactions, ACeS Philippines owned 36.99% of AIL as at the date of this report.

b. Transactions with Major Stockholders, Directors and Officers

Transactions to which PLDT or any of its subsidiaries is a party, in which a director, key officer or owner of more than 10% of the outstanding common stock of PLDT, or any member of the immediate family of a director, key officer or owner of more than 10% of the outstanding common stock of PLDT had a direct or indirect material interest, as at September 30, 2007 (unaudited) and December 31, 2006 (audited) and for the nine months ended September 30, 2007 and 2006 (unaudited) are as follows:

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

In connection with the transfer by NTT Communications of approximately 12.6 million shares of PLDT s common stock to 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.

Moreover, key provisions of the Cooperation Agreement pertain to, among other things:

• *Restriction on Ownership of Shares of PLDT by NTT Communications and DoCoMo.* Each of NTT Communications and DoCoMo has agreed not to beneficially own, directly or indirectly, in the aggregate with their respective subsidiaries and affiliates, more than 21% of then issued and outstanding shares of PLDT s common stock. If such event does occur, the FP Parties, as long as they own in the aggregate not less than 21% of then issued and outstanding shares of PLDT s common stock, have the right to terminate their respective rights and obligations under the Cooperation Agreement, the Shareholders Agreement and the Stock Purchase and Strategic Investment Agreement.

• *Limitation on Competition.* NTT Communications, DoCoMo and their respective subsidiaries are prohibited from investing in excess of certain thresholds in businesses competing with PLDT in respect of customers principally located in the Philippines and from using their assets in the Philippines in such businesses. Moreover, if PLDT, Smart or any of Smart s subsidiaries intends to enter into any contractual arrangement relating to certain competing businesses, PLDT is required to provide, or to use reasonable efforts to procure that Smart or any of Smart s subsidiaries provide, NTT Communications and DoCoMo with the same opportunity to enter into such agreement with PLDT or Smart or Smart s subsidiaries, as the case may be.

• *Business Cooperation.* PLDT and DoCoMo agreed in principle to collaborate with each other on the business development, roll-out and use of a wireless-code division multiple access mobile communication network. In addition, PLDT agreed, to the extent of the power conferred by its direct or indirect shareholding in Smart, to procure that Smart will (i) become a member of a strategic alliance group for international roaming and corporate sales and services and (ii) enter into a business relationship concerning preferred roaming and inter-operator tariff discounts with DoCoMo.

• *Additional Rights of DoCoMo.* Upon NTT Communications, DoCoMo and their subsidiaries owning in the aggregate 20% or more of the shares of PLDT s common stock and for as long as NTT Communications, DoCoMo and their subsidiaries continue to own in the aggregate 17.5% of the shares of PLDT s common stock then outstanding, DoCoMo will be entitled to certain additional rights under the Cooperation Agreement.

• *Change in Control.* Each of NTT Communications, DoCoMo and the FP Parties agreed that to the extent permissible under applicable laws and regulations of the Philippines and other jurisdictions, subject to certain conditions, to cast its vote as a shareholder in support of any resolution proposed by the Board of Directors of PLDT for the purpose of safeguarding PLDT from any Hostile Transferee. A *Hostile Transferee* is defined under the Cooperation Agreement to mean any person (other than NTT Communications, DoCoMo, First Pacific or any of their respective affiliates) determined to be so by the PLDT Board of Directors and includes, without limitation, a person who announces an intention to acquire, seeking to acquire or acquires 30% or more of PLDT common shares then issued and outstanding from time-to-time or having (by itself or together with itself) acquired 30% or more of the PLDT common shares announces an intention to acquire, seeking to acquire or acquires a further 2% of such PLDT common shares: (a) at a price per share which is less than the fair market value as determined by the board of directors of PLDT as advised by a professional financial advisor; (b) which is subject to conditions which are subjective or which could not reasonably be satisfied; (c) without making an offer for all PLDT common shares not held by it and/or its affiliates and/or persons who, pursuant to an agreement or understanding (whether formal or informal), actively cooperate to obtain or consolidate control over PLDT; (d) whose offer for the PLDT common shares is unlikely to succeed or (e) whose intention is otherwise not *bona fide*; provided that, no person will be deemed a

Hostile Transferee unless prior to making such determination, the board of directors of PLDT has used reasonable efforts to discuss with NTT Communications and DoCoMo in good faith whether such person should be considered a Hostile Transferee.

- *Termination.* If NTT Communications, DoCoMo or their respective subsidiaries cease to own, in the aggregate, full legal and beneficial title to at least 10% of the shares of PLDT s common stock then issued and outstanding, their respective rights and obligations under the Cooperation Agreement and the Shareholders Agreement will terminate and the Strategic Arrangements (as defined in the Stock Purchase and Strategic Investment Agreement) will terminate. If the FP Parties and their respective subsidiaries cease to have, directly or indirectly, effective voting power in respect of shares of PLDT s common stock representing at least 18.5% of the shares of PLDT s common stock then issued and outstanding, their respective rights and obligations under the Cooperation Agreement, the Stock Purchase and Strategic Investment Agreement, and the Shareholders Agreement will terminate.

2. Integrated i-mode Services Package Agreement between DoCoMo and Smart

An Integrated i-mode Services Package Agreement was entered into by Smart and DoCoMo on February 15, 2006, under which DoCoMo agreed to grant Smart, on an exclusive basis within the territory of the Philippines for a period of five years, an integrated i-mode services package including a non-transferable license to use the licensed materials and the i-mode brand, as well as implementation support and assistance and post-commercial launch support from DoCoMo. Pursuant to this agreement, Smart is required to pay an initial license fee and running royalty fees based on the revenue arising from i-mode subscription fees and data traffic. Outstanding obligation under this agreement amounted to Php53 million as at December 31, 2006. Smart has no outstanding obligation under this agreement as at September 30, 2007.

3. 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 dated January 31, 2006. Pursuant to the Advisory Services Agreement, DoCoMo will provide the services of certain key personnel in connection with certain aspects of the business of PLDT and Smart. Also, said agreement governs the terms and conditions of the appointments of such key personnel and the corresponding fees related thereto. Total fees under this agreement amounted to Php56 million and Php25 million for the nine months ended September 30, 2007 and 2006, respectively. Outstanding liability under this agreement amounted to Php18 million and Php32 million as at September 30, 2007 and December 31, 2006, respectively.

4. Other Agreements with NTT Communications and/or its Affiliates

PLDT is a party to the following agreements with NTT Communications and/or its affiliates:

• *Advisory Services Agreement*. On March 24, 2000, PLDT entered into an agreement with NTT Communications, as amended on March 31, 2003, March 31, 2005 and June 16, 2006, under which NTT Communications provides PLDT with technical, marketing and other consulting services for various business areas of PLDT starting April 1, 2000;

• *Arcstar Licensing Agreement and Arcstar Service Provider Agreement.* On March 24, 2000, PLDT entered into an agreement with NTT Worldwide Telecommunications Corporation under which PLDT markets managed data and other services under NTT Communications Arcstar brand to its corporate customers in the Philippines. PLDT also entered into a Trade Name and Trademark Agreement with NTT Communications under which PLDT has been given the right to use the tradename Arcstar and its related trademark, logo and symbols, solely for the purpose of PLDT s marketing, promotional and sales activities for the Arcstar services within the Philippines; and

• *Conventional International Telecommunications Services Agreement*. On March 24, 2000, PLDT entered into an agreement with NTT Communications under which PLDT and NTT Communications agreed to cooperative arrangements for conventional international telecommunications services to enhance their respective international businesses.

Total fees under these agreements amounted to Php83 million and Php144 million for the nine months ended September 30, 2007 and 2006, respectively. As at September 30, 2007 and December 31, 2006, outstanding obligations of PLDT under these agreements amounted to Php18 million.

