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**FIRST PACIFIC COMPANY LIMITED**

**第一太平**

*(Incorporated with limited liability under the laws of Bermuda)*

Website: <http://www.firstpacific.com>

**(Stock Code: 00142)**

### **OVERSEAS REGULATORY ANNOUNCEMENT**

*(This overseas regulatory announcement is issued pursuant to Rule 13.09(2) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.)*

**Please refer to the attached disclosures of Philippine Long Distance Telephone Company ("PLDT"), a major operating associate of First Pacific Company Limited, as filed with the Philippine Stock Exchange, in relation to the following:-**

- (i) SEC Form 17-C attached with the press release relating to PLDT's unaudited consolidated financial results for the nine months ended 30<sup>th</sup> September, 2010; and**
- (ii) SEC Form 17-Q relating to the PLDT's Management's Discussion and Analysis and the accompanying unaudited consolidated financial statements for the nine months ended 30<sup>th</sup> September, 2010.**

**Dated this the 4<sup>th</sup> day of November, 2010**

As at the date of this announcement, the board of directors of First Pacific Company Limited comprises the following directors:

Anthoni Salim, *Chairman*  
Manuel V. Pangilinan, *Managing Director and CEO*  
Edward A. Tortorici  
Robert C. Nicholson  
Ambassador Albert F. del Rosario  
Napoleon L. Nazareno  
Professor Edward K.Y. Chen\*, *GBS, CBE, JP*

Tedy Djuhar  
Ibrahim Risjad  
Benny S. Santoso  
Graham L. Pickles\*  
Sir David W.C. Tang\*, *KBE*  
Jun Tang\*

*\*Independent Non-executive Directors*

COVER SHEET

P W - 5 5  
S.E.C. Registration No.

P H I L I P P I N E L O N G D I S T A N C E

T E L E P H O N E C O M P A N Y

(Company's Full Name)

R A M O N C O J U A N G C O B L D G .

M A K A T I A V E . M A K A T I C I T Y

(Business Address: No. Street City/Town/Province)

MS. JUNE CHERYL A. CABAL

Contact Person

816-8534

Company Telephone Number

1 2 3 1

Month Day  
Fiscal Year

SEC FORM 17-C

FORM TYPE

0 6 Every 2<sup>nd</sup> Tuesday

Month Day  
Annual Meeting

C F D

Dept. Requiring this Doc.

N/A

Amended Articles  
Number/Section

2,182,513  
As of September 30, 2010

Total No. of Stockholders

Total Amount of Borrowings

N/A

Domestic

N/A

Foreign

To be accomplished by SEC Personnel concerned

File Number

File Number

LCU

LCU

Document I.D.

Document I.D.

Cashier

Cashier

STAMPS

Remarks: Please use black ink for scanning purposes.

SECURITIES AND EXCHANGE COMMISSION

CURRENT REPORT UNDER SECTION 17  
OF THE SECURITIES REGULATION CODE  
AND SRC RULE 17.1

1. November 4, 2010  
Date of Report (Date of earliest event reported)
  2. SEC Identification Number PW-55
  3. BIR Tax Identification No. 000-488-793
  4. PHILIPPINE LONG DISTANCE TELEPHONE COMPANY  
Exact name of issuer as specified in its charter
  5. PHILIPPINES  
Province, country or other jurisdiction of Incorporation
  6. \_\_\_\_\_ (SEC Use Only)  
Industry Classification Code
  7. Ramon Cojuangco Building, Makati Avenue, Makati City  
Address of principal office
  - 1200  
Postal Code
  8. (632) 816-8405  
Issuer's telephone number, including area code
  9. Not Applicable  
Former name or former address, if changed since last report
  10. Securities registered pursuant to Sections 8 and 12 of the Securities Regulation Code and Sections 4 and 8 of the Revised Securities Act
- | Title of Each Class | Number of Shares of Common Stock<br>Outstanding and Amount of Debt Outstanding |
|---------------------|--|
| _____               |  |
| _____               |  |
| _____               |  |

**NINE MONTHS' 2010 CONSOLIDATED NET INCOME UP 7% TO ₱32 BILLION**  
**CORE NET INCOME UP 2% TO ₱31.4 BILLION**  
**EBITDA AT ₱63.8 BILLION**  
**CELLULAR SUBSCRIBER BASE AT 44.1 MILLION**  
**TOTAL BROADBAND SUBSCRIBERS CROSSES 2 MILLION MARK**

- Consolidated net income of ₱32.0 billion for 9M2010, 7% higher than the ₱30.0 billion net income in 9M2009
- Consolidated core net income for 9M2010 at ₱31.4 billion, an increase of 2% from the ₱31.0 billion recorded in 9M2009
- Consolidated service revenues decline 1% year-on-year to ₱106.7 billion.
- Consolidated EBITDA lower at ₱63.8 billion; consolidated EBITDA margin at 60% of service revenues
- Consolidated free cash flow at ₱32.8 billion for 9M2010
- Cellular subscriber base at 44.1 million
- Total broadband subscribers over 2 million; aggregate revenue contribution from broadband and internet services of ₱12.9 billion for 9M2010, 20% higher than last year

**MANILA, Philippines, 4<sup>th</sup> November 2010** — Philippine Long Distance Telephone Company (“PLDT”) (PSE: TEL) (NYSE: PHI) today announced its unaudited financial and operating results for the first nine months of 2010 with consolidated Reported Net Income increasing by 7% to ₱32.0 billion, from the ₱30.0 billion recorded in the same period last year. Core Net Income for the first three quarters of 2010, net of exceptional items, rose 2% to ₱31.4 billion, from ₱31.0 billion in the same period in 2009. This year’s results reflect higher recurring net income and a higher net gain from foreign exchange revaluation of our financial assets and liabilities compared with last year.

A closer look at the underlying revenue mix will show the on-going transition of revenue streams with the lower traditional sources being replaced by the growth of new revenue streams.

Consolidated service revenues decreased by 1% to ₱106.7 billion, reflecting the combined effect of:

- a 20% increase in combined fixed and wireless broadband revenue;
- a 12% growth in cellular voice revenues, which includes a 24% increase in domestic voice revenues;
- an 18% rise in revenues from fixed data and other network services to third parties;
- a 13% reduction in cellular text revenues;
- a 34% decline in NLD revenues; and
- a 16% decrease in ILD revenues.

In addition, our service revenues were impacted by:

- the strengthening of the peso during the period which resulted in reduced service revenues of ₱1.5 billion; as well as
- the sale of our satellite business.

Approximately 28% of consolidated service revenues are directly or indirectly linked to the US Dollar. Had the peso remained stable, service revenues for the nine-month period of 2010 would have been flat to last year's levels.

Consolidated EBITDA was lower at ₱63.8 billion while EBITDA margin was at 60%, slightly down from the 61% margin of the same period last year but over the full year 2009 margin of 59%.

Consolidated free cash flow was at ₱ 32.8 billion for the period, reflecting a 7% decrease compared with the same period last year. Consolidated capital expenditures stood at ₱16.9 billion for the first nine months of 2010, as the Group continues to improve both broadband and cellular coverage and capacity. The capex estimate for 2010 remains at ₱28.6 billion.

The Group's consolidated debt balance as at the end of the first nine months of 2010 was US Dollar 2.2 billion with net debt at approximately US Dollar 1.5 billion. Net debt to EBITDA remained at 0.8x. The Company's debt maturities continue to be well spread out, with more than 50% due in and after 2014. The percentage of US Dollar-denominated debt to the Group's total debt portfolio further declined to 44%, down from 48% at the end of 2009. Taking into account our peso borrowings, our hedges and our U. S. Dollar cash holdings, only 22% of total debt remains unhedged. The Group's cash and short-term securities are invested primarily in bank placements and Government securities.

### **Wireless: Managing the Transformation**

Wireless service revenues dipped 1% to ₱70.4 billion for the first nine months of 2010, compared with the ₱71.2 billion recognized last year. Excluding the impact of our satellite operations and the peso appreciation, wireless service revenues would have been higher by ₱600 million or 1% higher compared with the same period last year. Cellular subsidiary Smart Communications, Inc. ("Smart") continues to lead the industry in terms of both revenues and subscribers.

Wireless EBITDA was stable at ₱44.3 billion in the first nine months of 2010 and EBITDA margin likewise at 63%.

The PLDT Group's total cellular subscriber base for the first nine months of 2010 grew to 44.1 million subscribers, a 13% growth year-on-year. Smart added 2.8 million subscribers for the period, as compared with 3.9 million in 2009. Smart Buddy recorded net additions of 1.4 million subscribers to end the period with 25.2 million subscribers while *Talk 'N Text* added approximately 1.1 million subscribers to end the nine months with 18.1 million subscribers. *Red Mobile*, the brand owned by Smart subsidiary, CURE, had about 381,000 subscribers at the end of September 2010, reflecting only those subscribers with regular top-up activity. *Red Mobile* was relaunched in March 2010 and positioned to meet market demand for unlimited services, particularly for "second SIM" holders.

Cellular voice revenues improved by 12% to ₱31.9 billion and now constitute 49% of total cellular service revenues from 43% for the same period last year. On the other hand, cellular data/text revenues fell 13% to ₱31.0 billion, despite a 25% increase in text volumes, as they

remain under pressure from the proliferation of lower yield offerings, multiple-SIM ownership and regulator-mandated load validity extensions.

On the broadband front, *SmartBro*, Smart's wireless broadband service offered through its wholly-owned subsidiary Smart Broadband, Inc. ("SBI") - continued to expand as its wireless broadband subscriber base grew to over 1.3 million at the end of the first nine months of 2010, over 900,000 of whom were on *SmartBro's* prepaid service. Wireless broadband revenues continued to grow strongly, up 24% to ₱6.1billion, compared with the ₱5.1 billion recorded in the same period of 2009. Wireless broadband revenues, which now include mobile internet browsing revenues of ₱821 million, make up 7% of wireless service revenues.

"With the cellular market nearing saturation and competition showing no signs of abating, it is incumbent upon us to both continue developing broadband as our growth sector as well as to be on the lookout for other aligned opportunities," stated **Orlando B. Ve**, **Chief Wireless Adviser of Smart**.

"Our wireless business registered respectable results for the first nine months of 2010, notwithstanding the price-competitive and market-share sensitive operating environment and the impact of the peso appreciation. We are facing challenging times for the cellular industry – organic growth is limited and declining yields and alternative means of communication are exerting pressure on revenues and margins. But we also know there are areas of opportunity out there and we are constantly evaluating options that best fit our strengths and capabilities," added **Napoleon L. Nazareno, President and CEO of PLDT and Smart**.

Smart continues to invest in its cellular and multi-platform broadband networks while upgrading its existing transmission, core and access facilities. Smart's 3G and HSPA networks now cover 50% and 47% of the country's population, respectively.

### **PLDT Fixed Line: Managing the Balance of New and Traditional**

Fixed line service revenues decreased by 4% to ₱36.8 billion in the first nine months of 2010 from ₱38.2 billion in 2009 as the strong Peso impacted the business unfavorably. Had the peso remained stable, service revenues would have been higher by ₱0.5 billion.

The 4% increase in data revenues, both from corporate data and residential DSL services, was unable to offset the declines in other segments of the business. Data service revenues contributed 45% of the fixed line's service revenues as compared with 42% in the same period last year.

PLDT DSL continued its strong performance as broadband subscribers grew by 71,000 to 631,000 at the end of September 2010 from 560,000 at the end of 2009. PLDT DSL generated ₱6.1 billion in revenues in 2010, up 20% from ₱5.1 billion in the same period in 2009.

Despite an increase in the number of postpaid billed lines, revenues from our local exchange or LEC services were down 2% as a result of LEC voice revenues being re-allocated to bundled voice and data services. National long distance revenues decreased 27% as a result of lower call volumes, while international long distance revenues continued to weaken due to the shifting of traffic to cellular and other means of communications, as well as the impact of the peso appreciation vis-à-vis the US Dollar.

Fixed line EBITDA margin was lower at 49% for the first nine months of 2010 as compared with 53% in the same period last year, but in line with the full year 2009 margin, mainly due to the changes in revenue mix and higher operating expenses.

"Our Fixed Line business is feeling the pinch, much like other operators around the world, as other means of communications continue to provide alternatives for consumers. We remain confident however that we can manage the long tail of this business and still create value, building on the strength of our broadband and corporate data networks and platforms," declared **Nazareno**.

### **ePLDT: Restructured for Growth**

ePLDT, the Group's information and communications technology arm, reported service revenues of ₱7.9 billion in the first nine months of 2010, a decline of 1% from the same period in 2009. With 70% of their revenues being dollar-denominated, ePLDT's results were particularly hard hit by the appreciation of the peso. Had the peso remained stable, service revenues for the period would have increased by 3% year-on-year.

ePLDT's EBITDA increased by 34% to ₱1.1 billion in 2010 as compared with ₱846 million in 2009, with a 5% decrease in cash operating expenses, largely due to a reduction in headcount. EBITDA margin at 14% was higher than the 11% recorded in the same period in 2009. ePLDT's revenues account for 7% of PLDT's consolidated revenues.

ePLDT recently reorganized its businesses to create better focus and maximize scale. ePLDT Ventus, which handles customer relationship management (more commonly known as "call center") and SPi Technologies, Inc., the knowledge processing arm (also known as business process outsourcing or "BPO") have combined their operations and will be known as SPi Global Solutions, Inc. while Vitro Data Center and internet and on-line gaming operations will remain housed under ePLDT.

"Both ePLDT and SPi Global Solutions are poised to participate in the robust outlook for the Philippine BPO sector and will pursue their efforts to expand their pipelines and service offerings," stated **Nazareno**.

### **Meralco: Improving Prospects**

Our nine months' financial results reflect the equity accounting of our share in Meralco's earnings through PLDT Communications and Energy Ventures, Inc (PCEV), formerly Piltel. PCEV's income is derived mainly from its direct equity share in the net income of Manila Electric Company ("Meralco") and its holdings in Beacon Electric Asset Holdings, Inc ("Beacon Electric"). PCEV owns 50% of Beacon Electric, a special purpose company jointly owned by PCEV and Metro Pacific Investments Corporation ("MPIC") whose sole purpose is to hold shares in Meralco, which presently amount to 392.5 million shares, equivalent to 34.8% of Meralco's outstanding common shares. PCEV'S direct holdings in Meralco consist of 68.8 million Meralco common shares (approximately 6% interest), retained by PCEV after the transfer of its 154.2 million shares to Beacon Electric in March 2010. PCEV acquired its original 20% investment in Meralco in July 2009.

Meralco's consolidated Reported Net Income for the first nine months of 2010 increased to ₱ 8.0 billion, 61% higher than the ₱5.0 billion realized for the same period in 2009. Consolidated Core Net Income, which excludes one-time, exceptional charges, stood at ₱9.2 billion, which was 80% better than the Core Net Income in 2009 of ₱5.1 billion. The improvements reflect the significantly higher volume of energy sold as a result of the warmer temperature along with the surge in demand from the commercial and industrial sectors. Also contributing to the increase were the higher number of billed customers and the later-than-scheduled implementation of the distribution rate adjustments approved by the Energy Regulations Commission (ERC).