5. Agreement between Smart and Asia Link B.V., or ALBV. Smart has an existing Technical Assistance Agreement with ALBV, a subsidiary of the First Pacific Group, for the latter s provision of technical support services and assistance in the operations and maintenance of cellular business for a period of five years, subject to renewal upon mutual agreement between the parties. The agreement provides for quarterly payments of technical service fees equivalent to 2% of the net revenues of Smart. In January 2004, the agreement was amended, reducing the technical service fees to be paid by Smart to ALBV to 1% of net revenues effective January 1, 2004. On February 18, 2004, Smart and ALBV entered into a renewal of the Technical Assistance Agreement extending the effectivity of the terms thereof to February 23, 2008. Furthermore, in view of the acquisition by Smart of ownership of 92.1% of the outstanding common stock of Piltel held by PLDT, the parties agreed to make the consolidated net revenues of Smart the basis for the computation of the 1% technical service fees payable by Smart to ALBV, effective January 1, 2005. Total service fees charged to operations under this agreement amounted to Php449 million and Php398 million for the nine months ended September 30, 2007 and 2006, respectively. As at September 30, 2007, Smart had advanced the payment of service fees to ALBV amounting to Php151 million. As at December 31, 2006, Smart had an outstanding liability to ALBV of Php128 million.

Smart also has an existing Services Agreement with ALBV for a period of 25 years starting January 1, 1999, which will automatically expire unless renewed by mutual agreement of both parties. Under the agreement, ALBV provides advice and assistance to Smart in sourcing capital equipment and negotiating with international suppliers, arranging international financing and other services therein consistent with and for the furtherance of the objectives of the services. Service agreement fees were paid for the whole 25-year period. Outstanding prepaid management fees as at September 30, 2007 and December 31, 2006 amounted to Php830 million and Php869 million, respectively. Financing service fee charged to operations amounted to Php38 million each for the nine months ended September 30, 2007 and 2006.

6. Agreements Relating to Insurance Companies. Gotuaco del Rosario and Associates, or Gotuaco, acts as the broker for certain insurance companies to cover certain insurable properties of the PLDT Group. Insurance premiums are remitted to Gotuaco and the broker s fees are settled between Gotuaco and the insurance companies. In addition, PLDT has an insurance policy with Malayan Insurance Co., Inc., or Malayan, wherein premiums are directly paid to Malayan. Total insurance expenses under these agreements amounted to Php168 million and Php189 million for the nine months ended September 30, 2007 and 2006, respectively. Two directors of PLDT have direct/indirect interests in or serve as a director/officer of Gotuaco and Malayan.

Compensation of Key Management Personnel of the PLDT Group

PLDT Group s compensation of key management personnel by benefit type follows:

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Short-term employee benefits	**557**	464
Share-based payments (Note 21)	**214**	812
Post-employment benefits	**43**	26
	814	1,302

Each of the directors, including the members of the advisory board of PLDT, is entitled to a director s fee in the amount of Php125,000 for each meeting of the board attended. Each of the members or advisors of the audit, executive compensation, governance and nomination and finance committees is entitled to a fee in the amount of Php50,000 for each committee meeting attended.

There are no agreements between PLDT Group and any of its key management personnel providing for benefits upon termination of employment, except for such benefits to which they may be entitled under PLDT Group s retirement and incentive plans.

21. Employee Benefits

Executive Stock Option Plan, or ESOP

On April 27, 1999 and December 10, 1999, the Board of Directors and stockholders, respectively, approved the establishment of an ESOP and the amendment of the Seventh Article of the Articles of Incorporation of PLDT denying the pre-emptive right of holders of common stock to subscribe for any issue of up to 1,289,745 common stock pursuant to the ESOP. The ESOP covers management executives, which include officers with rank of Vice President up to the President, executives with the rank of Manager up to Assistant Vice President, and advisors/consultants engaged by PLDT. The ESOP seeks to motivate option holders to achieve PLDT s goals, reward option holders for the creation of shareholder value, align the option holders interests with those of the stockholders of PLDT, and retain the option holders to serve the long-term interests of PLDT. The ESOP is administered by the Executive Compensation Committee of the Board of Directors. About 1.3 million shares of common stock of PLDT had been reserved as underlying option shares under the ESOP in 1999.

Movements in the number of stock options outstanding under the ESOP are as follows:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
Balance at beginning of period	**119,034**	197,500
Exercised shares*	**(89,876)**	(78,466)
Balance at end of period	**29,158**	119,034

** Based on date of payment of exercised shares.*

As at September 30, 2007, there are 840,692 shares exercised by certain officers and executives at an exercise price of Php814 per share.

The fair value of the ESOP was estimated at the date of grant using an option pricing model, which considered annual stock volatility, risk-free interest rate, expected life of the option, exercise price of Php814 per share, and a weighted average price of Php870 and Php315 per share for the 1999 and 2002 Grants, respectively, as at valuation date. Total fair value of shares granted amounted to Php359 million as at September 30, 2007 and December 31, 2006. No fair value of options were recognized as an expense for the nine months ended September 30, 2007 and 2006.

LTIP

On August 3, 2004, PLDT s Board of Directors approved the establishment of a Long-term Incentive Plan, or Original LTIP, for eligible key executive officers and advisors of PLDT and its subsidiaries, which is administered by the Executive Compensation Committee. The Original LTIP was a four-year cash-settled share based plan covering the period from January 1, 2004 to December 31, 2007, or the Performance Cycle. The payment was intended to be made at the end of the Performance Cycle (without interim payments) and contingent upon the achievement of an approved target increase in PLDT s common share price by the end of the Performance Cycle and a cumulative consolidated net income target for the Performance Cycle.

On August 28, 2006, PLDT s Board of Directors approved, in principle, the broad outline of the PLDT Group s strategic plans for 2007 to 2009 focusing on the development of new revenue streams to drive future growth while protecting the existing core communications business. To ensure the proper execution of the three-year plan, particularly with respect to the manpower resources being committed to such plans, a new LTIP, or New LTIP, upon endorsement of the Executive Compensation Committee, was approved by the Board of Directors to cover the period from January 1, 2007 to December 31, 2009, or New Performance Cycle. As a result of the establishment of the New LTIP, the Board also approved the early vesting of the Original LTIP by the end of 2006 for those of its participants who were invited to join the New LTIP and chose to join. Participants in the Original LTIP who were not invited to join the New LTIP, or who were invited but chose not to join, remained subject to the Original LTIP and its original vesting schedule.

Total number of shares appreciation rights remained outstanding under the existing 2004 to 2006 LTIP as at September 30, 2007 was 34,112 which is expected to be paid in May 2008. Total number of share appreciation rights awarded under the new 2007 to 2009 LTIP as at September 30, 2007 was 4,272,306, which will be paid in 2010.

The fair value of the LTIP was estimated using an option pricing model, which considered annual stock volatility, risk-free interest rates, the remaining life of options and the share price capped at Php2,300 as at December 31, 2006 for 2004 to 2006 LTIP and share price of Php2,910 as at September 30, 2007 for 2007 to 2009 LTIP. Incentive cost per share as at September 30, 2007 for the existing 2004 to 2006 LTIP and for the new 2007 to 2009 LTIP amounted to Php1,350 and Php1,068, respectively. The fair value of the LTIP recognized as an expense for the nine months ended September 30, 2007 (under the 2007 to 2009 LTIP) and 2006 (under the 2004 to 2006 LTIP) amounted to Php1,100 million and Php2,677 million, respectively. As at September 30, 2007 and December 31, 2006, total LTIP liability amounted to Php1,175 million and Php5,030 million, respectively, see *Note 3 Management s Use of Judgments, Estimates and Assumptions*.

Pension

Defined Benefit Pension Plans

We have defined benefit pension plans, covering substantially our permanent and regular employees, excluding those of Smart and its subsidiary, I-Contacts, which require contributions to be made to separate administrative funds.

Our actuarial valuation is done on an annual basis. Based on the latest actuarial valuation, the actual present value of accrued liabilities, net of pension cost and average assumptions used in developing the valuation are as follows:

	(in million pesos)
Benefit obligation as at December 31, 2006	13,314
Fair value of plan assets as at December 31, 2006	5,768
Funded status	7,546
Unrealized net transition obligation	(1)
Unrecognized net actuarial loss	(4,657)
Accrued benefit cost as at December 31, 2006 (Audited)	2,888
Accrual of pension cost during the period	1,081
Contributions	(1,318)
Accrued benefit cost as at September 30, 2007 (Unaudited)	2,651

Net pension cost was computed as follows:

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Components of net periodic benefit cost:		
Interest cost	**797**	670
Current service cost	**633**	376
Amortizations of unrecognized net actuarial loss	**96**	37
Recognition of transitional liability	**6**	
Expected return on plan assets	**(451)**	(406)
Net periodic benefit cost	**1,081**	677

The weighted average assumptions used to determine pension benefits as at September 30, 2007 and December 31, 2006 are as follows:

Discount rate	8%
Rate of increase in compensation	9%
Expected rate of return on plan assets	10%

As at September 30, 2007 and December 31, 2006, the assets of the beneficial trust fund established for the PLDT s pension plan include investments in shares of stocks of PLDT and Piltel with fair values aggregating Php2,464 million and Php2,185 million, which represent about 32% and 35%, respectively, of such beneficial trust fund s net assets available for plan benefits.

The Board of Trustees of the beneficial trust fund uses an investment approach of mixed equity and fixed income investments to maximize the long-term expected return of plan assets. The investment portfolio has been structured to achieve the objective of regular income with capital growth and out-performance of benchmarks. A majority of the investment portfolio consists of fixed income debt securities and various equity securities, while the remaining portion consists of multi-currency investments.

The allocation of the fair value of the beneficial trust fund s assets for the PLDT pension plan follows:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
Investments in equity securities	**57%**	52%
Investments in debt and fixed income securities	**22%**	23%
Investments in real estate	**8%**	10%
Investments in mutual funds	**6%**	8%
Investments in temporary placements	**7%**	7%
	100%	100%

Total contribution of PLDT to its pension plan for the nine months ended September 30, 2007 amounted to Php1,309 million.

Defined Contribution Plan

Contributions to the plan are made based on the employee s years of tenure and range from 5% to 10% of the employee s monthly salary. Additionally, employee has an option to make a personal contribution to the fund, at an amount not exceeding 10% of his monthly salary. The employer then provides an additional contribution to the fund ranging from 10% to 50% of the employee s contribution based on the latter s years of tenure.

The Plan s investment portfolio seeks to achieve regular income and long-term capital growth and consistent performance over its own portfolio benchmark. In order to attain this objective, the trustee s mandate is to invest in a diversified portfolio of bonds and equities, both domestic and international. The portfolio mix is kept at 60% to 90% for fixed income securities while 10% to 40% is allotted to equity securities.

The allocation of the fair value of plan assets for Smart as at September 30, 2007 (unaudited) and as at December 31, 2006 (audited) follows:

Investments in debt securities	68%
Investments in equity securities	29%
Others	3%
	100%

Smart currently expects to make approximately Php109 million of cash contributions to its pension plan in 2007.

Pension Benefit Cost

Total pension benefit cost follows:

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Expense recognized for defined benefit plans	**1,081**	677
Expense recognized for defined contribution plans	**99**	83

Total (Note 5)	**1,180**	760

22. Contractual Obligations and Commercial Commitments

Contractual Obligations

The following table discloses our unaudited consolidated contractual obligations outstanding as at September 30, 2007:

	Payments Due by Period				
	Total	**Within 1 year**	**2-3 years**	**4-5 Years**	**After 5 years**
	(in million pesos)				
Long-term debt(1)	69,214	7,073	17,617	16,861	27,663
Long-term lease obligations:					
Operating lease	3,511	620	1,241	827	823
Capital lease	1,441	1,414	26	1	
Unconditional purchase obligations(2)	796	71	45	242	438
Other long-term obligations	1,205	1,205			
Total contractual obligations	**76,167**	**10,383**	**18,929**	**17,931**	**28,924**

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

(2) Based on the Amended ATPA with AIL.

Long-term Debt

For a detailed discussion of our long-term debt, see *Note 17 Interest-bearing Financial Liabilities*.

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 10 to 25 years expiring at various dates. As at September 30, 2007, PLDT s aggregate remaining obligation under these contracts amounted to approximately Php4 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 September 30, 2007, PLDT s aggregate remaining obligation under this agreement was approximately Php20 million.

Other Long-term Operating Lease Obligations. The PLDT Group has various long-term lease contracts for periods ranging from two to ten years covering certain offices, warehouses, cell sites telecommunication equipment locations and various office equipment. In particular, Smart has lease obligations amounting to Php3,181 million as at September 30, 2007 in respect of office and cell site rentals with over 3,000 lessors nationwide, PLDT has lease obligations amounting to Php78 million as at September 30, 2007 in respect of office and lot rentals with over 175 lessors nationwide, ePLDT has lease obligations amounting to Php183 million as at September 30, 2007 in respect of certain office space rentals and PLDT Global has lease obligations amounting to Php45 million as at September 30, 2007 in respect of certain office space rentals.

Long-term Capital Lease Obligations

For the detailed discussion of our long-term capital lease obligations, see *Note 17 Interest-bearing Financial Liabilities*.

Unconditional Purchase Obligations

For a detailed discussion of PLDT s obligation under the amended ATPA, see *Note 20 Related Party Transactions*.

As at September 30, 2007, PLDT s aggregate remaining minimum obligation under the amended ATPA was approximately Php796 million.

Other Long-term Obligations

Mandatory Conversion and Purchase of Shares. As discussed in *Note 17 Interest-bearing Financial Liabilities*, as at September 30, 2007, PLDT had issued a total of 3 million shares of Series V Convertible Preferred Stock, 5 million shares of Series VI Convertible Preferred Stock and 4 million shares of Series VII Convertible Preferred Stock in exchange for a total of 58 million shares of Series K Class I Convertible Preferred Stock of Piltel, pursuant to the debt restructuring plan of Piltel adopted in June 2001. As at September 30, 2007, 2,687,490 shares of Series V Convertible Preferred Stock, 4,588,860 shares of Series VI Convertible Preferred Stock and 3,842,000 shares of Series VII Convertible Preferred Stock had been voluntarily converted to PLDT common shares. As at September 30, 2007, 33,950 shares of Series V and 706,244 shares of Series VI Convertible Preferred Stocks remained outstanding.

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

The aggregate value of the put option based on outstanding shares as at September 30, 2007 was Php1,205 million which is puttable on June 4, 2008, if all of the outstanding shares of Series V and VI Convertible Preferred Stocks were mandatorily converted and all the common shares were put to PLDT at that time. The market value of the underlying common shares was Php2,154 million, based on the market price of PLDT common shares of Php2,910 per share as at September 30, 2007.

Commercial Commitments

As at September 30, 2007, our outstanding commercial commitments, in the form of letters of credit, amounted to Php1,846 million. These commitments will expire within one year.

23. Provisions and Contingencies

As discussed below, we currently expect that going forward, we will pay local franchise taxes on an annual basis and based on the gross receipts received or collected for services rendered within the jurisdiction of the respective taxing authority. For this reason, we have made the appropriate provisions in our unaudited consolidated financial statements as at September 30, 2007.