Meralco's consolidated revenues, in which electricity sales account for approximately 97% of the total, increased by 32% to ₱188.9 billion. Approximately 35% of the total increase in consolidated electricity revenues is accounted for by the 11% growth in kilowatt-hour sold while 50% is due to higher average purchased power and transmission pass-through costs. The system loss charge continues to decrease as a result of improved system efficiencies as well as aggressive initiatives to reduce power line pilferages in coordination with various local government units.

Total cost and expenses amounted to ₱177.2 billion in the first nine months of 2010, 30% higher compared with ₱135.9 billion for the same period in 2009. Cost of purchased power accounted for 89% of total cost and expenses in 2010, compared with 88% in 2009.

Consolidated EBITDA for the period was 28% higher year-on-year at ₱16.3 billion, reflecting an EBITDA margin of 9% on consolidated revenues. EBITDA margin for pure distribution revenues stood at 46%.

Consolidated capital expenditures for first nine months of 2010 amounted to ₱5.1 billion, with electric capital projects accounting for 85% of the total, consisting largely of expansion, improvement of distribution facilities and purchases of meters and transformers.

## **Conclusion**

“Our 2010 performance to date underscores our earlier statements that 2010-2012 would be a critical period in the PLDT Group's transformation, as it is being undertaken at a time when the operating environment is becoming increasingly price-competitive and market-share sensitive. This transition is accelerating the decline of traditional revenue sources but also fuelling the growth of new revenue streams.

With these factors exerting significant pressure on our margins, efficiency and cost control are increasingly crucial. As such, we have reinstated our manpower reduction program and we expect to reduce headcount by a significant number by year-end. This organizational rationalization also allows us to align the skill sets of our workforce so that we remain responsive to the changes in our business and the new technologies we are deploying. Moreover, we continue to implement measures that will reduce network operating costs, not the least of which will be realized from the switch of the legacy fixed line network to NGN. What we will not sacrifice is quality and we will not cut back on investments that will improve our coverage, capacity and diversity.



On a more positive note, we are pleased that some of our investments, such as the one in Meralco, have in fact cushioned the negative impact of these changes. While we expect our service revenues to be slightly under our previous guidance, we estimate core net income for 2010 to rise to ₱41.5 billion, assuming the peso does not appreciate much further” **concluded Manuel V. Pangilinan, PLDT Chairman.**

####

|                                | PLDT Consolidated              |                |          |                                 |               |          |
|--------------------------------|--------------------------------|----------------|----------|---------------------------------|---------------|----------|
|                                | Nine months ended September 30 |                |          | Three months ended September 30 |               |          |
|                                | 2010                           | 2009           | % Change | 2010                            | 2009          | % Change |
|                                | (Unaudited)                    |                |          | (Unaudited)                     |               |          |
| Service revenues               | <u>106,716</u>                 | <u>108,277</u> | -1%      | <u>34,560</u>                   | <u>35,406</u> | -2%      |
| Total revenues                 | 108,272                        | 109,970        | -2%      | 35,065                          | 35,892        | -2%      |
| Expenses                       | 64,916                         | 65,515         | -1%      | 21,615                          | 22,197        | -3%      |
| Income before income tax       | 43,032                         | 41,903         | 3%       | 13,655                          | 14,632        | -7%      |
| Provision for income tax       | 10,974                         | 11,219         | -2%      | 3,218                           | 4,219         | -24%     |
| Net income - As Reported       | <u>31,988</u>                  | <u>30,018</u>  | 7%       | <u>10,309</u>                   | <u>10,298</u> | -        |
| EPS, Basic <sup>(a)</sup>      | 169.38                         | 158.70         | 7%       | 54.58                           | 54.48         | -        |
| EPS, Diluted <sup>(a)</sup>    | 169.38                         | 158.68         | 7%       | 54.61                           | 54.48         | -        |
| Core net income <sup>(b)</sup> | <u>31,423</u>                  | <u>30,951</u>  | 2%       | <u>10,193</u>                   | <u>10,113</u> | 1%       |
| EPS, Basic <sup>(c)</sup>      | 166.36                         | 163.70         | 2%       | 53.93                           | 53.50         | 1%       |
| EPS, Diluted <sup>(c)</sup>    | 166.39                         | 163.68         | 2%       | 53.93                           | 53.50         | 1%       |

<sup>(a)</sup> EPS based on reported net income

<sup>(b)</sup> Net income as adjusted for the net effect of gain/loss on FX and derivative transactions, additional depreciation charges and recognition of deferred tax assets

<sup>(c)</sup> EPS based on core net income

***This press release may contain some statements which constitute “forward-looking statements” that are subject to a number of risks and uncertainties that could affect PLDT’s business and results of operations. Although PLDT believes that expectations reflected in any forward-looking statements are reasonable, it can give no guarantee of future performance, action or events.***

**For further information, please contact:**

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***Melissa V. Vergel de Dios***  
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Fax No: 810-7138

***Ramon R. Isberto***  
Tel No: 511-3101  
Fax No: 893-5174

#### **About PLDT**

**PLDT is the leading telecommunications provider in the Philippines. Through its three principal business groups – fixed line, wireless, and information and communications technology – PLDT offers a wide range of telecommunications services across the Philippines’ most extensive fiber optic backbone and fixed line, and cellular network.**

**PLDT is listed on the Philippine Stock Exchange (PSE:TEL) and its American Depositary Shares are listed on the New York Stock Exchange (NYSE:PHI). PLDT has one of the largest market capitalizations among Philippine listed companies.**

**Further information can be obtained by visiting the web at [www.pldt.com](http://www.pldt.com).**

SEC Number  
File Number

**PW-55**

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**PHILIPPINE LONG DISTANCE  
TELEPHONE COMPANY**

---

(Company's Full Name)

**Ramon Cojuangco Building  
Makati Avenue, Makati City**

---

(Company's Address)

**(632) 816-8556**

---

(Telephone Number)

**Not Applicable**

---

(Fiscal Year Ending)  
(month & day)

**SEC Form 17-Q**

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Form Type

**Not Applicable**

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Amendment Designation (if applicable)

**September 30, 2010**

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Period Ended Date

**Not Applicable**

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(Secondary License Type and File Number)

November 4, 2010

Securities & Exchange Commission  
SEC Building, EDSA  
Mandaluyong City

Attention: Director Justina Callangan  
Corporation Finance Department

Gentlemen:

In accordance with Section 17.1(b) of the Securities Regulation Code and SRC Rule 17.1, we submit herewith two (2) copies of SEC Form 17-Q with Management's Discussion and Analysis and accompanying unaudited consolidated financial statements for the nine (9) months ended September 30, 2010.

Very truly yours,

**PHILIPPINE LONG DISTANCE TELEPHONE COMPANY**

  
**MA. LOURDES C. RAUSA-CHAN**  
Corporate Secretary



COVER SHEET

P W - 5 5  
S.E.C. Registration No.

P H I L I P P I N E L O N G D I S T A N C E

T E L E P H O N E C O M P A N Y  
(Company's Full Name)

R A M O N C O J U A N G C O B L D G .

M A K A T I A V E . M A K A T I C I T Y  
(Business Address: No. Street City/Town/Province)

MS. JUNE CHERYL A. CABAL  
Contact Person

816-8534  
Company Telephone Number

1 2 3 1  
Month Day  
Fiscal Year

SEC FORM 17-Q  
FORM TYPE

0 6 Every 2<sup>nd</sup>  
Month Day Tuesday  
Annual Meeting

C F D  
Dept. Requiring this Doc.

N/A  
Amended Articles  
Number/Section

2,182,513  
As of September 30, 2010  
Total No. of Stockholders

Total Amount of Borrowings  
N/A  
Domestic

N/A  
Foreign

To be accomplished by SEC Personnel concerned

File Number

LCU

Document I.D.

Cashier

STAMPS

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**SECURITIES AND EXCHANGE COMMISSION**

**SEC FORM 17-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 17  
OF THE SECURITIES REGULATION CODE ("SRC") AND  
SRC 17 (2) (b) THEREUNDER**

1. For the quarterly period ended September 30, 2010
2. SEC Identification Number PW-55
3. BIR Tax Identification No. 000-488-793
4. Philippine Long Distance Telephone Company  
Exact name of registrant as specified in its charter
5. Republic of the Philippines  
Province, country or other jurisdiction of incorporation or organization
6. Industry Classification Code: \_\_\_\_\_ (SEC Use Only)
7. Ramon Cojuangco Building, Makati Avenue, Makati City  
Address of registrant's principal office 0721  
Postal Code
8. (632) 816-8556  
Registrant's telephone number, including area code
9. Not Applicable  
Former name, former address, and former fiscal year, if changed since last report
10. Securities registered pursuant to Sections 8 of the SRC

**Title of Each Class      Number of Shares of Common Stock Outstanding**

Common Capital Stock, Php5 par value 186,797,521 shares as at September 30, 2010

11. Are any or all of these securities listed on the Philippine Stock Exchange?

Yes [  ]                      No [  ]

12. Check whether the registrant

(a) has filed all reports required to be filed by Section 17 of the SRC during the preceding ten months (or for such shorter period that the registrant was required to file such reports):

Yes [  ]                      No [  ]

(b) has been subject to such filing requirements for the past 90 days.

Yes [  ]                      No [  ]

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## PART I — FINANCIAL INFORMATION

### Item 1. Consolidated Financial Statements

*Our consolidated financial statements as at September 30, 2010 (unaudited) and December 31, 2009 (audited) and for the nine months ended September 30, 2010 and 2009 (unaudited) and related notes (pages F-1 to F-119) are filed as part of this report on Form 17-Q.*

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying unaudited consolidated financial statements and the related notes. Our unaudited consolidated financial statements, and the financial information discussed below, have been prepared in accordance with Philippine Financial Reporting Standards, or PFRS, which have certain differences from International Financial Reporting Standards as issued by the International Accounting Standards Board. PFRS differ in certain significant respects from generally accepted accounting principles in the U.S.*

*The financial information appearing in this report and in the accompanying unaudited consolidated financial statements is stated in Philippine pesos. All references to "Philippine pesos," "Php" or "pesos" are to the lawful currency of the Philippines; all references to "U.S. dollars," "US\$" or "dollars" are to the lawful currency of the United States; all references to "Japanese yen," "JP¥" or "yen" are to the lawful currency of Japan and all references to "Euro" or "€" are to the lawful currency of the European Union. Unless otherwise indicated, translations of Philippine peso amounts into U.S. dollars in this report and in the accompanying unaudited consolidated financial statements were made based on the exchange rate of Php43.92 to US\$1.00, the volume weighted average exchange rate on September 30, 2010 quoted through the Philippine Dealing System.*

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

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



## Financial Highlights and Key Performance Indicators

| (in millions, except for earnings per common share, operational data and exchange rates) | September 30,<br>2010 | December 31,<br>2009 | Decrease    |      |
|--|-----------------------|----------------------|-------------|------|
|  | (Unaudited)           | (Audited)            | Amount      | %    |
| <b>Consolidated Statements of Financial Position</b>                                     |                       |                      |             |      |
| Total assets   | Php265,096            | Php280,148           | (Php15,052) | (5)  |
| Property, plant and equipment – net  | 158,033               | 161,256              | (3,223)     | (2)  |
| Cash and cash equivalents and short-term investments                                     | 30,268                | 42,143               | (11,875)    | (28) |
| Total equity attributable to equity holders of PLDT                                      | 88,690                | 98,575               | (9,885)     | (10) |
| Notes payable and long-term debt   | 93,460                | 98,729               | (5,269)     | (5)  |
| Net debt <sup>(1)</sup> to equity ratio  | 0.71x                 | 0.57x                | –           | –    |
| <b>Consolidated Income Statements</b>  |                       |                      |             |      |
|  | 2010                  | 2009                 | Change      |      |
|  | (Unaudited)           |                      | Amount      | %    |
| Revenues   | Php108,272            | Php109,970           | (Php1,698)  | (2)  |
| Expenses   | 64,916                | 65,515               | (599)       | (1)  |
| Other expenses   | 324                   | 2,552                | (2,228)     | (87) |
| Income before income tax   | 43,032                | 41,903               | 1,129       | 3    |
| Net income for the period  | 32,058                | 30,684               | 1,374       | 4    |
| Net income attributable to equity holders of PLDT  |                       |                      |             |      |
| Reported net income  | 31,988                | 30,018               | 1,970       | 7    |
| Core income <sup>(2)</sup>   | 31,423                | 30,951               | 472         | 2    |
| EBITDA <sup>(3)</sup>  | 63,813                | 65,745               | (1,932)     | (3)  |
| EBITDA margin <sup>(4)</sup>   | 60%                   | 61%                  | –           | –    |
| Reported earnings per common share   |                       |                      |             |      |
| Basic  | 169.38                | 158.70               | 10.68       | 7    |
| Diluted  | 169.38                | 158.68               | 10.70       | 7    |
| Core earnings per common share   |                       |                      |             |      |
| Basic  | 166.36                | 163.70               | 2.66        | 2    |
| Diluted  | 166.36                | 163.68               | 2.68        | 2    |
| <b>Consolidated Statements of Cash Flows</b>   |                       |                      |             |      |
| Net cash provided by operating activities  | 54,026                | 56,326               | (2,300)     | (4)  |
| Net cash used in investing activities  | 15,502                | 36,157               | (20,655)    | (57) |
| Capital expenditures   | 16,923                | 18,064               | (1,141)     | (6)  |
| Net cash used in financing activities  | 49,676                | 26,797               | 22,879      | 85   |
| <b>Operational Data</b>  |                       |                      |             |      |
| Number of cellular subscribers   | 44,112,343            | 39,147,990           | 4,964,353   | 13   |
| Number of fixed line subscribers   | 1,839,962             | 1,787,441            | 52,521      | 3    |
| Number of broadband subscribers  | 2,005,384             | 1,377,439            | 627,945     | 46   |
| Fixed Line   | 630,984               | 548,313              | 82,671      | 15   |
| Wireless   | 1,374,400             | 829,126              | 545,274     | 66   |
| Number of employees  | 29,624                | 29,448               | 176         | 1    |
| Fixed Line   | 8,047                 | 8,117                | (70)        | (1)  |
| Wireless   | 5,494                 | 5,499                | (5)         | –    |
| Information and Communications Technology  | 16,083                | 15,832               | 251         | 2    |
| <b>Exchange Rates</b>  |                       |                      |             |      |
|  | Php per US\$          |                      |             |      |
| September 30, 2010   | 43.92                 |                      |             |      |
| December 31, 2009  | 46.43                 |                      |             |      |
| September 30, 2009   | 47.42                 |                      |             |      |
| December 31, 2008  | 47.65                 |                      |             |      |

(1) Net debt is derived by deducting cash and cash equivalents and short-term investments from total debt (notes payable and long-term debt, including current portion).