NTC Supervision and Regulation Fees, or SRF

Since 1976, PLDT has received assessments from NTC for permit, SRF and other charges pursuant to Section 40 of Commonwealth Act 146, otherwise known as the Public Service Act. As at September 30, 2007, PLDT had paid, since 1994, a total amount of Php2,541 million in SRF, of which Php2,251 million was paid under protest.

PLDT is contesting the manner by which these assessments were calculated and the basis for such calculations. The case is now with the Supreme Court and upon the rules and practice of court, stands submitted for decision.

Local Business and Franchise Tax Assessments

PLDT is presently a party to several cases involving the issue of exemption of PLDT from local franchise and business taxes. PLDT believes, based on the opinion of its legal counsel, that it is exempt from payment of local franchise and business taxes.

The Local Government Code of 1991, or Republic Act (R.A.) 7160, which took effect on January 1, 1992, extended to local government units, or LGUs, the power to tax businesses within their territorial jurisdiction granted under Batas Pambansa 337, and withdrew tax exemptions previously granted to franchise grantees under Section 12 of R.A. 7082.

PLDT believes, based on the opinion of its legal counsel, that R.A. 7925 which took effect on March 16, 1995, and the grant of local franchise and business taxes exemption privileges to other franchise holders subsequent to the effectivity of R.A. 7160, implicitly restored its local franchise and business taxes exemption privilege under Section 12 of R.A. 7082, or the PLDT Franchise pursuant to Section 23 thereof or the quality of treatment clause.

To confirm this position, PLDT sought and obtained on June 2, 1998 a ruling from the Bureau of Local Government Finance, or BLGF, of the Philippine Department of Finance, which ruled that PLDT is exempt from the payment of local franchise and business taxes imposable by LGUs under R.A. 7160.

By virtue of the BLGF Ruling, PLDT stopped paying local franchise and business taxes starting with the fourth quarter of 1998 and has filed with certain LGUs claims for tax refund covering the period from the second quarter of 1995 to the third quarter of 1998. PLDT has received assessments for local franchise and business taxes from several cities and provinces following PLDT s decision to stop payment of local franchise and business taxes.

Following a decision of the Supreme Court on March 25, 2003, a judgment in the amount of Php4 million against PLDT involving the City of Davao became final and executory on April 9, 2003, pursuant to which PLDT was declared not exempt from the local franchise tax. Pursuant to the said decision, PLDT has voluntarily paid the total amount of Php15 million for the period from the fourth quarter of 1998 until December 31, 2003, which includes the Php4 million subject of the case. The said amount constitutes only the basic franchise tax due for the said period, excluding surcharges and interest which PLDT is asking the City of Davao, through the local council, to waive. PLDT believes, based on the opinion of its legal counsel, that PLDT is not liable for surcharges and interest considering that the legal issue involved was a difficult one and PLDT s non-payment of the said taxes was made in good faith. On August 2, 2005, the local Sanggunian passed a resolution denying PLDT s request for abatement of surcharges and penalties and directing the City Treasurer to update PLDT s liability and immediately collect the same. Accordingly, on August 26, 2005, the city treasurer issued an assessment to PLDT in the amount of Php12 million. In order to maintain and preserve its good standing and relationship with the City of Davao, PLDT has paid the surcharges and penalties as at December 31, 2005.

Although PLDT believes that it is not liable to pay local franchise and business taxes, PLDT has entered into compromise settlements with several LGUs, including the City of Makati, in order to maintain and preserve its good standing and relationship with these LGUs. Under these compromise settlements, which have mostly been approved by the relevant courts, PLDT has paid a total amount of Php680 million for local franchise tax covering prior periods up to the end of 2006 as at September 30, 2007.

PLDT no longer had contested assessments from LGUs for franchise taxes based on gross receipts received or collected for services within their respective territorial jurisdiction as at December 31, 2006.

PLDT likewise continues to contest the imposition of local business taxes in addition to local franchise tax by the Cities of Tuguegarao, Balanga and Caloocan in the amounts of Php1.9 million, Php0.2 million and Php6.2 million, respectively, for the years 1998 to 2003 for the City of Tuguegarao, and for the years 2005 to 2007 for the Cities of Balanga and Caloocan. PLDT is likewise contesting the imposition of a business tax on the transmission of messages by the Municipality of San Pedro in the amount of Php0.3 million for the years 2005 to 2007. In addition, PLDT is contesting the imposition of franchise tax by the Province of Cagayan based on gross receipts derived from outside its territorial jurisdiction in the amount of Php3 million for the years 1999 to 2006.

PLDT currently expects that going forward it will pay local franchise taxes on an annual basis and based on the gross receipts received or collected for services rendered within the jurisdiction of the respective taxing authority.

Smart has received and paid under protest the local franchise tax assessment issued by the City of Makati totaling approximately Php312 million, but which had been finally resolved by the Regional Trial Court (RTC) of Makati and upheld by the Court of Appeals (CA) in favor of Smart in the case entitled *Smart Communications, Inc. vs. City of Makati* (Civil Cases No. 02-249 and 02-725, August 3, 2004) dated August 3, 2004. The said RTC decision declaring Smart exempt from payment of local franchise tax and in reversing the decision of the Makati City Miscellaneous Taxes, Fees and Charge Division to assess and/or collect from Smart an amount totaling approximately Php312 million had already become final and executory.

Also, Smart received LFT assessments issued by the City of Iloilo amounting to approximately Php1 million. The RTC of Iloilo likewise ruled in favor of Smart in its decision dated January 19 2005, but the City of Iloilo filed an appeal with the Supreme Court which remains unresolved to date.

Piltel s Bureau of Internal Revenue, or BIR, Assessment

On December 12, 2005, Piltel filed a collective application for a compromise settlement with the BIR for the deficiency tax assessments arising from taxable years 1998, 1999 and 2001, citing reasonable doubt as to the validity of the tax assessments as a basis. The prescribed minimum percentage of the compromise settlement for such basis is 40% of the basic assessed tax.

On January 27, 2006, Piltel received the favorable recommendation and approval from the BIR on the said application for a compromise settlement. On January 31, 2006, Piltel settled the total amount of Php114 million, which is equivalent to 40% of the basic taxes per final assessment notices received, to effect the immediate cancellation of the tax assessments. On February 24, 2006, the BIR accepted Piltel s application for compromise settlement of income tax and VAT for the years 1998 and 1999, and income taxes and VAT for the year 2001, and accordingly, issued the Certificate of Availment on the said date.

Enhanced Voluntary Assessment Program, or EVAP, Availment

In 2005, the BIR launched the EVAP which grants taxpayers, who availed themselves of the program and are qualified, the privilege of the last priority in BIR audit and investigation. The EVAP apply to all internal revenue taxes covering the taxable year ending December 31, 2004 and all prior years, including one-time transactions such as estate tax, donor s tax, capital gains tax, expanded withholding tax and documentary stamp tax on the transfer, sale, exchange, or disposition of assets, and shall likewise cover taxpayers enjoying preferential tax treatment. A taxpayer who has availed of the EVAP and is qualified to avail shall not be audited except upon prior authorization and approval of the Commissioner of Internal Revenue when there is strong evidence or finding of understatement in the payment of a taxpayer s correct tax liability by more than 30% as supported by a written report of the appropriate office stating in detail the facts and the law on which such finding is based: Provided, however, that any EVAP payment should be allowed as tax credit against the deficiency tax due, if any, in case the concerned taxpayer has been subjected to tax audit.

PLDT availed itself of the program and paid a total of Php6 million for VAT and income tax for taxable year 2004, and VAT and withholding tax for taxable year 2002.