(2) Core income for the period is measured as net income attributable to equity holders of PLDT, excluding foreign exchange gains (losses) – net, gains (losses) on derivative financial instruments – net, excluding hedge cost, asset impairment on noncurrent assets, other nonrecurring gains (losses), net of tax effect of aforementioned adjustments, as applicable, and similar adjustments to equity share in net earnings (losses) of associates and joint ventures.

(3) EBITDA is measured as net income excluding depreciation and amortization, amortization of intangible assets, asset impairment on noncurrent assets, financing costs, interest income, equity share in net earnings (losses) of associates and joint ventures, foreign exchange gains (losses) – net, gains (losses) on derivative financial instruments – net, provision for (benefit from) income tax and other nonrecurring gains (losses) – net.

(4) EBITDA margin is derived as a percentage of service revenues.

## Overview

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

- *Wireless* — wireless telecommunications services provided by Smart Communications, Inc., or Smart, PLDT Communications and Energy Ventures, Inc., or PCEV, (formerly known as Pilipino Telephone Corporation, or Piltel, whereas on August 17, 2009, Smart acquired the cellular business of Piltel) and Connectivity Unlimited Resources Enterprises, or CURE, our cellular service providers; Smart Broadband, Inc., or SBI, Blue Ocean Wireless, or BOW, Airborne Access Corporation, and Primeworld Digital Systems, Inc., or PDSI, our wireless broadband service providers; Wolfpac Mobile, Inc., or Wolfpac, and Chikka Holdings Limited, or Chikka, and Subsidiaries, or Chikka Group, our wireless content operators; and ACeS Philippines Cellular Satellite Corporation, or ACeS Philippines, our satellite operator;
- *Fixed Line* — fixed line telecommunications services primarily provided by PLDT. We also provide fixed line services through PLDT's subsidiaries, namely, PLDT Clark Telecom, Inc., PLDT Subic Telecom, Inc., PLDT-Philcom, Inc. (formerly known as Philcom Corporation), or Philcom, PLDT-Maratel, Inc., SBI, PDSI, Bonifacio Communications Corporation, and PLDT Global Corporation, or PLDT Global, all of which together account for approximately 4% of our consolidated fixed line subscribers; and
- *Information and Communications Technology, or ICT* — information and communications infrastructure and services for internet applications, internet protocol, or IP-based solutions and multimedia content delivery provided by ePLDT, Inc., or ePLDT, and BayanTrade, Inc., or BayanTrade; knowledge processing solutions provided by SPi Technologies, Inc. and its subsidiaries, or SPi Group; customer relationship management provided by SPi CRM Inc., or SPi CRM (formerly known as *ePLDT Ventus*), (on April 8, 2010, SPi CRM, Parlance Systems, Inc. and Vocativ Systems, Inc. were merged wherein SPi CRM became the surviving entity); internet access and online gaming services provided by Infocom Technologies, Inc., or Infocom, Digital Paradise, Inc., netGames, Inc. and Level Up!, Inc., or Level Up!; and e-commerce, and IT-related services provided by other investees of ePLDT, as discussed in *Note 10 – Investments in Associates and Joint Ventures* of the accompanying unaudited consolidated financial statements.

We registered consolidated revenues of Php108,272 million in the nine months ended September 30, 2010, a decrease of Php1,698 million, or 2%, as compared with Php109,970 million in the same period in 2009, primarily due to a decline in our service revenues by Php1,561 million mainly from national and international long distance services of our fixed line business, as well as lower revenues from our wireless business, as a result of lower cellular and satellite service revenues.

Consolidated expenses decreased by Php599 million, or 1%, to Php64,916 million in the nine months ended September 30, 2010 from Php65,515 million in the same period in 2009, largely resulting from decreases in asset impairment, selling and promotions, compensation and employee benefits, and cost of sales partly offset by higher depreciation and amortization, professional and other contracted services, repairs and maintenance, and rent expenses.

Consolidated other expenses – net in the nine months ended September 30, 2010 amounted to Php324 million, a decrease of Php2,228 million, or 87%, from Php2,552 million in the same period in 2009 primarily due to the combined effects of the following: (i) higher net foreign exchange gains by Php1,435 million in the first nine months of 2010 as compared with the same period in 2009 due to the revaluation of foreign-currency denominated liabilities as a result of the effect of the appreciation of the Philippine peso to the U.S. dollar; (ii) net increase in equity share in net earnings of associates and joint ventures of Php1,108 million mainly due to the share in net earnings of Manila Electric Company, or Meralco (223 million Meralco shares were acquired by PCEV on July 14, 2009, of which 154.2 million shares were transferred to Beacon Electric Asset Holdings, Inc., or Beacon, where PCEV has acquired a 50% equity interest effective March 31, 2010); (iii) net losses on derivative financial instruments of Php495 million in the first nine months of 2010 as compared with Php534 million in the same period in 2009 due to the mark-to-market valuation of principal-only currency swaps; (iv) lower interest income by Php377 million due to lower average level of money market placements and special deposits; and (v) an increase in net financing costs by Php298 million mainly due to higher interest on loans and other related items – net, on account of PLDT's and Smart's higher average loan balances, and higher accretion on amortization of debt issuance cost and debt discount, and contingent consideration for business acquisitions.

Consolidated net income increased by Php1,374 million, or 4%, to Php32,058 million in the nine months ended September 30, 2010 from Php30,684 million in the same period in 2009. The increase was mainly due to the combined effects of the following: (i) decrease in consolidated other expenses by Php2,228 million; (ii) a decrease in consolidated expenses by Php599 million; (iii) decrease in the consolidated provision for income tax by Php245 million mainly due to lower taxable income of our wireless and ICT businesses partially offset by higher taxable income of our fixed line business; and (iv) a decrease in consolidated revenues by Php1,698 million. Consolidated net income attributable to equity holders of PLDT increased by Php1,970 million, or 7%, to Php31,988 million in the first nine months of 2010 from Php30,018 million in the same period in 2009. The increase in our consolidated net income attributable to equity holders of PLDT is higher as compared with the increase in our consolidated net income mainly due to the favorable effect of Smart's acquisition of equity interest from PCEV's non-controlling shareholders in 2009. Consolidated core income increased by Php472 million, or 2%, to Php31,423 million in the first nine months of 2010 from Php30,951 million in the same period in 2009. Our consolidated basic and diluted earnings per common share increased to Php169.38 for the first nine months of 2010 from Php158.70 and Php158.68 for our consolidated basic and diluted earnings per common share, respectively, in the same period in 2009. The increase in consolidated basic and diluted earnings per share of Php10.68, or 7%, and Php10.70, or 7%, respectively, is due to a 7% increase in our reported net income attributable to equity holders of PLDT. Likewise, our consolidated core basic and diluted earnings per common share increased to Php166.36 for the first nine months of 2010 from Php163.70 and Php163.68 for our consolidated core basic and diluted earnings per common share, respectively, in the same period in 2009. Our weighted average number of common shares was approximately 187 million in each of the nine months ended September 30, 2010 and 2009.

## Results of Operations

The table below shows the contribution by each of our business segments to our revenues, expenses, other income (expenses) and net income for the nine months ended September 30, 2010 and 2009. The majority of our revenues are derived from our operations within the Philippines.

|   | Wireless      | Fixed Line | ICT           | Inter-segment Transactions | Consolidated  |          |               |            |      |
|---|---------------|------------|---------------|----------------------------|---------------|----------|---------------|------------|------|
| (in millions)   |               |            |               |                            |               |          |               |            |      |
| <b>For the nine months ended September 30, 2010 (Unaudited)</b> |               |            |               |                            |               |          |               |            |      |
| Revenues  | Php71,515     | Php37,043  | Php8,261      | (Php8,547)                 | Php108,272    |          |               |            |      |
| Expenses  | 37,407        | 28,291     | 7,931         | (8,713)                    | 64,916        |          |               |            |      |
| Other income (expenses)   | 1,472         | (1,670)    | 40            | (166)                      | (324)         |          |               |            |      |
| Income before income tax  | 35,580        | 7,082      | 370           | –                          | 43,032        |          |               |            |      |
| Net income for the period                                       | 26,597        | 5,071      | 390           | –                          | 32,058        |          |               |            |      |
| Net income attributable to equity holders of PLDT               |               |            |               |                            |               |          |               |            |      |
| Reported net income   | 26,518        | 5,063      | 407           | –                          | 31,988        |          |               |            |      |
| Core income   | 26,242        | 4,686      | 495           | –                          | 31,423        |          |               |            |      |
| EBITDA  | 44,323        | 18,189     | 1,135         | 166                        | 63,813        |          |               |            |      |
| EBITDA margin   | 63%           | 49%        | 14%           | –                          | 60%           |          |               |            |      |
| <b>For the nine months ended September 30, 2009 (Unaudited)</b> |               |            |               |                            |               |          |               |            |      |
| Revenues  | 72,468        | 38,388     | 8,386         | (9,272)                    | 109,970       |          |               |            |      |
| Expenses  | 38,313        | 28,298     | 8,300         | (9,396)                    | 65,515        |          |               |            |      |
| Other income (expenses)   | 956           | (3,623)    | 241           | (126)                      | (2,552)       |          |               |            |      |
| Income before income tax  | 35,111        | 6,467      | 327           | (2)                        | 41,903        |          |               |            |      |
| Net income for the period                                       | 25,858        | 4,663      | 165           | (2)                        | 30,684        |          |               |            |      |
| Net income attributable to equity holders of PLDT               |               |            |               |                            |               |          |               |            |      |
| Reported net income   | 25,198        | 4,657      | 165           | (2)                        | 30,018        |          |               |            |      |
| Core income   | 24,430        | 6,360      | 163           | (2)                        | 30,951        |          |               |            |      |
| EBITDA  | 44,521        | 20,254     | 846           | 124                        | 65,745        |          |               |            |      |
| EBITDA margin   | 63%           | 53%        | 11%           | –                          | 61%           |          |               |            |      |
| <b>Increase (Decrease)</b>                                      | <b>Amount</b> | <b>%</b>   | <b>Amount</b> | <b>%</b>                   | <b>Amount</b> | <b>%</b> | <b>Amount</b> | <b>%</b>   |      |
| (in millions)   |               |            |               |                            |               |          |               |            |      |
| Revenues  | (Php953)      | (1)        | (Php1,345)    | (4)                        | (Php125)      | (1)      | 725           | (Php1,698) | (2)  |
| Expenses  | (906)         | (2)        | (7)           | –                          | (369)         | (4)      | 683           | (599)      | (1)  |
| Other income (expenses)   | 516           | 54         | (1,953)       | (54)                       | (201)         | (83)     | (40)          | (2,228)    | (87) |
| Income before income tax  | 469           | 1          | 615           | 10                         | 43            | 13       | 2             | 1,129      | 3    |
| Net income for the period                                       | 739           | 3          | 408           | 9                          | 225           | 136      | 2             | 1,374      | 4    |
| Net income attributable to equity holders of PLDT               |               |            |               |                            |               |          |               |            |      |
| Reported net income   | 1,320         | 5          | 406           | 9                          | 242           | 147      | 2             | 1,970      | 7    |
| Core income   | 1,812         | 7          | (1,674)       | (26)                       | 332           | 204      | 2             | 472        | 2    |
| EBITDA  | (198)         | –          | (2,065)       | (10)                       | 289           | 34       | 42            | (1,932)    | (3)  |

## Wireless

### Revenues

Revenues generated from our wireless business amounted to Php71,515 million in the nine months ended September 30, 2010, a decrease of Php953 million, or 1%, from Php72,468 million in the same period in 2009. The following table summarizes our total revenues from our wireless business for the nine months ended September 30, 2010 and 2009 by service segment:

|   | 2010          | %   | 2009      | %   | Increase (Decrease) |      |
|---|---------------|-----|-----------|-----|---------------------|------|
|   |               |     |           |     | Amount              | %    |
|   | (in millions) |     |           |     |                     |      |
| Service Revenues:   |               |     |           |     |                     |      |
| Cellular  | Php64,819     | 91  | Php65,844 | 91  | (Php1,025)          | (2)  |
| Wireless broadband, satellite and others  |               |     |           |     |                     |      |
| Wireless broadband  | 4,781         | 7   | 3,899     | 5   | 882                 | 23   |
| Satellite and others  | 845           | 1   | 1,459     | 2   | (614)               | (42) |
|   | 70,445        | 99  | 71,202    | 98  | (757)               | (1)  |
| Non-Service Revenues:   |               |     |           |     |                     |      |
| Sale of cellular handsets, cellular subscriber identification module, or SIM,-packs and broadband data modems | 1,070         | 1   | 1,266     | 2   | (196)               | (15) |
| Total Wireless Revenues   | Php71,515     | 100 | Php72,468 | 100 | (Php953)            | (1)  |

### Service Revenues

Our wireless service revenues decreased by Php757 million, or 1%, to Php70,445 million in the first nine months of 2010 as compared with Php71,202 million in the same period in 2009, mainly as a result of lower revenues from our cellular services, satellite and other revenues. Revenues from domestic and international text messaging services declined due to the increase in multiple SIM card ownership, intense competition, the continued decline in short messaging service, or SMS, yield as a result of aggressive SMS offers, and the prescribed extension of load validity periods, partially offset by an increase in voice revenues due to the introduction of new unlimited voice offers in the second half of 2009. Our dollar-linked revenues were negatively affected as well by the appreciation of the weighted average exchange rate of the Philippine peso to the U.S. dollar on our dollar-linked revenues to Php45.60 for the nine months ended September 30, 2010 from Php47.93 for the nine months ended September 30, 2009. With subscriber growth being driven by multiple SIM card ownership, especially in the lower income segment of the Philippine wireless market, average monthly cellular ARPUs for the first nine months of 2010 were lower as compared with the same period in 2009. We expect this trend to continue due to the popularity of unlimited voice offers and competitive pressure. As a percentage of our total wireless revenues, service revenues remained stable at 99% and 98% in the nine months ended September 30, 2010 and 2009, respectively.

#### Cellular Service

Our cellular service revenues in the first nine months of 2010 amounted to Php64,819 million, a decrease of Php1,025 million, or 2%, from Php65,844 million in the same period in 2009. Cellular service revenues accounted for 92% of our wireless service revenues in each of the first nine months of 2010 and 2009.

The following tables show the breakdown of our cellular service revenues and other key measures of our cellular business as at and for the nine months ended September 30, 2010 and 2009:

|                           | 2010          | 2009      | Increase (Decrease) |      |
|---------------------------|---------------|-----------|---------------------|------|
|                           |               |           | Amount              | %    |
|                           | (in millions) |           |                     |      |
| Cellular service revenues | Php64,819     | Php65,844 | (Php1,025)          | (2)  |
| <i>By service type</i>    |               |           |                     |      |
| Prepaid                   | 62,880        | 63,945    | (1,065)             | (2)  |
| Postpaid                  | 57,919        | 59,021    | (1,102)             | (2)  |
| Postpaid                  | 4,961         | 4,924     | 37                  | 1    |
| <i>By component</i>       |               |           |                     |      |
| Voice                     | 62,880        | 63,945    | (1,065)             | (2)  |
| Data                      | 31,861        | 28,459    | 3,402               | 12   |
| Data                      | 31,019        | 35,486    | (4,467)             | (13) |
| Others <sup>(1)</sup>     | 1,939         | 1,899     | 40                  | 2    |

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

|  | 2010       | 2009       | Increase (Decrease) |     |
|--|------------|------------|---------------------|-----|
|  |            |            | Amount              | %   |
| Cellular subscriber base                 | 44,112,343 | 39,147,990 | 4,964,353           | 13  |
| Prepaid                                  | 43,693,765 | 38,715,974 | 4,977,791           | 13  |
| <i>Smart Buddy</i>                       | 25,175,430 | 22,089,866 | 3,085,564           | 14  |
| <i>Talk 'N Text</i>                      | 18,136,858 | 16,552,143 | 1,584,715           | 10  |
| <i>Red Mobile</i>                        | 381,477    | 73,965     | 307,512             | 416 |
| Postpaid                                 | 418,578    | 432,016    | (13,438)            | (3) |
| Systemwide traffic volumes (in millions) |            |            |                     |     |
| Calls (in minutes)                       | 19,577     | 10,071     | 9,506               | 94  |
| Domestic                                 | 17,323     | 7,897      | 9,426               | 119 |
| <i>Inbound</i>                           | 1,086      | 1,127      | (41)                | (4) |
| <i>Outbound</i>                          | 16,237     | 6,770      | 9,467               | 140 |
| International                            | 2,254      | 2,174      | 80                  | 4   |
| <i>Inbound</i>                           | 2,098      | 2,030      | 68                  | 3   |
| <i>Outbound</i>                          | 156        | 144        | 12                  | 8   |
| SMS count                                | 253,494    | 202,459    | 51,035              | 25  |
| Text messages                            | 252,354    | 201,218    | 51,136              | 25  |
| Domestic                                 | 252,122    | 200,988    | 51,134              | 25  |
| <i>Bucket-Priced</i>                     | 238,485    | 186,655    | 51,830              | 28  |
| <i>Standard</i>                          | 13,637     | 14,333     | (696)               | (5) |
| International                            | 232        | 230        | 2                   | 1   |
| Value-Added Services                     | 1,122      | 1,227      | (105)               | (9) |
| Financial Services                       | 18         | 14         | 4                   | 29  |

Revenues attributable to our cellular prepaid service amounted to Php57,919 million in the first nine months of 2010, a decrease of Php1,102 million, or 2%, as compared with Php59,021 million earned in the same period in 2009. Prepaid cellular service revenues accounted for 92% of cellular voice and data revenues in each of the first nine months of 2010 and 2009. Revenues attributable to Smart's postpaid cellular service amounted to Php4,961 million in the first nine months of 2010, an increase of Php37 million, or 1%, over the Php4,924 million earned in the same period in 2009, and accounted for 8% of cellular voice and data revenues in each of the first nine months of 2010 and 2009.

### Voice Services

Cellular revenues from our voice services, which include all voice traffic and voice value-added services, or VAS, such as voice mail and outbound international roaming, increased by Php3,402 million, or 12%, to Php31,861 million in the first nine months of 2010 from Php28,459 million in the same period in 2009 primarily due to an increase in domestic call revenues, partially offset by a decrease in international call revenues. Cellular voice services accounted for 49% of our cellular service revenues in the first nine months of 2010 as compared with 43% in the same period in 2009.

The following table shows the breakdown of our cellular voice revenues for the nine months ended September 30, 2010 and 2009:

|                      | 2010             | 2009<br>(in millions) | Increase (Decrease) |            |
|----------------------|------------------|-----------------------|---------------------|------------|
|                      |                  |                       | Amount              | %          |
| Voice services:      |                  |                       |                     |            |
| <i>Domestic</i>      |                  |                       |                     |            |
| Inbound              | Php1,695         | Php1,317              | Php378              | 29         |
| Outbound             | 17,693           | 14,269                | 3,424               | 24         |
|                      | <u>19,388</u>    | <u>15,586</u>         | <u>3,802</u>        | <u>24</u>  |
| <i>International</i> |                  |                       |                     |            |
| Inbound              | 10,250           | 10,347                | (97)                | (1)        |
| Outbound             | 2,223            | 2,526                 | (303)               | (12)       |
|                      | <u>12,473</u>    | <u>12,873</u>         | <u>(400)</u>        | <u>(3)</u> |
| Total                | <u>Php31,861</u> | <u>Php28,459</u>      | <u>Php3,402</u>     | <u>12</u>  |

Domestic voice service revenues increased by Php3,802 million, or 24%, to Php19,388 million in the first nine months of 2010 from Php15,586 million in the same period in 2009 primarily due to an increase in domestic outbound call revenues by Php3,424 million, or 24%, to Php17,693 million in the first nine months of 2010 from Php14,269 million in the same period in 2009 mainly due to unlimited voice offerings. This was complemented by the higher revenue contribution of our inbound domestic voice service by Php378 million, or 29%, to Php1,695 million in the first nine months of 2010 from Php1,317 million in the same period in 2009 as a result of higher traffic to other domestic carriers and downward traffic settlement adjustments, partly offset by lower call volumes from fixed rate calling packages. Inbound and outbound domestic call volumes were 1,086 million minutes and 16,237 million minutes, respectively, in the first nine months of 2010 from 1,127 million minutes and 6,770 million minutes, respectively, in the same period in 2009. The aggregate increase was mainly due to higher call volumes from unlimited voice offerings.

International voice service revenues decreased by Php400 million, or 3%, to Php12,473 million in the first nine months of 2010 from Php12,873 million in the same period in 2009 primarily due to a decline in the outbound and inbound international voice service revenues by Php303 million, or 12%, to Php2,223 million and by Php97 million, or 1%, to Php10,250 million, respectively, in the first nine months of 2010 from Php2,526 million and Php10,347 million, respectively, in the same period in 2009, including the effect on our dollar-linked revenues of the appreciation of the weighted average exchange rate of the Philippine peso to the U.S. dollar to Php45.60 for the nine months ended September 30, 2010 from Php47.93 for the nine months ended September 30, 2009. On the other hand, international inbound and outbound calls totaled 2,254 million minutes in the first nine months of 2010, an increase of 80 million minutes, or 4%, as compared with 2,174 million minutes in the same period in 2009, mainly due to an increase in our cellular subscriber base.

*Smartalk*, Smart's unlimited voice offering, is now available to *Smart Buddy* and *Smart Gold* subscribers nationwide. The service does not require any change in SIM or cellular phone number and enables *Smart Buddy* and *Smart Gold* subscribers to make unlimited calls to any subscriber on the Smart network. Smart subscribers could avail of the service, via registration or via retailer loading, by purchasing loads for unlimited calls which come in two denominations:

- “*Smartalk 100*” which offers five days of unlimited calls for Php100; and
- “*Smartalk 500*” which offers 30 days of unlimited calls for Php500 to any subscriber on the Smart network.

In addition, Smart also offers *Smartalk Plus*, which offers unlimited calling and on-net texting during off-peak hours and reduced rates during peak hours. *Smartalk Plus*' Php100 load denomination is valid for five days and provides on-net unlimited calls and SMS from 10:01 p.m. to 5:00 p.m., and call and SMS rates of Php2.50 per minute and Php0.20 per SMS, respectively, from 5:01 p.m. to 10:00 p.m.

Through the *Talk 'N Text UnliTalk Plus 100* package, existing *Talk 'N Text* subscribers can avail of unlimited off-peak calls from 10:00 p.m. to 5:00 p.m. and special peak hour rates of Php2.50 per minute from 5:01 p.m. to 9:59 p.m. to any *Smart Buddy*, Smart Postpaid and *Talk 'N Text* subscribers. The package also includes all day unlimited texting to any *Smart Buddy*, Smart Postpaid and *Talk 'N Text* subscribers. Each registration to this promo is valid for five days.

*Red Mobile* introduced its unlimited voice and SMS offer which utilizes a secondary prepaid network powered by Smart. *Red Mobile Unlimited* offers unlimited *Red-to-Red* call and text, and unlimited *Red-to-Red* text packages, as well as unlimited calling and texting to all Smart subscribers.

#### *Data Services*

Cellular revenues from our data services, which include all text messaging-related services, as well as VAS, decreased by Php4,467 million, or 13%, to Php31,019 million in the first nine months of 2010 from Php35,486 million in the same period in 2009. Cellular data services accounted for 48% and 54% of our cellular service revenues in the first nine months of 2010 and 2009, respectively.



The following table shows the breakdown of our cellular data revenues for the nine months ended September 30, 2010 and 2009:

|                                 | 2010             | 2009             | Increase (Decrease) |             |
|---------------------------------|------------------|------------------|---------------------|-------------|
|                                 |                  |                  | Amount              | %           |
|                                 |                  |                  | (in millions)       |             |
| Text messaging                  |                  |                  |                     |             |
| Domestic                        | Php28,159        | Php32,471        | (Php4,312)          | (13)        |
| <i>Bucket-Priced</i>            | 17,512           | 20,365           | (2,853)             | (14)        |
| <i>Standard</i>                 | 10,647           | 12,106           | (1,459)             | (12)        |
| International                   | 994              | 1,143            | (149)               | (13)        |
|                                 | <u>29,153</u>    | <u>33,614</u>    | <u>(4,461)</u>      | <u>(13)</u> |
| Value-added services            |                  |                  |                     |             |
| Standard <sup>(1)</sup>         | 773              | 787              | (14)                | (2)         |
| Rich Media <sup>(2)</sup>       | 756              | 752              | 4                   | 1           |
| <i>Pasa Load</i> <sup>(3)</sup> | 308              | 310              | (2)                 | (1)         |
|                                 | <u>1,837</u>     | <u>1,849</u>     | <u>(12)</u>         | <u>(1)</u>  |
| Financial services              |                  |                  |                     |             |
| <i>Smart Money</i>              | 25               | 20               | 5                   | 25          |
| Mobile Banking                  | 4                | 3                | 1                   | 33          |
|                                 | <u>29</u>        | <u>23</u>        | <u>6</u>            | <u>26</u>   |
| Total                           | <u>Php31,019</u> | <u>Php35,486</u> | <u>(Php4,467)</u>   | <u>(13)</u> |

<sup>(1)</sup> Includes standard services such as info-on-demand, ringtone and logo downloads, etc.

<sup>(2)</sup> Includes Multimedia Messaging System, or MMS, internet browsing, General Packet Radio Service, or GPRS, etc.

<sup>(3)</sup> A service which allows prepaid subscribers to transfer small denominations of air time credits to other prepaid subscribers.

Text messaging-related services contributed revenues of Php29,153 million in the first nine months of 2010, a decrease of Php4,461 million, or 13%, as compared with Php33,614 million in the same period in 2009, and accounted for 94% and 95% of our total cellular data revenues in the first nine months of 2010 and 2009, respectively. The decrease in revenues from text messaging-related services resulted mainly from the continued decline in SMS yield as a result of aggressive SMS offers and the increased number of subscribers who also hold SIM cards from other cellular operators and who selectively use such SIM cards. Other factors that contributed to this decline in revenues were the prescribed extension of load validity periods and cheaper alternative means of communication. Text messaging revenues from the various bucket-priced plans totaled Php17,512 million in the first nine months of 2010, a decrease of Php2,853 million, or 14%, as compared with Php20,365 million in the same period in 2009. Likewise, standard text messaging revenues decreased by Php1,459 million, or 12%, to Php10,647 million in the first nine months of 2010 from Php12,106 million in the same period in 2009. The decrease in international text messaging revenues was mainly due to the higher average/effective rate of roaming costs in the first nine months of 2010.

Bucket-priced text messages in the first nine months of 2010 totaled 238,485 million, an increase of 51,830 million, or 28%, as compared with 186,655 million in the same period in 2009 primarily due to the continued patronage of bucket and unlimited text messaging offers. Standard text messages totaled 13,637 million in the first nine months of 2010, a decrease of 696 million, or 5%, as compared with 14,333 million in the same period in 2009 as a result of lower usage owing to a shift to bucket-priced text services.

VAS, which contributed revenues of Php1,837 million in the first nine months of 2010, decreased by Php12 million, or 1%, as compared with Php1,849 million in the same period in 2009 primarily due to lower usage of standard VAS and *Pasa Load* owing to the continued patronage of low-denomination top-ups partially offset by an increase in rich media VAS mainly from mobile internet browsing.

*Subscriber Base, ARPU and Churn Rates*

In the first nine months of 2010, Smart, including *Talk 'N Text* and *Red Mobile* subscribers totaled 44,112,343 an increase of 4,964,353, or 13%, over their combined cellular subscriber base of 39,147,990 in the same period in 2009. Our cellular prepaid subscriber base grew by 13% to 43,693,765 in the first nine months of 2010 from 38,715,974 in the same period in 2009, while our cellular postpaid subscriber base decreased by 13,438, or 3%, to 418,578 in the first nine months of 2010 from 432,016 in the same period in 2009. Prepaid subscribers accounted for 99% of our total subscriber base as at September 30, 2010 and 2009. Prepaid and postpaid subscribers reflected net activations of 2,800,667 and net reductions of 16,965, respectively, in the first nine months of 2010 as compared with net activations of 3,889,506 and 33,880, respectively, in the same period in 2009.

Our net subscriber activations for the nine months ended September 30, 2010 and 2009 were as follows:

|                     | 2010      | 2009      | Increase (Decrease) |       |
|---------------------|-----------|-----------|---------------------|-------|
|                     |           |           | Amount              | %     |
| Prepaid             | 2,800,667 | 3,889,506 | (1,088,839)         | (28)  |
| <i>Smart Buddy</i>  | 1,412,616 | 1,588,249 | (175,633)           | (11)  |
| <i>Talk 'N Text</i> | 1,086,145 | 2,243,650 | (1,157,505)         | (52)  |
| <i>Red Mobile</i>   | 301,906   | 57,607    | 244,299             | 424   |
| Postpaid            | (16,965)  | 33,880    | (50,845)            | (150) |
| Total               | 2,783,702 | 3,923,386 | (1,139,684)         | (29)  |

For *Smart Buddy*, the average monthly churn rate in the first nine months of 2010 and 2009 was 4.9% and 4.4%, respectively, while the average monthly churn rate for *Talk 'N Text* subscribers was 5.4% and 4.9% in the first nine months of 2010 and 2009, respectively. The average monthly churn rate for *Red Mobile* subscribers was 79% and 8.5% in the first nine months of 2010 and 2009, respectively.

The average monthly churn rate for Smart's postpaid subscribers is 2.4% and 1.8% for the first nine months of 2010 and 2009, respectively. 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 if the subscriber has exceeded the prescribed credit limit. If the subscriber does not make a payment within 44 days of redirection, the account is temporarily disconnected. If the account is not settled within 30 days from temporary disconnection, the account is then considered as churned. From the time that temporary disconnection is initiated, a series of collection activities is implemented, involving the sending of a collection letter, call-out reminders and collection messages via text messaging.