Maratel availed itself of the EVAP for income tax for the taxable year 2004, SubicTel availed the program for its income tax, withholding tax and percentage tax for taxable year 2002 and ClarkTel availed of the program for its income tax for both taxable years 2003 and 2004. The total payment of Maratel, SubicTel and ClarkTel amounted to Php800,000. Smart availed of the EVAP and paid Php53 million for the following tax types and taxable years: income tax for the taxable years 2003 and 2004; VAT for the taxable year 2002; OCT for the year 2002; and the withholding taxes for the taxable years 2002, 2003 and 2004. On August 2, 2006, Smart received its Certificate of Qualification, or CQ, for the EVAP availment for income tax, VAT, OCT and withholding taxes for taxable year 2002. Piltel likewise availed of EVAP and paid Php3 million for the following tax types and taxable years: income tax for the taxable year 2003; and the expanded withholding tax for the taxable years 2003 and 2004. To date, the BIR has not issued the CQ for Piltel s EVAP availment.

PLDT received its EVAP CQ on January 22, 2007 for income tax and VAT for taxable year 2004 and on March 28, 2007 for VAT for taxable year 2002 while it received a Notice of Disqualification for EVAP on March 30, 2007 for withholding tax for taxable year 2002. SubicTel and ClarkTel received their respective EVAP CQ on September 13, 2006 and December 10, 2006, respectively, while Maratel was advised by BIR Revenue District Office No. 101, Iligan City in December 2006, that its EVAP application has been disqualified, however, Notice of Disqualification has not been issued by the BIR.

Improved Voluntary Assessment Program, or IVAP, Availment

In 2006, the BIR launched the IVAP which similarly grants taxpayers who availed themselves of the program and are qualified, the privilege of the last priority in BIR audit and investigation. The IVAP applies to all internal revenue taxes covering the taxable year ending December 31, 2005 and fiscal year ending on any day not later than June 30, 2006 and all prior years, including one-time transactions such as estate tax, donor s tax, capital gains tax, expanded withholding tax and documentary stamp tax on the transfer, sale, exchange, or disposition of assets, and shall likewise cover taxpayers enjoying preferential tax treatment. Unlike the EVAP, however, where the taxpayers only enjoy the privilege of last priority in audit, with the IVAP, taxpayers who availed themselves of the same will no longer be subject to tax audit except only in the case of fraud manifested through understatement of the correct tax liability by more than 30%.

Smart availed of the IVAP and paid Php40 million for the following tax types and taxable years: income tax for year 2005; and VAT for year 2005. To date, the BIR has not issued the CQ for Smart s IVAP availment.

Maratel availed itself of the IVAP for the taxable years 2004 and 2005 for its income, VAT, percentage and withholding taxes, while SubicTel availed itself of the program for the taxable year 2004 for its income and value added taxes only and for the taxable year 2005, for its income, VAT and withholding taxes. ClarkTel availed itself of the IVAP for the taxable years 2003, 2004, 2005 for income and withholding taxes except for income taxes for taxable years 2003 and 2004 where an EVAP CQ covering these taxable periods was already issued. The total collective IVAP payments for Maratel, SubicTel and ClarkTel amounted to Php12 million. The IVAP CQ has been issued for the IVAP availments made by Maratel last April 12, 2007 and May 9, 2007 for 2004 and 2005 respectively. In July 2007, the IVAP CQ has been issued for the IVAP availments made by Clarktel for taxable years 2003 2004 and 2005. The IVAP CQ of Subictel is still being processed by their BIR Regional Office.

24. Financial Assets and Liabilities

Our financial assets and liabilities are recognized initially at fair value. Transaction costs (debt issuance costs) are included in the initial measurement of all financial assets and liabilities except those classified as financial instruments measured at fair value through profit and loss. Subsequent to initial recognition, assets and liabilities are either valued at amortized cost using the effective interest rate method or at fair value depending on the classification.

The following table sets forth the carrying values and estimated fair values of our financial assets and liabilities recognized as at September 30, 2007 and December 31, 2006. There are no material unrecognized financial assets and liabilities as at September 30, 2007 and December 31, 2006.

	Carrying Value		**Fair Value**	
	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)	**September 30, 2007 (Unaudited)**	December 31, 2006 (Audited)
		(in million pesos)		
Noncurrent Financial Assets				
Investments-available-for-sale (Note 2)	**142**	116	**142**	116
Derivative financial assets (Note 2)	**93**	434	**93**	434
Investment in debt securities (Note 2)	**268**		**269**	
Total noncurrent financial assets	**503**	550	**504**	550
Current Financial Assets				
Cash and cash equivalents (Notes 2 and 13)	**8,471**	16,870	**8,471**	16,870
Short-term investments (Note 2)	**11,522**	8,327	**11,522**	8,327
Trade and other receivables (Notes 2, 3 and 14)	**10,245**	10,158	**10,245**	10,158
Derivative financial assets (Note 2)	**80**	47	**80**	47
Total current financial assets	**30,318**	35,402	**30,318**	35,402
Total Financial Assets	**30,821**	35,952	**30,822**	35,952

Noncurrent Financial Liabilities				
Long-term debt - net of current portion* (Notes 2, 8, 17, and 22)	**57,273**	63,769	**61,632**	70,416
Obligations under capital lease* (Notes 2, 8, 17, and 22)	**26**	106	**26**	106
Preferred stock subject to mandatory redemption* (Notes 2, 17 and 22)		1,369		1,528
Derivative financial liabilities (Note 2)	**6,800**	6,872	**6,800**	6,872
Total noncurrent financial liabilities	**64,099**	72,116	**68,458**	78,922
Current Financial Liabilities				
Accounts payable (Note 2)	**12,042**	8,634	**12,042**	8,634
Notes payable* (Notes 2, 8, 17, and 22)	**487**	201	**487**	201
Derivative financial liabilities (Note 2)	**15**	108	**15**	108
Current portion of long-term debt* (Notes 2, 8, 17, and 22)	**6,965**	16,184	**7,845**	17,512
Obligations under capital lease* (Notes 2, 8, 17, and 22)	**911**	924	**911**	924
Preferred stock subject to mandatory redemption* (Notes 2, 17 and 22)	**1,114**		**1,164**	
Total current financial liabilities	**21,534**	26,051	**22,464**	27,379
Total Financial Liabilities	**85,633**	98,167	**90,922**	106,301

* *Included under Interest-bearing Financial Liabilities in the consolidated balance sheets.*

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

Interest-bearing Financial Liabilities:

Long-term debt: Fair value is based on the following:

Debt Type	Fair Value Assumptions
Fixed Rate Loans:	
U.S. dollar notes/convertible debt	Quoted market price.
Other loans in all other currencies	Estimated fair value is based on the discounted value of future cash flows using the applicable CIRR and PDST rates for similar types of loans.

Variable Rate Loans	The carrying value approximates fair value because of recent and regular repricing based on market conditions.

Preferred stock subject to mandatory redemption: The fair values were determined using a discounted cash flow model.

Derivative financial instruments:

Foreign currency options: The fair values were computed using an option pricing model.

Forward foreign exchange contracts, bifurcated foreign currency forwards, foreign currency and interest rate swaps: The fair values were computed as the present value of estimated future cash flows.

Bifurcated equity call options: The fair values were computed using an option pricing model.

Due to the short-term nature of the transactions, the fair value of cash and cash equivalents, short-term investments, trade and other receivables, notes payable and accounts payable approximate the carrying amounts as of the balance sheet date.

Financial assets and liabilities carried at amortized cost

Unamortized debt discount, representing debt issuance costs and any difference between the fair value of consideration given or received on initial recognition, included in following financial liabilities amounted to Php5,571 million and Php6,753 million as at September 30, 2007 and December 31, 2006, respectively, see *Note 17 Interest-bearing Financial Liabilities*.

Financial assets and liabilities carried at fair value

The following financial assets and liabilities were carried at fair value as at September 30, 2007 and December 31, 2006.

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Investments-available-for-sale	**142**	116
Derivative financial instruments	**(6,642)**	(6,499)
	(6,500)	(6,383)

Derivative Financial Instruments

Our derivative financial instruments are accounted for as either cash flow hedges or transactions not designated as hedges. Cash flow hedges refer to those transactions that hedge our exposure to variability in cash flows attributable to a particular risk associated with a recognized asset or liability. Changes in the fair value of these instruments representing effective hedges are recognized as cumulative translation adjustments in equity until the hedged item is recognized in earnings. For transactions that are not designated as hedges, any gains or losses arising from the changes in fair value are recognized directly to income for the period.

The table below sets out the information about our derivative financial instruments as at September 30, 2007 and December 31, 2006:

		September 30, 2007 (Unaudited)		December 31, 2006 (Audited)	
	Maturity	**Notional**	**Mark-to-market Gains (Losses)**	Notional	Mark-to-market Gain (Loss)
			(in millions)		
PLDT					
Cash flow hedges:					
Long-term currency swaps					
	2017	**US$300**	**(Php3,003)**	US$300	(Php2,716)
	2012	**250**	**(2,798)**	250	(2,475)
Long-term foreign currency options	2009	**136**	**(586)**	167	(747)
Transactions not designated as hedges:					
Long-term foreign currency options	2009	**136**(1)	**84**	167(1)	138

Short-term currency options	2007			7	(6)
Interest rate swap	2012	**31**	**(206)**	63	(423)
Forward foreign exchange contracts				202	(90)
Bifurcated equity call options	2008	**1 share**	**(213)**	1 share	(224)
			(6,722)		(6,543)
Smart					
Transactions not designated as hedges:					
Forward foreign exchange contracts	2007	**US$19**	**30**	US$	
Bifurcated embedded derivatives	2007	**11**	**50**	15	44
			80		44
Net liabilities			**(Php6,642)**		(Php6,499)

(1) Non-hedged portion of 2009 long-term foreign currency options based on the same notional amount as the hedged portion.

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Presented as:		
Noncurrent assets	**93**	434
Current assets	**80**	47
Noncurrent liabilities	**(6,800)**	(6,872)
Current liabilities	**(15)**	(108)
Net liabilities	**(6,642)**	(6,499)

Cumulative translation adjustments as at September 30, 2007 and December 31, 2006 consists of:

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited)
	(in million pesos)	
Cumulative translation adjustments at beginning of period	**(1,796)**	1,253

Movements of cumulative translation adjustments:		
Deferred income tax effects on cash flow hedges	**(633)**	1,088
Currency translation differences	**(935)**	(535)
Net gains (losses) on available-for-sale financial assets	**31**	(5)
Net losses on cash flow hedges removed from cumulative translation adjustments and taken to income	**2,570**	2,855
Net losses on cash flow hedges	**(460)**	(6,452)
	573	(3,049)
Cumulative translation adjustments at end of period	**(1,223)**	(1,796)

Analysis of loss on derivative transactions for the nine months ended September 30, 2007 and 2006 are as follows:

	Nine Months Ended September 30,	
	2007	2006
	(Unaudited) (in million pesos)	
Net mark-to-market losses at end of period	**(6,642)**	(5,075)
Net mark-to-market losses at beginning of period	**(6,499)**	(3,284)
Net change	**(143)**	(1,791)
Net losses charged to cumulative translation adjustments	**460**	4,711
Settlements, accretion and conversion	**(524)**	(3,071)
Net losses on derivative transactions (Note 5)	**(207)**	(151)

PLDT

Cash Flow Hedges

Long-term Currency Swaps

PLDT entered into long-term principal only currency swap agreements with various foreign counterparties to hedge the currency risk on its fixed rate notes maturing in 2009, 2012 and 2017. As at September 30, 2007 and December 31, 2006, these long-term currency swaps have an aggregate notional amount of US$550 million. Under the swaps, PLDT effectively exchanges the principal of its U.S. dollar-denominated fixed rate notes into Philippine peso-denominated loan exposures at agreed swap exchange rates. The agreed swap exchange rates are reset to the lowest U.S. dollar/Philippine peso spot exchange rate during the term of the swaps, subject to a minimum exchange rate. In March and April 2004, PLDT entered into amendments to keep the lowest reset exchange rate and unwind the downward resettable feature of US$550 million of its long-term principal only currency swap agreements in order to lower the running hedging cost of the swaps. As at September 30, 2007 and December 31, 2006, the outstanding swap contracts have an agreed average swap exchange rate of Php50.76.

In order to manage hedge costs, these swaps included a credit-linkage feature with PLDT as the reference entity. The specified credit events include bankruptcy, failure to pay, obligation acceleration, moratorium/repudiation, and restructuring of PLDT bonds or all or substantially all of PLDT s obligations. Upon the occurrence of any of these credit events, subject to agreed threshold amounts where applicable, the obligations to both PLDT and its counterparty under the swap contracts terminate without further settlements to either party, including any mark-to-market value of the swaps. As at September 30, 2007 and December 31, 2006, US$686 million and US$717 million, respectively, of PLDT s long-term currency swaps/options have been structured to include credit-linkage with PLDT as the reference entity. The semi-annual fixed or floating swap cost payments that PLDT is required to make to its counterparties averaged about 4.08% and 5.18% per annum as at September 30, 2007 and December 31, 2006, respectively. As cash flow hedges, any movements in the fair value of these instruments will be taken as a cumulative translation adjustment under equity in our consolidated balance sheets.

Long-term Foreign Currency Options

To manage hedging costs, the currency swap agreement relating to the 2009 fixed rate notes with a notional amount of US$175 million has been structured to include currency option contracts. If the Philippine peso to U.S. dollar spot exchange rate on maturity date settles beyond Php90.00 to US$1.00, PLDT will have to purchase U.S. dollar at an exchange rate of Php52.50 to US$1.00 plus the excess above the agreed threshold rate. On the other hand, if on maturity, the Philippine peso to U.S. dollar spot exchange rate is lower than the exchange rate of Php52.50 to US$1.00, PLDT will have the option to purchase at the prevailing Philippine peso to U.S. dollar spot exchange rate. In July 2004, PLDT and its counterparty, agreed to re-document and re-classify the transaction into long-term currency option contracts. The net semi-annual floating hedge cost payments that PLDT is required to pay under these transactions was approximately 5.74% and 6.17% per annum as at September 30, 2007 and December 31, 2006, respectively.

The option currency contract relating to PLDT s option to purchase U.S. dollar at Php52.50 to US$1.00 or prevailing spot exchange rate at maturity, whichever is lower, qualifies as a cash flow hedge. The option currency contract relating to the counterparty s option to purchase foreign currency from PLDT at Php90.00 to US$1.00 is not designated as a hedge. Please refer to discussion below (under transactions not designated as hedges).

In December 2006, the currency option agreement was partially terminated, which effectively lowered the outstanding currency options notional amount to US$167 million. Total amounts settled for the unwinding is Php40 million.

In January 2007, the currency option agreement was again partially terminated where the outstanding currency options notional amount was lowered to US$136 million. Total amounts settled for the unwinding is Php177 million.

Transactions Not Designated as Hedges

Due to the amounts of PLDT s foreign currency hedging requirements and the large interest differential between the Philippine peso and the U.S. dollar, the costs to book long-term hedges can be significant. In order to manage such hedging costs, PLDT utilizes structures that include currency option contracts, and fixed-to-floating coupon-only swaps that may not qualify for hedge accounting.

Long-term Foreign Currency Options

With reference to the above-mentioned hedge on PLDT s 2009 fixed rate notes, PLDT simultaneously sold a currency option contract with the same notional amount of US$175 million with the same maturity that gives the counterparty a right to purchase foreign currency at Php90.00 to US$1.00. Together with the long-term currency option contract classified under cash flow hedges, PLDT has the obligation to purchase U.S. dollars at an exchange rate of Php52.50 to US$1.00 plus the excess above the agreed threshold rate. In exchange for this condition, the overall net hedging cost for the transaction is reduced. In December 2006, the currency option agreement was partially terminated, which lowered the notional amount to US$167 million. Since charges in fair value have already been recognized as profit and loss in prior periods, the corresponding proceeds from the partial termination of the currency option contract amounted to Php7 million.