The following table summarizes our average monthly cellular ARPUs for the nine months ended September 30, 2010 and 2009:

|   | Gross <sup>(1)</sup> |        | Decrease |      | Net <sup>(2)</sup> |        | Decrease |      |
|---|----------------------|--------|----------|------|--------------------|--------|----------|------|
|   | 2010                 | 2009   | Amount   | %    | 2010               | 2009   | Amount   | %    |
| Prepaid                                     |                      |        |          |      |                    |        |          |      |
| Smart Buddy                                 | Php221               | Php263 | (Php42)  | (16) | Php175             | Php208 | (Php33)  | (16) |
| Talk 'N Text                                | 138                  | 164    | (26)     | (16) | 114                | 135    | (21)     | (16) |
| Red Mobile                                  | 7                    | 20     | (13)     | (65) | 6                  | 12     | (6)      | (50) |
| Prepaid – Blended <sup>(3)</sup>            | 184                  | 221    | (37)     | (17) | 148                | 177    | (29)     | (16) |
| Postpaid – Smart                            | 1,671                | 1,826  | (155)    | (8)  | 1,257              | 1,316  | (59)     | (4)  |
| Prepaid and Postpaid Blended <sup>(4)</sup> | 199                  | 238    | (39)     | (16) | 159                | 189    | (30)     | (16) |

- <sup>(1)</sup> Gross monthly ARPU is calculated by dividing gross cellular service revenues for the month, gross of discounts, allocated content-provider costs and interconnection income but excluding inbound roaming revenues, by the average number of subscribers in the month.
- <sup>(2)</sup> Net monthly ARPU is calculated by dividing gross cellular service revenues for the month, including interconnection income net of interconnection expense, but net of discounts and content-provider costs, by the average number of subscribers in the month.
- <sup>(3)</sup> The average monthly ARPU of Smart Buddy, Talk 'N Text and Red Mobile.
- <sup>(4)</sup> The average monthly ARPU of all prepaid and postpaid cellular subscribers.

Prepaid service revenues consist mainly of charges for the subscribers' actual usage of their loads. Prepaid blended gross average monthly ARPU in the first nine months of 2010 was Php184, a decrease of 17%, as compared with Php221 in the same period in 2009. The decrease was primarily due to a decline in the average outbound domestic text messaging revenue per subscriber, as well as a drop in the average inbound international and domestic voice revenue per subscriber in the first nine months of 2010 as compared with the same period in 2009. On a net basis, prepaid blended average monthly ARPU in the first nine months of 2010 was Php148, a decrease of 16%, as compared with Php177 in the same period in 2009.

Gross average monthly ARPU for postpaid subscribers decreased by 8% to Php1,671 as net average monthly ARPU also decreased by 4% to Php1,257 in the first nine months of 2010 as compared with Php1,826 and Php1,316 in the same period in 2009, respectively. Prepaid and postpaid gross average monthly blended ARPU was Php199 in the first nine months of 2010, a decrease of 16%, as compared with Php238 in the same period in 2009. Likewise, net average monthly prepaid and postpaid blended ARPU decreased by 16% to Php159 in the first nine months of 2010 from Php189 in the same period in 2009.

Our average monthly prepaid and postpaid ARPUs per quarter for the three quarters of 2010 and four quarters of 2009 were as follows:

|                | Prepaid              |                    |                      |                    |                      |                    | Postpaid             |                    |
|----------------|----------------------|--------------------|----------------------|--------------------|----------------------|--------------------|----------------------|--------------------|
|                | Smart Buddy          |                    | Talk 'N Text         |                    | Red Mobile           |                    | Smart                |                    |
|                | Gross <sup>(1)</sup> | Net <sup>(2)</sup> | Gross <sup>(1)</sup> | Net <sup>(2)</sup> | Gross <sup>(1)</sup> | Net <sup>(2)</sup> | Gross <sup>(1)</sup> | Net <sup>(2)</sup> |
| <b>2010</b>    |                      |                    |                      |                    |                      |                    |                      |                    |
| First Quarter  | Php232               | Php184             | Php140               | Php115             | Php11                | Php8               | Php1,686             | Php1,286           |
| Second Quarter | 224                  | 179                | 141                  | 116                | 4                    | 3                  | 1,665                | 1,257              |
| Third Quarter  | 207                  | 163                | 135                  | 112                | 6                    | 5                  | 1,661                | 1,229              |
| <b>2009</b>    |                      |                    |                      |                    |                      |                    |                      |                    |
| First Quarter  | 272                  | 216                | 176                  | 144                | 25                   | 14                 | 1,863                | 1,364              |
| Second Quarter | 269                  | 212                | 168                  | 138                | 16                   | 10                 | 1,816                | 1,278              |
| Third Quarter  | 249                  | 197                | 148                  | 122                | 19                   | 12                 | 1,801                | 1,307              |
| Fourth Quarter | 252                  | 203                | 152                  | 127                | 18                   | 15                 | 1,791                | 1,304              |

- <sup>(1)</sup> Gross monthly ARPU is calculated based on the average of the gross monthly ARPUs for the quarter.
- <sup>(2)</sup> Net monthly ARPU is calculated based on the average of the net monthly ARPUs for the quarter.

### *Wireless Broadband, Satellite and Other Services*

Our revenues from wireless broadband, satellite and other services consist mainly of wireless broadband service revenues from SBI, charges for ACeS Philippines' satellite information and messaging services and service revenues generated by the mobile virtual network operations of PLDT Global's subsidiary.

#### *Wireless Broadband*

Revenues from our wireless broadband services increased by Php882 million, or 23%, to Php4,781 million in the first nine months of 2010 from Php3,899 million in the same period in 2009 primarily due to the growth in wireless broadband subscribers.

SBI offers a number of wireless broadband services and had a total of 1,337,965 subscribers as at September 30, 2010, an increase of 536,407 subscribers, or 67%, as compared with 801,558 subscribers as at September 30, 2009. Our postpaid wireless broadband subscriber base grew by 3,492, or 1%, to 432,504 as at September 30, 2010 from 429,012 as at September 30, 2009, while our prepaid wireless broadband subscriber base increased by 532,915, or 143%, to 905,461 as at September 30, 2010 from 372,546 as at September 30, 2009.

*SmartBro*, SBI's wireless broadband service linked to Smart's wireless broadband-enabled base stations, allows subscribers to connect to the internet using an outdoor aerial antenna installed in a subscriber's home.

SBI offers mobile internet access through *SmartBro Plug-It*, a wireless modem which provides instant connectivity in places where there is Smart network coverage. *SmartBro Plug-It* is available in both postpaid and prepaid variants, with prepaid offering 30-minute internet access for every Php10 worth of load. SBI also offers unlimited internet surfing with *Unli Surf200*, *Unli Surf100* and *Unli Surf50* for *SmartBro Plug-It Prepaid* subscribers with specific internet usage needs. We also have an additional array of load packages that offer per minute-based charging and longer validity periods.

*SmartBro Share-It* service allows users to share their broadband access with other computers in a home network via a WiFi router. *SmartBro Share-It* runs on a High Speed Packet Access, or HSPA, 850 network ready for transfer capacities of up to 2 Mbps.

Smart also offers *Sandbox*, the latest web platform from Smart which unites social networking, online media content downloading, as well as web services. Browsing on the portal is free of charge but downloading content is charged accordingly. Content is delivered straight to the subscriber's mobile and the cost for any requested music, game and video is automatically charged to the subscriber's prepaid load or added to the monthly service fee for postpaid subscribers.

*SmartBro WiMAX* service is available in Metro Manila and selected key cities in Visayas and Mindanao. *WiMAX*, which stands for Worldwide Interoperability for Microwave Access, is a wide area network technology that allows for a more efficient band use, interference avoidance and higher data rates over longer distances. *WiMAX* was initially being offered at Plan 999 for unlimited broadband usage with a burst speed of 1 Mbps. Additional unlimited broadband packages are now available under Plan 799 and Plan 1995.

### *Satellite and Other Services*

Revenues from our satellite and other services decreased by Php614 million, or 42%, to Php845 million in the first nine months of 2010 from Php1,459 million in the same period in 2009 primarily due to lower satellite transponder rental revenues due to the sale of transponders by Mabuhay Satellite and the effect of the appreciation of the weighted average exchange rate of the Philippine peso to the U.S. dollar to Php45.60 for the nine months ended September 30, 2010 from Php47.93 for the nine months ended September 30, 2009 on our U.S. dollar and U.S. dollar-linked satellite and other service revenues.

### *Non-Service Revenues*

Our wireless non-service revenues consist of proceeds from sales of cellular handsets, cellular SIM-packs and broadband data modems. Our wireless non-service revenues decreased by Php196 million, or 15%, to Php1,070 million in the first nine months of 2010 as compared with Php1,266 million in the same period in 2009 primarily due to the lower combined average retail price of cellular phonekits and SIM-packs, partly offset by increased sales of broadband data modems.

### *Expenses*

Expenses associated with our wireless business in the first nine months of 2010 amounted to Php37,407 million, a decrease of Php906 million, or 2%, from Php38,313 million in the same period in 2009. A significant portion of this decrease was attributable to lower expenses related to asset impairment, rent, cost of sales, and selling and promotions, partially offset by higher expenses related to repairs and maintenance, depreciation and amortization, professional and other contracted services, and compensation and employee benefits. As a percentage of our total wireless revenues, expenses associated with our wireless business accounted for 52% and 53% in the first nine months of 2010 and 2009, respectively.

Cellular business expenses accounted for 85% of our wireless business expenses, while wireless broadband, satellite and other business expenses accounted for the remaining 15% of our wireless business expenses in the first nine months of 2010 as compared with 86% and 14%, respectively, in the same period in 2009.

The following table summarizes the breakdown of our total wireless-related expenses for the nine months ended September 30, 2010 and 2009 and the percentage of each expense item to the total:

|   | 2010             |            | 2009             |            | Increase (Decrease) |            |
|---|------------------|------------|------------------|------------|---------------------|------------|
|   | Amount           | %          | Amount           | %          | Amount              | %          |
|   | (in millions)    |            |                  |            |                     |            |
| Depreciation and amortization                     | Php10,127        | 27         | Php9,836         | 26         | Php291              | 3          |
| Rent  | 7,233            | 19         | 7,782            | 20         | (549)               | (7)        |
| Compensation and employee benefits <sup>(1)</sup> | 4,815            | 13         | 4,629            | 12         | 186                 | 4          |
| Repairs and maintenance                           | 3,651            | 10         | 3,283            | 9          | 368                 | 11         |
| Selling and promotions                            | 2,862            | 8          | 3,197            | 8          | (335)               | (10)       |
| Cost of sales                                     | 2,748            | 7          | 3,184            | 8          | (436)               | (14)       |
| Professional and other contracted services        | 2,145            | 6          | 1,875            | 5          | 270                 | 14         |
| Taxes and licenses                                | 1,324            | 3          | 1,313            | 3          | 11                  | 1          |
| Communication, training and travel                | 685              | 2          | 723              | 2          | (38)                | (5)        |
| Insurance and security services                   | 593              | 2          | 549              | 2          | 44                  | 8          |
| Asset impairment                                  | 486              | 1          | 1,133            | 3          | (647)               | (57)       |
| Amortization of intangible assets                 | 75               | –          | 99               | –          | (24)                | (24)       |
| Other expenses                                    | 663              | 2          | 710              | 2          | (47)                | (7)        |
| <b>Total</b>                                      | <b>Php37,407</b> | <b>100</b> | <b>Php38,313</b> | <b>100</b> | <b>(Php906)</b>     | <b>(2)</b> |

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

Depreciation and amortization charges increased by Php291 million, or 3%, to Php10,127 million in the first nine months of 2010 principally due to increased depreciation on the growing asset base of 3G and 2G networks.

Rent expenses decreased by Php549 million, or 7%, to Php7,233 million primarily due to decrease in domestic leased circuits partially offset by the increase in co-location and cell site rental charges. In the first nine months of 2010, we had 5,778 cell sites, 9,733 cellular/mobile broadband base stations and 2,219 fixed wireless broadband-enabled base stations, as compared with 5,464 cell sites, 8,945 cellular/mobile broadband base stations and 2,006 fixed wireless broadband-enabled base stations in the same period in 2009.

Compensation and employee benefits expenses increased by Php186 million, or 4%, to Php4,815 million primarily due to higher salaries and employee benefits as a result of merit-based increases and higher MRP costs, partially offset by decreased provision for pension and LTIP benefits. Smart and subsidiaries employee headcount increased to 5,494 in the first nine months of 2010 as compared with 5,446 in the same period in 2009.

Repairs and maintenance expenses increased by Php368 million, or 11%, to Php3,651 million mainly due to an increase in cellular and broadband network and software maintenance expenses, higher site electricity cost and higher fuel costs for power generation, partly offset by lower computer hardware and office equipment maintenance costs.

Selling and promotion expenses decreased by Php335 million, or 10%, to Php2,862 million primarily due to lower spending on advertising and promotional campaigns and commission expenses.

Cost of sales decreased by Php436 million, or 14%, to Php2,748 million primarily due to the lower combined average cost of cellular phonekits and SIM-packs and lower average cost of retention packages, partly offset by higher sales volume of broadband data modems.

Professional and other contracted service fees increased by Php270 million, or 14%, to Php2,145 million primarily due to the increase in consultancy fees, management fees and other professional fees, partly offset by lower contracted service fees and customer relationship management service fees.

Taxes and licenses increased by Php11 million, or 1%, to Php1,324 million primarily due to higher real property taxes and business-related taxes and license fees.

Communication, training and travel expenses decreased by Php38 million, or 5%, to Php685 million primarily due to lower communication, training and travel expenses incurred in the first nine months of 2010.

Insurance and security services increased by Php44 million, or 8%, to Php593 million primarily due to higher site security expenses.

Asset impairment decreased by Php647 million, or 57%, to Php486 million mainly due to the impairment loss recognized on the investment in Blue Ocean Wireless in 2009, lower provision for uncollectible subscriber receivables and provision for obsolescence of slow-moving network inventory in the first nine months of 2010.

Amortization of intangible assets decreased by Php24 million, or 24%, to Php75 million primarily due to the full amortization of the technology application intangible asset relating to SBI as at August 2009.

Other expenses decreased by Php47 million, or 7%, to Php663 million primarily due to lower various business and operational-related expenses.

### **Other Income**

The following table summarizes the breakdown of our total wireless-related other income for the nine months ended September 30, 2010 and 2009:

|  | 2010            | 2009          | Change        |           |
|--|-----------------|---------------|---------------|-----------|
|  |                 |               | Amount        | %         |
|  | (in millions)   |               |               |           |
| Other Income (Expenses):                                 |                 |               |               |           |
| Equity share in net earnings of associates               | Php1,285        | Php277        | Php1,008      | 364       |
| Foreign exchange gains – net                             | 800             | 118           | 682           | 578       |
| Interest income  | 520             | 976           | (456)         | (47)      |
| Gains (losses) on derivative financial instruments – net | (1)             | 1,166         | (1,167)       | (100)     |
| Financing costs – net                                    | (1,992)         | (1,938)       | (54)          | 3         |
| Others   | 860             | 357           | 503           | 141       |
| <b>Total</b>   | <b>Php1,472</b> | <b>Php956</b> | <b>Php516</b> | <b>54</b> |

Our wireless business segment's other income – net amounted to Php1,472 million in the first nine months of 2010, an increase of Php516 million, or 54%, as compared with Php956 million in the same period in 2009 primarily due to the combined effects of the following: (1) increase in equity share in net earnings of associates by Php1,008 million mainly due to the share in net earnings of Meralco and Beacon, as discussed below; (2) net increase in foreign exchange gains by Php682 million on account of higher gains on revaluation of foreign currency-denominated liabilities due to the effect of the appreciation of the Philippine peso to the U.S. dollar and increase in capitalized foreign exchange gains; (3) higher net financing costs by Php54 million primarily due to higher interest on loans and other related items on account of Smart's higher average loan balances and increase in accretion of financial liabilities; (4) decrease in interest income by Php456 million mainly due to Smart's lower average level of short-term investments and lower average dollar and peso placements; (5) net loss on derivative financial instruments of Php1 million in the first nine months of 2010 as against net gains of Php1,166 million in the same period in 2009 mainly due to a gain in the mark-to-market valuation relating to the derivative option of the exchangeable note purchased as part of the Meralco share acquisition by PCEV in 2009; and (6) increase in other income by Php503 million mainly due to a gain on sale of fixed assets.

In the nine months ended September 30, 2010, Meralco's reported and core income amounted to Php7,966 million and Php9,154 million, respectively, as compared with Php4,951 million and Php5,091 million, respectively, in the same period in 2009. These results reflect the higher volume of energy sold resulting from the surge in demand due to warmer temperature as well as higher demand from the commercial and industrial customers reflecting the improvement in economic activity. In addition, the results were boosted by the increase in billed customers as well as the later-than-scheduled implementation of the distribution rate adjustments approved by the Energy Regulatory Commission. PCEV's share in the reported and core income of Meralco (PCEV acquired 223 million Meralco shares on July 14, 2009, of which 154.2 million shares were transferred to Beacon, where PCEV acquired a 50% equity interest effective March 31, 2010), including share in Beacon's September 30, 2010 results of operations, amounted to Php1,284 million and Php1,566 million, respectively, in the first nine months of 2010. PCEV's share in Meralco's reported and core income for the period from July 14, 2009 to September 30, 2009 amounted to Php361 million and Php427 million, respectively.

### ***Provision for Income Tax***

Provision for income tax decreased by Php270 million, or 3%, to Php8,983 million in the first nine months of 2010 from Php9,253 million in the same period in 2009 due to lower taxable income. In the first nine months of 2010, the effective tax rate for our wireless business was 25% as compared with 26% in the same period in 2009. Smart and certain of its subsidiaries opted to use the optional standard deduction method in computing their taxable income in the first nine months of 2010 and 2009.

### ***Net Income***

Our wireless business segment recorded a net income of Php26,597 million in the first nine months of 2010, an increase of Php739 million, or 3%, from Php25,858 million recorded in the same period in 2009 on account of a decrease in wireless-related expenses by Php906 million, an increase in other income – net by Php516 million and lower provision for income tax by Php270 million, partially offset by a decrease in wireless revenues by Php953 million. Our wireless business segment's net income attributable to equity holders increased by Php1,320 million, or 5%, to Php26,518 million in the first nine months of 2010 from Php25,198 million in the same period in 2009 mainly due to the favorable effect of Smart's acquisition of equity interest from PCEV's non-controlling shareholders in 2009 complemented by an increase in net income. Our wireless business segment's core income increased by Php1,812 million, or 7%, to Php26,242 million in the first nine months of 2010 from Php24,430 million in the same period in 2009.

### ***Fixed Line***

#### ***Revenues***

Revenues generated from our fixed line business amounted to Php37,043 million in the first nine months of 2010, a decrease of Php1,345 million, or 4%, from Php38,388 million in the same period in 2009. The following table summarizes our total revenues from our fixed line business for the nine months ended September 30, 2010 and 2009 by service segment:

|  | 2010             | %          | 2009             | %          | Increase (Decrease) |            |
|--|------------------|------------|------------------|------------|---------------------|------------|
|  |                  |            |                  |            | Amount              | %          |
|  | (in millions)    |            |                  |            |                     |            |
| Fixed Line Services:   |                  |            |                  |            |                     |            |
| Service Revenues:  |                  |            |                  |            |                     |            |
| Local exchange   | Php11,559        | 31         | Php11,739        | 31         | (Php180)            | (2)        |
| International long distance  | 3,987            | 11         | 4,768            | 12         | (781)               | (16)       |
| National long distance   | 3,401            | 9          | 4,686            | 12         | (1,285)             | (27)       |
| Data and other network   | 16,605           | 45         | 15,965           | 42         | 640                 | 4          |
| Miscellaneous  | 1,225            | 3          | 1,056            | 3          | 169                 | 16         |
|  | <u>36,777</u>    | <u>99</u>  | <u>38,214</u>    | <u>100</u> | <u>(1,437)</u>      | <u>(4)</u> |
| Non-Service Revenues:  |                  |            |                  |            |                     |            |
| Sale of computers, PLDT Landline Plus, or PLP, units and SIM cards | 266              | 1          | 174              | –          | 92                  | 53         |
| Total Fixed Line Revenues  | <u>Php37,043</u> | <u>100</u> | <u>Php38,388</u> | <u>100</u> | <u>(Php1,345)</u>   | <u>(4)</u> |

#### ***Service Revenues***

Our fixed line business provides local exchange service, international and national long distance services, data and other network services, and miscellaneous services. Our fixed line service revenues decreased by Php1,437 million, or 4%, to Php36,777 million in the first nine months of 2010 from Php38,214 million in the same period in 2009 due to decreases in revenues from our national long distance, international long distance and local exchange services, partially offset by the increase in revenues from our data and other network services as a result of higher revenues contributed by our DSL and i-Gate services, and miscellaneous services.



### Local Exchange Service

The following table summarizes the key measures of our local exchange service business as at and for the nine months ended September 30, 2010 and 2009:

|   | 2010      | 2009      | Increase (Decrease) |      |
|---|-----------|-----------|---------------------|------|
|   |           |           | Amount              | %    |
| Total local exchange service revenues (in millions) | Php11,559 | Php11,739 | (Php180)            | (2)  |
| Number of fixed line subscribers                    | 1,839,962 | 1,787,441 | 52,521              | 3    |
| Postpaid  | 1,709,919 | 1,579,534 | 130,385             | 8    |
| Prepaid   | 130,043   | 207,907   | (77,864)            | (37) |
| Number of fixed line employees                      | 8,047     | 8,117     | (70)                | (1)  |
| Number of fixed line subscribers per employee       | 229       | 220       | 9                   | 4    |

Revenues from our local exchange service decreased by Php180 million, or 2%, to Php11,559 million in the first nine months of 2010 from Php11,739 million in the same period in 2009 primarily owing to a decrease in ARPU on account of lower fixed charges due to the increase in demand for bundled voice and data services and lower installation and service connection charges, partially offset by an increase in the average number of postpaid billed lines as a result of the launching of *PLDT Call All* service promotions related to PLP. The percentage contribution of local exchange revenues to our total fixed line service revenues accounted for 32% and 31% in the first nine months of 2010 and 2009, respectively.

PLDT offers PLP, a postpaid fixed wireless service where subscribers to the service benefit from a text-capable home phone which can be brought around the area where it was applied for. The monthly service fee is at Php600 with free 600 local minutes and Php1,000 with free 1,000 local minutes for residential and business subscribers, respectively. As at September 30, 2010, there were a total of 301,307 active PLP subscribers, of which 263,434 and 37,873 were postpaid and prepaid subscribers, respectively, whereas there were a total of 189,232 active PLP subscribers as at September 30, 2009, of which 125,580 and 63,652 were postpaid and prepaid subscribers, respectively.

### International Long Distance Service

The following table shows our international long distance service revenues and call volumes for the nine months ended September 30, 2010 and 2009:

|  | 2010     | 2009     | Increase (Decrease) |      |
|--|----------|----------|---------------------|------|
|  |          |          | Amount              | %    |
| Total international long distance service revenues (in millions)   | Php3,987 | Php4,768 | (Php781)            | (16) |
| Inbound  | 3,398    | 3,964    | (566)               | (14) |
| Outbound   | 589      | 804      | (215)               | (27) |
| International call volumes (in million minutes, except call ratio) | 1,278    | 1,407    | (129)               | (9)  |
| Inbound  | 1,123    | 1,253    | (130)               | (10) |
| Outbound   | 155      | 154      | 1                   | 1    |
| Inbound-outbound call ratio  | 7.2:1    | 8.1:1    | -                   | -    |

Our total international long distance service revenues decreased by Php781 million, or 16%, to Php3,987 million in the first nine months of 2010 from Php4,768 million in the same period in 2009 primarily due to a decrease in the average collection and settlement rates, the unfavorable effect of the appreciation of the weighted average exchange rate of the Philippine peso to the U.S. dollar to Php45.60 for the nine months ended September 30, 2010 from Php47.93 for the nine months ended September 30, 2009 and a decrease in call volumes. The percentage contribution of international long distance service revenues to our total fixed line service revenues accounted for 11% and 12% in the first nine months of 2010 and 2009, respectively.

Our revenues from inbound international long distance service decreased by Php566 million, or 14%, to Php3,398 million in the first nine months of 2010 from Php3,964 million in the same period in 2009 due to a decline in inbound call volumes and the effect of the appreciation of the weighted average exchange rate of the Philippine peso to the U.S. dollar, since settlement charges for inbound calls are primarily billed in U.S. dollar.

Our revenues from outbound international long distance service decreased by Php215 million, or 27%, to Php589 million in the first nine months of 2010 from Php804 million in the same period in 2009 primarily due to lower average collection rate in dollar terms and the effect of the appreciation of the weighted average exchange rate of the Philippine peso to the U.S. dollar to Php45.60 for the nine months ended September 30, 2010 from Php47.93 for the nine months ended September 30, 2009, resulting in a decrease in the average billing rates to Php45.84 in the first nine months of 2010 from Php47.92 in the same period in 2009.

#### *National Long Distance Service*

The following table shows our national long distance service revenues and call volumes for the nine months ended September 30, 2010 and 2009:

|   | 2010     | 2009     | Decrease   |      |
|---|----------|----------|------------|------|
|   |          |          | Amount     | %    |
| Total national long distance service revenues (in millions) | Php3,401 | Php4,686 | (Php1,285) | (27) |
| National long distance call volumes (in million minutes)    | 966      | 1,453    | (487)      | (34) |

Our national long distance service revenues decreased by Php1,285 million, or 27%, to Php3,401 million in the first nine months of 2010 from Php4,686 million in the same period in 2009 primarily due to a decrease in call volumes, partially offset by an increase in the average revenue per minute for our national long distance services due to cessation of certain promotions on our national long distance calling rates. The percentage contribution of national long distance revenues to our fixed line service revenues decreased to 9% in the first nine months of 2010 from 12% in the same period in 2009.

#### *Data and Other Network Services*

The following table shows information of our data and other network service revenues for the nine months ended September 30, 2010 and 2009:

|   | 2010      | 2009      | Increase (Decrease) |      |
|---|-----------|-----------|---------------------|------|
|   |           |           | Amount              | %    |
| Data and other network service revenues (in millions) | Php16,605 | Php15,965 | Php640              | 4    |
| Domestic  | 11,960    | 12,042    | (82)                | (1)  |
| Broadband   | 6,327     | 5,256     | 1,071               | 20   |
| DSL   | 6,138     | 5,099     | 1,039               | 20   |
| WeRoam  | 189       | 157       | 32                  | 20   |
| Leased Lines and Others                               | 5,633     | 6,786     | (1,153)             | (17) |
| International   |           |           |                     |      |
| Leased Lines and Others                               | 4,645     | 3,923     | 722                 | 18   |
| Subscriber base:                                      |           |           |                     |      |
| Broadband   | 652,729   | 564,790   | 87,939              | 16   |
| DSL   | 630,984   | 548,313   | 82,671              | 15   |
| WeRoam  | 21,745    | 16,477    | 5,268               | 32   |

In the first nine months of 2010, our data and other network services posted revenues of Php16,605 million, an increase of Php640 million, or 4%, as compared with Php15,965 million in the same period in 2009 primarily due to increases in domestic data revenues, particularly broadband services owing to higher revenues from *PLDT DSL*, *Shops.Work Unplugged* or, *SWUP*, Internet Protocol Virtual Private Network, or IP-VPN and Metro Ethernet, and an increase in international data revenues, particularly from i-Gate, partially offset by decreases in leased line revenues mainly due to lower revenues from Diginet. The percentage contribution of this service segment to our fixed line service revenues increased to 45% in the first nine months of 2010 from 42% in the same period in 2009.

#### Domestic

Domestic data services contributed Php11,960 million in the first nine months of 2010, a decrease of Php82 million, or 1%, as compared with Php12,042 million in the same period in 2009 mainly due to lower Diginet revenues partially offset by the continued growth in DSL, SWUP, IP-VPN and Metro Ethernet subscribers as demand for offshoring and outsourcing services increased. The percentage contribution of domestic data service revenues to total data and other network services accounted for 72% and 75% in the first nine months of 2010 and 2009, respectively.

#### *Broadband*

Broadband data services include *PLDT DSL* broadband internet service, which is intended for individual internet users, small and medium enterprises, and large corporate with multiple branches, and *PLDT WeRoam*, our broadband service, running on the PLDT Group's nationwide wireless network (using GPRS, EDGE, 3G/HSDPA/HSPA and WiFi technologies). Broadband data revenues amounted to Php6,327 million in the first nine months of 2010, an increase of Php1,071 million, or 20%, from Php5,256 million in the same period in 2009 primarily due to the higher revenue contribution of DSL which contributed revenues of Php6,138 million in the first nine months of 2010 from Php5,099 million in the same period in 2009 owing to the increase in the number of subscribers, partially offset by lower ARPU as a result of launching of lower-priced promotional plans. DSL revenues accounted for 37% and 32% of total data and other network service revenues in the first nine months of 2010 and 2009, respectively. DSL subscribers increased by 15% to 630,984 subscribers as at September 30, 2010 from 548,313 subscribers in the same period in 2009. *WeRoam* revenues amounted to Php189 million in the first nine months of 2010 from Php157 million in the same period in 2009 as subscribers increased by 32%, to 21,745 subscribers in the first nine months of 2010 from 16,477 subscribers in the same period in 2009.

#### *Leased Lines and Others*

Leased lines and other data services include: (1) Diginet, our domestic private leased line service providing Smart's fiber optic and leased line data requirements; (2) IP-VPN, a managed corporate IP network that offers a secure means to access corporate network resources; (3) Metro Ethernet, our high-speed wide area networking services that enable mission-critical data transfers; (4) *Shops.Work*, our connectivity solution for retailers and franchisers that links company branches to their head office; and (5) *SWUP*, our wireless VPN service that powers mobile point-of-sale terminals and off-site bank ATMs, as well as other retail outlets located in remote areas. As at September 30, 2010, *SWUP* has a total subscriber base of 14,690 compared with 11,091 subscribers as at the same period in 2009. Leased lines and other data revenues amounted to Php5,633 million in the first nine months of 2010, a decrease of Php1,153 million, or 17%, from Php6,786 million in the same period in 2009 primarily due to decrease in Diginet revenues partially offset by higher revenues from Metro

Ethernet and IP-VPN. The percentage contribution of leased lines and other data service revenues to total data and other network services accounted for 34% and 42% in the first nine months of 2010 and 2009, respectively.