In January 2007, the currency option agreement was again partially terminated where outstanding notional amount was lowered to US$136 million. Proceeds from the transaction amounted to Php33 million.

Short-term Foreign Currency Options

PLDT entered into short-term U.S. dollar currency option contracts to hedge our other short-term foreign currency obligations. There were no outstanding currency option contracts as at September 30, 2007. As at December 31, 2006, outstanding U.S. dollar currency option contracts amounted to US$7 million with an average rating of US$50.40.

Interest Rate Swap

A portion of PLDT s currency swap agreements to hedge its 2017 fixed rate notes carry fixed rate swap cost payments. To effectively lower the running cost of such swap agreements, PLDT, in April 2003, entered into an agreement to swap the coupon on US$125 million of its 2012 fixed rate notes into a floating rate Japanese yen amount. Under this agreement, PLDT is entitled to receive a fixed coupon rate of 11.375%, provided the Japanese yen to U.S. dollar exchange rate stays above JP¥99.90 to US$1.00. Below this level, a reduced fixed coupon rate of 3% will be due to PLDT. In order to mitigate the risk of the Japanese yen strengthening below the agreed threshold, PLDT, in December 2003, entered into an overlay swap transaction to effectively lower the portion of the coupon indexed to the U.S. dollar to Japanese yen rate to 3% such that the fixed coupon rate due to PLDT when the Japanese yen strengthens below the agreed threshold will be 8.375%. Both swap agreements include a credit-linkage feature with PLDT as the reference entity.

In March 2006, the interest rate and overlay swap agreements were partially terminated to effectively lower the outstanding interest rate swap notional amount to US$62.5 million. Since changes in fair values have already been recognized as profit and loss in prior periods, the corresponding liability settled by PLDT amounted to Php804 million.

In April 2007, the interest and overlay swap agreements were again partially terminated where outstanding notional amount was lowered to US$31 million. Total amounts settled for the unwinding is Php276 million.

Forward Foreign Exchange Contracts

PLDT entered into short-term U.S. dollar forward foreign exchange contracts to hedge short-term foreign currency obligations. There were no outstanding forward foreign exchange contracts as at September 30, 2007. As at December 31, 2006, outstanding forward foreign exchange contracts amounted to US$202 million with an average exchange rate of Php49.50.

Bifurcated Equity Call Options

Pursuant to Piltel s debt restructuring plan, PLDT issued its Series VI and VII Convertible Preferred Stock, see *Note 17 Interest-bearing Financial Liabilities*. Each share of Series VI and VII Convertible Preferred Stock is convertible at any time at the option of the holder into one share of PLDT s common stock. On the date immediately following the seventh anniversary of the issue date of the Series VI Convertible Preferred Stock and on the eighth anniversary of the issue date of the Series VII Convertible Preferred Stock, the remaining outstanding shares under these series will be mandatorily converted into shares of PLDT common stock. For 30 days thereafter, the holders of these mandatorily converted shares of common stock have the option to sell such shares of common stock back to PLDT for US$36.132 per share and JPY4,071.89 per share for Series VI and VII, respectively. On August 18, 2006, all 3,842,000 shares of Series VII shares were converted to PLDT common stock. As at September 30, 2007 and December 31, 2006, the negative fair market value of these embedded call options amounted to Php213 million and Php224 million, respectively.

Smart

Smart entered into short-term offshore deliverable and non-deliverable forward contracts in July and August 2007 for a total amount of US$19 million to hedge 38% of the total expected loan proceeds from the undrawn facility of US$50 million.

Smart s other embedded derivatives were bifurcated from service and purchase contracts. As at September 30, 2007 and December 31, 2006, outstanding contracts included service contract with foreign equipment suppliers and various suppliers covering handset importations denominated in U.S. dollars, which is not the functional currency of a substantial party to the contract or the routine currency of the transaction.

Financial Risk Management Objectives and Policies

The main purpose of our financial instruments is to fund our operations. We also enter into derivative transactions, the purpose of which is to manage the currency risks and interest rate risks arising from our operations and our sources of financing. It is, and has been throughout the year under review, our policy that no trading in financial instruments shall be undertaken.

The main risks arising from our financial instruments are liquidity risk, foreign exchange risk, interest rate risk and credit risk. Our Board reviews and approves policies for managing each of these risks. These risks are summarized below. We also monitor the market price risk arising from all financial instruments. Our accounting policies in relation to derivatives are set out in *Note 2 Summary of Significant Accounting Policies and Practices*.

Liquidity Risk

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

The following table shows our consolidated foreign currency-denominated monetary assets and liabilities and their peso equivalents as at September 30, 2007 and December 31, 2006:

	September 30, 2007 (Unaudited)		December 31, 2006 (Audited)	
	U.S. Dollar	**Php Equivalent**(1)	U.S. Dollar	Php Equivalent(2)
		(in millions)		
Noncurrent Financial Assets				
Derivative financial assets	**US$2**	**Php93**	US$9	Php434
Current Financial Assets				
Cash and cash equivalents	**80**	**3,582**	155	7,578
Short-term investments	**49**	**2,195**	92	4,521
Trade and other receivables	**255**	**11,482**	277	13,589
Derivative financial assets	**2**	**80**	1	47
Total current financial assets	**386**	**17,339**	525	25,735
Total Financial Assets	**US$388**	**Php17,432**	US$534	Php26,169
Noncurrent Financial Liabilities				
Interest-bearing financial liabilities - net of current portion	**US$1,121**	**Php50,431**	US$1,239	Php60,756
Derivative financial liabilities	**151**	**6,800**	140	6,872
Total noncurrent financial liabilities	**1,272**	**57,231**	1,379	67,628
Current Financial Liabilities				
Accounts payable	**US$183**	**Php8,224**	US$268	Php13,115
Accrued expenses and other current liabilities	**80**	**3,578**	74	3,605
Derivative financial liabilities		**15**	2	108
Current portion of interest-bearing financial liabilities	**177**	**7,978**	328	16,104
Total current financial liabilities	**440**	**19,795**	672	32,932
Total Financial Liabilities	**US$1,712**	**Php77,026**	US$2,051	Php100,560

(1) The exchange rate used was Php44.974 to US$1.00.

(2) The exchange rate used was Php49.045 to US$1.00.

In translating the foreign currency-denominated monetary assets and liabilities into peso amounts, the exchange rates used were Php44.974 to US$1.00 and Php49.045 to US$1.00, the Philippine peso-U.S. dollar exchange rates as at September 30, 2007 and December 31, 2006, respectively.

As at November 5, 2007, the peso-dollar exchange rate was Php43.749 to US$1.00. Using this exchange rate, our consolidated net foreign currency-denominated liabilities as at September 30, 2007 would have decreased by Php1,622 million.

The revaluation of our foreign-currency denominated assets and liabilities as a result of the appreciation or depreciation of the Philippine peso is recognized as foreign exchange gains or losses as at the balance sheet date. The extent of foreign exchange gains or losses is largely dependent on the amount of foreign currency debt and hedges we carry. While a certain percentage of our revenues are either linked to or denominated in U.S. dollars, most of our indebtedness and related interest expense, a substantial portion of our capital expenditures and a portion of our operating expenses are denominated in foreign currencies, mostly in U.S. dollars. As such, a strengthening or weakening of the Philippine peso against the U.S. dollar will decrease or increase in Philippine peso terms both the principal amount of our unhedged foreign currency-denominated debts and the related interest expense our foreign currency-denominated capital expenditures and operating expenses as well as our U.S. dollar linked and U.S. dollar denominated revenues. In addition, many of our financial ratios and other financial tests are affected by the movements in the Philippine peso to U.S. dollar exchange rate.

To manage our foreign exchange risks, stabilize cash flows, and improve investment and cash flow planning, we enter into forward foreign exchange contracts, currency swap contracts, currency option contracts and other hedging products aimed at reducing and/or managing the adverse impact of changes in foreign exchange rates on our operating results and cash flows. However, these hedges do not cover all of our exposure to foreign exchange risks. Specifically, we use forward foreign exchange contracts, currency swap contracts, foreign currency option contracts to manage the foreign exchange risks 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 foreign currency option contracts, and fixed to floating coupon only swap agreements. We accounted for these instruments as either cash flow hedges, wherein changes in the fair value are recognized as cumulative translation adjustments in equity until when the hedged transaction affects the consolidated statement of income or when the hedging instrument expires, or transactions not designated as hedges, wherein changes in the fair value are recognized directly as income or expense for the period.

As at September 30, 2007, approximately 89% of our total consolidated debts was denominated in U.S. dollars. Consolidated foreign currency-denominated debt was reduced to Php56,472 million from Php81,850 million as at September 30, 2006. PLDT s outstanding long-term principal only currency swap contracts and foreign currency option contracts amounted to US$550 million and US$136 million, respectively, as at September 30, 2007. Consequently, the unhedged portion of consolidated debts amounts is approximately 45% or 38%, net of our U.S. dollar cash balances as at September 30, 2007.

For the nine months ended September 30, 2007, approximately 38% of our consolidated revenues are either denominated in U.S. dollars or are linked to the U.S. dollars. In this respect, the recent appreciation of the peso against the U.S. dollar reduced our revenues, and consequently, our cash flow from operations in peso terms.

The Philippine peso had appreciated by 8% against the U.S. dollar to Php44.974 to US$1.00 as at September 30, 2007, from Php49.045 to US$1.00 as at December 31, 2006. Likewise, as at September 30, 2006, the peso had appreciated by 5% to Php50.249 to US$1.00 from Php53.062 to US$1.00 as at December 31, 2005. As a result of the foreign exchange movements as well as the amount of our outstanding foreign currency debts and hedges, we recognized foreign exchange gains of Php1,662 million and Php1,601 million in the first nine months of 2007 and 2006, respectively.

Interest Rate Risk

On a limited basis, we enter into interest rate swap agreements in order to manage our exposure to interest rate fluctuations. We make use of hedging instruments and structures solely for reducing or managing financial risks associated with our liabilities and not for trading or speculative purposes.

The following tables set out the carrying amount, by maturity, of our financial instruments that are exposed to interest rate risk:

Nine Months Ended September 30, 2007 (Unaudited)

	Below 1 year	1-2 years	2-3 years	3-5 years	Over 5 years	In U.S. Dollar	In Php	Discount/ Debt Issuance Cost In Php	Carrying Value In Php	Fair Value In U.S. Dollar	Fair Value In Php
									(in millions)		
Liabilities:											
Long-term Debt											
Fixed Rate											
US$ Notes (in millions)		136		250	300	686	30,847	437	30,410	767	34,510
Interest rate		10.500%		11.375%	8.350%						
US$ Fixed Loans (in millions)	57	48	34	8	280	427	19,213	4,480	14,733	354	15,931
Interest rate	4.49% to 8.9%	4.49% to 6.66%	4.49% to 6%	4.700%	2.250%						
				85	35	120	5,420	12	5,408	118	5,302

Philippine Peso (in millions)											
Interest rate	7.09%	6.500%	6.500%	5.625% to 6.50%	6.125% to 6.50%						
Variable Rate											
U.S. Dollar (in millions)	88	85	64	16		253	11,366	38	11,328	253	11,366
Interest rate	GOVCO s Cost + 0.20%; 0.05% to 2.75% over US$ LIBOR	0.05% to 2.75% over US$ LIBOR	0.05% to 2.75% over US$ LIBOR	0.65% to 2.50% over US$ LIBOR							
Philippine Peso (in millions)	12	12	13	16		53	2,368	9	2,359	53	2,368
Interest rate	MART1 + 0.75% to 5.70%	MART1 + 0.75% to 5.70%	MART1 + 0.75% to 5.70%	MART1 + 0.75%							
						1,539	**69,214**	**4,976**	**64,238**	**1,539**	**69,477**
Interest rate swap (fixed to floating)											
U.S. Dollar (US$63 million)						5	206		206	5	206
Japanese Yen (JPY7,519 million)											
Fixed Rate on US$ notional	11.375%	11.375%	11.375%	11.375%	11.375%						
Variable Rate on JPY notional	8.11% over LIBOR	8.11% over LIBOR	8.11% over LIBOR	8.11% over LIBOR	8.11% over LIBOR						

Year Ended December 31, 2006 (Audited)

Discount/ Debt

Over 5

	Below 1 year	1-2 years	2 3 years	3-5 years	years	In U.S. Dollar	In Php	Issuance Cost In Php	Carrying Value In Php	Fair Value In U.S. Dollar	Fair Value In Php
									(in millions)		
Liabilities:											
Long-term Debt											
Fixed Rate											
US$ Notes (in millions)	130		167		550	847	41,510	539	40,971	966	47,350
Interest rate	7.85% to 10.625%		10.50%		8.35% to 11.375%						
US$ Fixed Loans (in millions)	69	55	46	33	280	483	23,683	5,326	18,357	400	19,640
Interest rate	1.75% to 10%	4.49% to 10%	4.49% to 10%	4.515% to 4.70%	2.25%						
Philippine Peso (in millions)				17		17	810	2	808	21	1,035
Interest rate				15%							
Variable Rate											
U.S. Dollar (in millions)	128	92	81	53		354	17,392	74	17,318	355	17,392
Interest rate	GOVCO s Cost + 0.20%; 0.05% to 2.75% over LIBOR	0.05% to 2.75% over LIBOR	0.05% to 2.75% over LIBOR	0.05% to 2.5% over LIBOR							
Philippine Peso (in millions)	6	11	11	23		51	2,511	12	2,499	51	2,511
Interest rate	3% over 90-day PHIBOR, MART1 + 0.75%	MART1 + 0.75%	MART1 + 0.75%	MART1 + 0.75%							

						1,752	**85,906**	**5,953**	**79,9[illegible]3**	**1,752**	**87,928**
Interest rate swap (fixed to floating)											
U.S. Dollar (US$63 million)						9	423		423		
										9	423
Japanese Yen (JPY7,519 million)											
Fixed Rate on US$ notional	11.375%	11.375%	11.375%	11.375%	11.375%						
Variable Rate on JPY notional	8.11% over LIBOR	8.11% over LIBOR	8.11% over LIBOR	8.11% over LIBOR	8.11% over LIBOR						

Fixed rate financial instruments are subject to fair value interest rate risk while floating rate financial instruments are subject to cash flow interest rate risk.

Repricing of floating rate financial instruments is mostly done on intervals of three months or six months. Interest on fixed rate financial instruments is fixed until maturity of instrument. Financial instruments that are not subject to interest rate risk were not included in the above tables.

Credit Risk

We trade only with recognized and creditworthy third parties. It is our policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an on-going basis to reduce our exposure to bad debts.

With respect to credit risk arising from our financial assets, which comprise cash and cash equivalents, trade and other receivables, notes receivable and certain derivative financial instruments, our exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these financial instruments.

We have no significant concentrations of credit risk.

25. Reclassification of Accounts

Certain accounts in December 31, 2006 audited consolidated financial statements were reclassified to conform with the September 30, 2007 unaudited consolidated financial statements presentation.