#### International

##### *Leased Lines and Others*

International leased lines and other data services consist mainly of: (1) i-Gate, our premium dedicated internet access service that provides high speed, reliable and managed connectivity to the global internet, and is intended for enterprises and VAS providers; (2) Fibernet, which provides cost-effective and reliable bilateral point-to-point private networking connectivity, through the use of our extensive international alliances to offshore and outsourcing, banking and finance, and semiconductor industries; and (3) other international managed data services in partnership with other Global Service Providers, such as AT&T, BT-Infonet, NTT Arcstar, Orange Business, SingTel, Tata, Telstra, Verizon Business, among others, which provide data networking services to multinational companies. International data service revenues increased by Php722 million, or 18%, to Php4,645 million in the first nine months of 2010 from Php3,923 million in the same period in 2009 primarily due to an increase in i-Gate revenues. The percentage contribution of international data service revenues to total data and other network service revenues accounted for 28% and 25% in the first nine months of 2010 and 2009, respectively.

##### *Miscellaneous Services*

Miscellaneous service revenues are derived mostly from directory advertising, facilities management and rental fees. In the first nine months of 2010, these service revenues increased by Php169 million, or 16%, to Php1,225 million from Php1,056 million in the same period in 2009 mainly due to an increase in rental income owing to higher co-location charges and facilities management fees. The percentage contribution of miscellaneous service revenues to our total fixed line service revenues was 3% in each of the first nine months of 2010 and 2009.

##### *Non-service Revenues*

Non-service revenues increased by Php92 million, or 53%, to Php266 million in the first nine months of 2010 from Php174 million in the same period in 2009 primarily due to higher sales of PLP units and SIM cards.

##### *Expenses*

Expenses related to our fixed line business totaled Php28,291 million in the first nine months of 2010, a decrease of Php7 million as compared with Php28,298 million in the same period in 2009. The decrease was primarily due to lower asset impairment, compensation and employee benefits, rent and selling and promotions expenses, partly offset by increases in professional and other contracted services, depreciation and amortization, repairs and maintenance, and cost of sales. As a percentage of our total fixed line revenues, expenses associated with our fixed line business accounted for 76% and 74% in the first nine months of 2010 and 2009, respectively.



The following table shows the breakdown of our total fixed line-related expenses for the nine months ended September 30, 2010 and 2009 and the percentage of each expense item to the total:

|   | 2010             |            | 2009             |            | Increase (Decrease) |          |
|---|------------------|------------|------------------|------------|---------------------|----------|
|   | Amount           | %          | Amount           | %          | Amount              | %        |
|   | (in millions)    |            |                  |            |                     |          |
| Depreciation and amortization                     | Php9,267         | 33         | Php8,860         | 31         | Php407              | 5        |
| Compensation and employee benefits <sup>(1)</sup> | 7,497            | 27         | 7,683            | 27         | (186)               | (2)      |
| Repairs and maintenance                           | 3,159            | 11         | 2,984            | 11         | 175                 | 6        |
| Professional and other contracted services        | 2,274            | 8          | 1,582            | 6          | 692                 | 44       |
| Rent  | 2,069            | 7          | 2,169            | 8          | (100)               | (5)      |
| Asset impairment                                  | 982              | 4          | 2,060            | 7          | (1,078)             | (52)     |
| Selling and promotions                            | 919              | 3          | 990              | 3          | (71)                | (7)      |
| Taxes and licenses                                | 608              | 2          | 600              | 2          | 8                   | 1        |
| Communication, training and travel                | 456              | 2          | 451              | 2          | 5                   | 1        |
| Cost of sales                                     | 369              | 1          | 197              | 1          | 172                 | 87       |
| Insurance and security services                   | 325              | 1          | 384              | 1          | (59)                | (15)     |
| Other expenses                                    | 366              | 1          | 338              | 1          | 28                  | 8        |
| <b>Total</b>                                      | <b>Php28,291</b> | <b>100</b> | <b>Php28,298</b> | <b>100</b> | <b>(Php7)</b>       | <b>-</b> |

<sup>(1)</sup> Includes salaries and employee benefits, LTIP, pension and MRP costs.

Depreciation and amortization charges increased by Php407 million, or 5%, to Php9,267 million due to a higher depreciable asset base in the first nine months of 2010 as compared with the same period in 2009.

Compensation and employee benefits expenses decreased by Php186 million, or 2%, to Php7,497 million primarily due to lower provisions for pension costs and LTIP, partially offset by higher salaries and employee benefits due to collective bargaining agreement-related increases.

Repairs and maintenance expenses increased by Php175 million, or 6%, to Php3,159 million primarily due to higher electricity charges, domestic cable and wire facilities, and higher building repairs and maintenance costs.

Professional and other contracted services increased by Php692 million, or 44%, to Php2,274 million primarily due to higher legal fees and contracted service fees for customer relationship management outsourcing project services, partially offset by lower management fees.

Rent expenses decreased by Php100 million, or 5%, to Php2,069 million due to a decrease in international leased circuit and pole rental charges, partially offset by an increase in site and domestic leased circuit rental charges.

Asset impairment decreased by Php1,078 million, or 52%, to Php982 million mainly due to impairment loss on prepaid transponder lease to ProtoStar in 2009 partially offset by higher impairment charges on payphone assets, investments and provision for uncollectible customer receivables in the first nine months of 2010.

Selling and promotion expenses decreased by Php71 million, or 7%, to Php919 million primarily due to lower spending on advertising and promotions, and commission expenses, partially offset by higher public relations in the first nine months of 2010.

Taxes and licenses increased by Php8 million, or 1%, to Php608 million as a result of higher business-related taxes.

Communication, training and travel expenses increased by Php5 million, or 1%, to Php456 million mainly due to higher foreign and local training expenses, local travel expenses and fuel consumption, partially offset by lower foreign travel expenses, and mailing and courier charges.

Cost of sales increased by Php172 million, or 87%, to Php369 million due to higher cost of SIM and PLP units sold for PLP prepaid subscribers partially offset by lower computer-bundled sales in relation to our DSL promotion.

Insurance and security services decreased by Php59 million, or 15%, to Php325 million primarily due to lower insurance and bond premiums, and lower security services.

Other expenses increased by Php28 million, or 8%, to Php366 million due to increases in various business and fixed line operational-related expenses.

### ***Other Expenses***

The following table summarizes the breakdown of our total fixed line-related other expenses for the nine months ended September 30, 2010 and 2009:

|  | 2010              | 2009              | Change          |           |
|--|-------------------|-------------------|-----------------|-----------|
|  |                   |                   | Amount          | %         |
|  |                   |                   | (in millions)   |           |
| Other Income (Expenses):                         |                   |                   |                 |           |
| Foreign exchange gains – net                     | Php922            | Php104            | Php818          | 787       |
| Interest income                                  | 382               | 318               | 64              | 20        |
| Equity share in net losses of joint ventures     | –                 | (72)              | 72              | 100       |
| Losses on derivative financial instruments – net | (499)             | (1,705)           | 1,206           | 71        |
| Financing costs – net                            | (2,941)           | (2,710)           | (231)           | 9         |
| Others   | 466               | 442               | 24              | 5         |
| Total  | <u>(Php1,670)</u> | <u>(Php3,623)</u> | <u>Php1,953</u> | <u>54</u> |

Our fixed line business segment's other expenses – net amounted to Php1,670 million in the first nine months of 2010, a decrease of Php1,953 million, or 54%, from Php3,623 million in the same period in 2009. The change was due to the combined effects of the following: (i) lower loss on derivative financial instruments by Php1,206 million in the first nine months of 2010 as compared with the same period in 2009 due to the mark-to-market valuation on principal-only currency swaps; (ii) net increase in foreign exchange gains by Php818 million on account of higher gains on foreign exchange revaluation of foreign-currency denominated liabilities due to the effect of the appreciation of the Philippine peso to the U.S. dollar; (iii) lower share in net losses of joint ventures of Php72 million; (iv) an increase in interest income by Php64 million; and (v) an increase in net financing costs by Php231 million due to an increase in interest expense on loans and related items – net on account of higher level of average loan balances as well as lower capitalized interest, partially offset by lower level of average interest rate.

### ***Provision for Income Tax***

Provision for income tax amounted to Php2,011 million in the first nine months of 2010, an increase of Php207 million, or 11%, as compared with Php1,804 million in the same period in 2009 primarily due to higher taxable income.

### ***Net Income***

In the first nine months of 2010, our fixed line business segment contributed a net income of Php5,071 million, an increase of Php408 million, or 9%, as compared with Php4,663 million in the same period in 2009 primarily as a result of decreases in other expenses – net by Php1,953 million and lower fixed line-related expenses by Php7 million, partially offset by a decrease in fixed line revenues

by Php1,345 million and higher provision for income tax by Php207 million. Our fixed line business segment's net income attributable to equity holders increased by Php406 million, or 9%, to Php5,063 million in the first nine months of 2010 from Php4,657 million in the same period in 2009. On the other hand, our fixed line business segment's core income decreased by Php1,674 million, or 26%, to Php4,686 million in the first nine months of 2010 from Php6,360 million in the same period in 2009.

## Information and Communications Technology

### Revenues

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

In the first nine months of 2010, our ICT business generated revenues of Php8,261 million, a decrease of Php125 million, or 1%, as compared with Php8,386 million in the same period in 2009. This decrease was primarily due to the decline in the revenue contribution of our customer relationship management, and internet and online gaming businesses, and decline in point-product sales, partially offset by the continued growth of our data center and knowledge processing solutions businesses' service revenues.

The following table summarizes our total revenues from our ICT business for the nine months ended September 30, 2010 and 2009 by service segment:

|                                  | 2010            | %          | 2009<br>(in millions) |            | Increase (Decrease) |             |
|----------------------------------|-----------------|------------|-----------------------|------------|---------------------|-------------|
|                                  |                 |            |                       |            | Amount              | %           |
| Service Revenues:                |                 |            |                       |            |                     |             |
| Knowledge processing solutions   | Php3,876        | 47         | Php3,837              | 46         | Php39               | 1           |
| Customer relationship management | 2,152           | 26         | 2,474                 | 29         | (322)               | (13)        |
| Internet and online gaming       | 780             | 10         | 830                   | 10         | (50)                | (6)         |
| Data center and others           | 1,096           | 13         | 816                   | 10         | 280                 | 34          |
|                                  | <u>7,904</u>    | <u>96</u>  | <u>7,957</u>          | <u>95</u>  | <u>(53)</u>         | <u>(1)</u>  |
| Non-Service Revenues:            |                 |            |                       |            |                     |             |
| Point-product sales              | <u>357</u>      | <u>4</u>   | <u>429</u>            | <u>5</u>   | <u>(72)</u>         | <u>(17)</u> |
| Total ICT Revenues               | <u>Php8,261</u> | <u>100</u> | <u>Php8,386</u>       | <u>100</u> | <u>(Php125)</u>     | <u>(1)</u>  |

### Service Revenues

Service revenues generated by our ICT business segment amounted to Php7,904 million in the nine months ended September 30, 2010, a decrease of Php53 million, or 1%, as compared with Php7,957 million in the same period in 2009 primarily as a result of a decline in revenues from our customer relationship management and internet and online gaming businesses. This was partially offset by an increase in co-location and disaster recovery revenues from our data center business and increase in revenues from our knowledge processing solutions business. As a percentage of our total ICT business revenues, service revenues increased to 96% in the first nine months of 2010 from 95% in the same period in 2009.

#### Knowledge Processing Solutions

We provide our knowledge processing solutions business primarily through the SPi Group. The knowledge processing solutions business contributed revenues of Php3,876 million in the nine months ended September 30, 2010, an increase of Php39 million, or 1%, from Php3,837 million in the same period in 2009. Dollar revenues increased by 7% partially offset by the appreciation of peso to the U.S.

dollar by 5%. Knowledge processing solutions business revenues accounted for 49% and 48% of total service revenues of our ICT business in the nine months ended September 30, 2010 and 2009, respectively.

#### *Customer Relationship Management*

We provide our customer relationship management business primarily through SPi CRM. Revenues relating to our customer relationship management business decreased by Php322 million, or 13%, to Php2,152 million in the first nine months of 2010 from Php2,474 million in the same period in 2009 primarily due to lower domestic sales by 4% and international dollar-denominated revenues by 10% and the effect of the appreciation of the Philippine peso to the U.S. dollar. In total, we own and operate approximately 7,160 seats with an average of 4,660 customer service representatives, or CSRs, in the first nine months of 2010 as compared with approximately 7,170 seats with an average of 4,880 CSRs in the same period in 2009. As at September 30, 2010 and 2009, SPi CRM had seven customer interaction solution sites. Customer relationship management business revenues accounted for 27% and 31% of total service revenues of our ICT business in the first nine months of 2010 and 2009, respectively.

#### *Internet and Online Gaming*

Revenues from our internet and online gaming business decreased by Php50 million, or 6%, to Php780 million in the first nine months of 2010 from Php830 million in the same period in 2009 primarily due to lower online gaming revenues on account of a decrease in publishing revenues as a result of more competitive games in the market, the power outages throughout the country during the first half of the year and increase in electricity costs which resulted to shortening of operating hours of internet cafés. Our internet and online gaming business revenues accounted for 10% and 11% of total service revenues of our ICT business in the first nine months of 2010 and 2009, respectively.

#### *Data Center and Others*

ePLDT operates an internet data center under the brand name *Vitro*<sup>™</sup>, which provides co-location or rental services, server hosting, disaster recovery and business continuity services, intrusion detection, security services such as firewalls and managed firewalls, and other data services. In the first nine months of 2010, our data center contributed revenues of Php1,096 million, an increase of Php280 million, or 34%, from Php816 million in the same period in 2009 primarily due to an increase in co-location or rental and disaster recovery services revenues. Our data center revenues accounted for 14% and 10% of total service revenues of our ICT business in the first nine months of 2010 and 2009, respectively.

#### *Non-Service Revenues*

Non-service revenues consist of sales generated from reselling certain software licenses, server solutions, networking products, storage products and data security products. In the first nine months of 2010, non-service revenues generated by our ICT business decreased by Php72 million, or 17%, to Php357 million from Php429 million in the same period in 2009 primarily due to lower revenues from sales of software licenses.

#### *Expenses*

Expenses associated with our ICT business totaled Php7,931 million in the first nine months of 2010, a decrease of Php369 million, or 4%, as compared with Php8,300 million in the same period in 2009 primarily due to lower compensation and employee benefits, cost of sales, professional and other



contracted services, rent and depreciation and amortization expenses, partially offset by higher repairs and maintenance expenses, asset impairment and amortization of intangible assets. As a percentage of our total ICT revenues, expenses related to our ICT business accounted for 96% and 99% in the first nine months of 2010 and 2009, respectively.

The following table shows the breakdown of our total ICT-related expenses for the nine months ended September 30, 2010 and 2009 and the percentage of each expense item to the total:

|   | 2010            | %          | 2009            | %          | Increase (Decrease) |            |
|---|-----------------|------------|-----------------|------------|---------------------|------------|
|   |                 |            |                 |            | Amount              | %          |
|   | (in millions)   |            |                 |            |                     |            |
| Compensation and employee benefits <sup>(1)</sup> | Php4,533        | 57         | Php4,848        | 58         | (Php315)            | (6)        |
| Depreciation and amortization                     | 559             | 7          | 570             | 7          | (11)                | (2)        |
| Repairs and maintenance                           | 549             | 7          | 489             | 6          | 60                  | 12         |
| Rent  | 512             | 6          | 541             | 7          | (29)                | (5)        |
| Cost of sales                                     | 444             | 6          | 529             | 6          | (85)                | (16)       |
| Professional and other contracted services        | 377             | 5          | 427             | 5          | (50)                | (12)       |
| Communication, training and travel                | 341             | 4          | 351             | 4          | (10)                | (3)        |
| Amortization of intangible assets                 | 193             | 2          | 182             | 2          | 11                  | 6          |
| Taxes and licenses                                | 83              | 1          | 81              | 1          | 2                   | 2          |
| Selling and promotions                            | 76              | 1          | 79              | 1          | (3)                 | (4)        |
| Asset impairment                                  | 66              | 1          | 28              | –          | 38                  | 136        |
| Insurance and security services                   | 58              | 1          | 48              | 1          | 10                  | 21         |
| Other expenses                                    | 140             | 2          | 127             | 2          | 13                  | 10         |
| <b>Total</b>                                      | <b>Php7,931</b> | <b>100</b> | <b>Php8,300</b> | <b>100</b> | <b>(Php369)</b>     | <b>(4)</b> |

<sup>(1)</sup> Includes salaries and employee benefits, LTIP, pension and MRP costs.

Compensation and employee benefits decreased by Php315 million, or 6%, to Php4,533 million mainly due to a decline in salaries and employee benefits as a result of lower salaries and benefits, and lower provision for LTIP, partially offset by the increase in MRP costs and pension benefits. ePLDT and subsidiaries' employee headcount increased by 251 to 16,083 in the nine months ended September 30, 2010 as compared with 15,832 in the same period in 2009.

Depreciation and amortization charges decreased by Php11 million, or 2%, to Php559 million primarily due to a decrease in the depreciable asset base of our customer relationship management and knowledge processing solutions businesses on account of higher fully depreciated assets and lower capital expenditures, partially offset by higher depreciation in relation to Data Center expansion.

Repairs and maintenance expenses increased by Php60 million, or 12%, to Php549 million primarily due to higher office and site electricity charges, and higher site facilities and IT software repairs and maintenance costs, partially offset by a decrease in janitorial services and lower purchases of low-value hardware.

Rent expenses decreased by Php29 million, or 5%, to Php512 million primarily due to lower office building rental charges partially offset by higher co-location and site rental charges.

Cost of sales decreased by Php85 million, or 16%, to Php444 million primarily due to lower volume of sales of software licenses and hardware products.

Professional and other contracted services decreased by Php50 million, or 12%, to Php377 million primarily due to lower contracted service fees incurred by our knowledge processing solutions business.

Communication, training and travel expenses decreased by Php10 million, or 3%, to Php341 million primarily due to lower local and foreign travel and training expenses, and communications

charges by our customer relationship management business, and lower mailing and courier charges from our knowledge processing solutions business, partially offset by higher trunk line charges by our data center business.

Amortization of intangible assets increased by Php11 million, or 6%, to Php193 million due to intangible assets recognized in relation to the acquisition of Laguna Medical and additional game licenses acquired by our gaming business in late 2009 and in the first nine months of 2010.

Taxes and licenses increased by Php2 million, or 2%, to Php83 million primarily due to higher business-related taxes.

Selling and promotion expenses decreased by Php3 million, or 4%, to Php76 million mainly due to our gaming business' lower promotional expenses due to timing of its new major games in 2009 as compared with 2010 and decrease in commission and advertising expenses of our knowledge processing solutions business, partially offset by higher advertisements by our customer relationship management business.

Asset impairment increased by Php38 million, or 136%, to Php66 million primarily due to impairment provision on unutilized input VAT of our customer relationship management business and higher provision for uncollectible receivables in the first nine months of 2010.

Insurance and security services increased by Php10 million, or 21%, to Php58 million primarily due to higher security services and insurance premiums.

Other expenses increased by Php13 million, or 10%, to Php140 million mainly due to higher various business and ICT operational-related costs.

### ***Other Income***

The following table summarizes the breakdown of our total ICT-related other income for the nine months ended September 30, 2010 and 2009:

|   | 2010   | 2009   | Change        |       |
|---|--------|--------|---------------|-------|
|   |        |        | Amount        | %     |
|   |        |        | (in millions) |       |
| Other Income (Expenses):                        |        |        |               |       |
| Equity share in net earnings of associates      | Php134 | Php106 | Php28         | 26    |
| Interest income                                 | 26     | 20     | 6             | 30    |
| Gains on derivative financial instruments – net | 5      | 5      | –             | –     |
| Foreign exchange gains (losses) – net           | (55)   | 10     | (65)          | (650) |
| Financing costs – net                           | (132)  | (128)  | (4)           | 3     |
| Others  | 62     | 228    | (166)         | (73)  |
| Total   | Php40  | Php241 | (Php201)      | (83)  |

Our ICT business segment's other income – net amounted to Php40 million in the first nine months of 2010, a decrease of Php201 million, or 83%, from Php241 million in the same period in 2009 primarily due to the combined effects of the following: (i) net foreign exchange losses of Php55 million in the first nine months of 2010 as against net foreign exchange gains of Php10 million in the same period in 2009 due to the revaluation of net foreign currency-denominated assets as a result of the effect of the appreciation of the Philippine peso to the U.S. dollar in the first nine months of 2010; (ii) an increase in financing costs – net by Php4 million; (iii) an increase in interest income of Php6 million; (iv) an increase in equity share in net earnings of associates by Php28 million; and (v) a decrease in other income by Php166 million mainly due to the de-recognition of liabilities in 2009 partly offset by insurance claims received in the first nine months of 2010.

### ***Provision for (Benefit from) Income Tax***

Net benefit from income tax of Php20 million in the nine months ended September 30, 2010 as against provision for income tax of Php162 million in the same period in 2009 primarily due to lower net taxable income.

### ***Net Income***

In the first nine months of 2010, our ICT business segment registered a net income of Php390 million, an increase of Php225 million from Php165 million in the same period in 2009 mainly as a result of a decrease in ICT-related expenses by Php369 million, net benefit from income tax of Php20 million in 2010 as against a provision for income tax of Php162 million in the same period in 2009, partially offset by a decrease in ICT revenues by Php125 million. Our ICT business segment's net income attributable to equity holders increased by Php242 million to Php407 million in the first nine months of 2010 as compared with Php165 million in the same period in 2009. Our ICT business segment's core income amounted to Php495 million in the first nine months of 2010, an increase of Php332 million, or 204%, as compared with Php163 million in the same period in 2009.

### **Liquidity and Capital Resources**

The following table shows our consolidated cash flows for the nine months ended September 30, 2010 and 2009 as well as our consolidated capitalization and other consolidated selected financial data as at September 30, 2010 and December 31, 2009:

|   | <b>Nine Months Ended September 30,</b> |                     |
|---|--|---------------------|
|   | <b>2010</b>                            | <b>2009</b>         |
|   | (Unaudited)                            |                     |
| <b>(in millions)</b>  |  |                     |
| <b>Cash Flows</b>   |  |                     |
| Net cash provided by operating activities   | Php54,026                              | Php56,326           |
| Net cash used in investing activities   | 15,502                                 | 36,157              |
| <i>Capital expenditures</i>   | <i>16,923</i>                          | <i>18,064</i>       |
| Net cash used in financing activities   | 49,676                                 | 26,797              |
| Net decrease in cash and cash equivalents   | 11,417                                 | 6,747               |
|   | <b>September 30,</b>                   | <b>December 31,</b> |
|   | <b>2010</b>                            | <b>2009</b>         |
|   | (Unaudited)                            | (Audited)           |
| <b>(in millions)</b>  |  |                     |
| <b>Capitalization</b>   |  |                     |
| Long-term portion of interest-bearing financial liabilities – net of current portion: |  |                     |
| Long-term debt  | Php80,773                              | Php86,066           |
| Obligations under finance lease   | 9                                      | 13                  |
|   | <u>80,782</u>                          | <u>86,079</u>       |
| Current portion of interest-bearing financial liabilities:                            |  |                     |
| Notes payable   | –                                      | 2,279               |
| Long-term debt maturing within one year   | 12,687                                 | 10,384              |
| Obligations under finance lease maturing within one year                              | 33                                     | 51                  |
|   | <u>12,720</u>                          | <u>12,714</u>       |
| Total interest-bearing financial liabilities  | 93,502                                 | 98,793              |
| Total equity attributable to equity holders of PLDT                                   | 88,690                                 | 98,575              |
|   | <u>Php182,192</u>                      | <u>Php197,368</u>   |
| <b>Other Selected Financial Data</b>  |  |                     |
| Total assets  | Php265,096                             | Php280,148          |
| Property, plant and equipment   | 158,033                                | 161,256             |
| Cash and cash equivalents   | 26,902                                 | 38,319              |
| Short-term investments  | 3,366                                  | 3,824               |

As at September 30, 2010, our consolidated cash and cash equivalents and short-term investments totaled Php30,268 million. Principal sources of consolidated cash and cash equivalents in the first nine months of 2010 were cash flows from operating activities amounting to Php54,026 million, net proceeds from maturity of short-term investments of Php445 million, proceeds from availment of long-term debt of Php7,246 million and interest received of Php929 million. These funds were used principally for: (1) dividend payments of Php40,947 million; (2) capital outlays of Php16,923 million; (3) total debt principal and interest payments of Php10,732 million and Php4,124 million, respectively; and (4) settlement of derivative financial instruments of Php969 million.

### ***Operating Activities***

Our consolidated net cash flows from operating activities in the first nine months of 2010 decreased by Php2,300 million, or 4%, to Php54,026 million from Php56,326 million in the same period in 2009 primarily due to higher level of settlement of various payables, partially offset by higher collection of receivables.

A significant portion of our consolidated cash flow from operating activities is generated by our wireless service business, which accounted for 61% of our total service revenues in each of the first nine months of 2010 and 2009. Revenues from our fixed line and ICT businesses accounted for 32% and 7%, respectively, of our total service revenues in each of the first nine months of 2010 and 2009.

Cash flows from operating activities of our wireless business amounted to Php36,161 million in the first nine months of 2010, a decrease of Php7,865 million, or 18%, as compared with Php44,026 million in the same period in 2009. The decrease in our wireless business segment's cash flows from operating activities was a result of a higher level of outstanding receivables in the first nine months of 2010, mainly from dealers, carriers and subscribers, LTIP payout in 2010 and a higher net settlement of other payables in the first nine of 2010. Likewise, cash flows from operating activities of our ICT business decreased by Php54 million, or 5%, to Php1,102 million in the first nine months of 2010 from Php1,156 million in the same period in 2009 mainly due to higher working capital requirements in the first nine months of 2010. On the other hand, cash flows provided by operating activities of our fixed line business amounted to Php16,776 million in the first nine months of 2010, an increase of Php5,635 million, or 51%, as compared with Php11,141 million in the same period in 2009 primarily due to higher collection of accounts receivables and absence of pension contributions made to the beneficial trust fund, partially offset by LTIP payout in 2010 and higher level of settlement of other current liabilities in the first nine months of 2010.

### ***Investing Activities***

Consolidated net cash used in investing activities amounted to Php15,502 million in the first nine months of 2010, a decrease of Php20,655 million, or 57%, as compared with Php36,157 million in the same period in 2009 primarily due to the combined effects of the following: (1) lower purchase of investment in subsidiaries and associates of Php25,632 million; (2) decrease in capital expenditures by Php1,141 million in the first nine months of 2010; (3) higher dividends received in 2010 of Php437 million, as discussed below; (4) lower net proceeds from the maturity of short-term investments by Php4,750 million; (5) lower net proceeds of investments in debt securities by Php836 million; (6) lower proceeds from disposal of fixed assets of Php612 million; and (7) lower interest received of Php265 million.

Our consolidated capital expenditures in the first nine months of 2010 totaled Php16,923 million, a decrease of Php1,141 million, or 6%, as compared with Php18,064 million in the same period in 2009 primarily due to decreases in PLDT's and Smart's capital spending. PLDT's capital spending of Php7,144 million in the first nine months of 2010 was principally used to finance the expansion and upgrade of its domestic fiber optic network facilities, NGN roll-out, fixed line data and IP-based

network services and outside plant rehabilitation. Smart's capital spending of Php9,123 million in the first nine months of 2010 was used primarily to build a secondary network for unlimited services, expand its 3G broadband network, and to further upgrade its core, access and transmission network facilities. ePLDT and its subsidiaries' capital spending of Php508 million in the first nine months of 2010 was primarily used to fund the continued expansion of its customer relationship management facilities. The balance represented other subsidiaries' capital spending.

As part of our growth strategy, we may from time to time, continue to make acquisitions and investments in companies or businesses.

Dividends received in the first nine months of 2010 amounted to Php445 million, an increase of Php437 million, as compared with Php8 million in the same period in 2009. The dividends received in the first nine months of 2010 were mainly from Meralco, Philweb, Inc. and ePDS, Inc. amounting to Php393 million, Php33 million and Php19 million, respectively, while the dividends received in the first nine months of 2009 were mainly from ePDS, Inc. and Meralco amounting to Php5 million and Php3 million, respectively.

### ***Financing Activities***

On a consolidated basis, net cash used in financing activities amounted to Php49,676 million in the first nine months of 2010, an increase of Php22,879 million, or 85%, as compared with Php26,797 million in the same period in 2009 resulting largely from the combined effects of the following: (1) lower proceeds from the issuance of long-term debt and notes payable by Php26,743 million in the first nine months of 2010; (2) lower net proceeds of capital expenditures under long-term financing by Php885 million; (3) higher cash dividend payments by Php1,753 million; (4) higher interest payments by Php376 million; (5) lower repayments of long-term debt and notes payable by Php4,468 million; (6) lower share buyback in the first nine months of 2010 by Php1,723 million; and (7) lower settlement of derivative financial instruments by Php668 million.

#### ***Debt Financing***

Our consolidated long-term debt decreased by Php2,990 million to Php93,460 million in the first nine months of 2010 mainly due to debt amortizations and prepayments partially offset by proceeds from the availing of long-term debt during the period. Total long-term debt of PLDT and Smart decreased by 5% and less than 1% to Php51,101 million and Php42,235 million, respectively, as at September 30, 2010 as compared with December 31, 2009.

On July 13, 2010, PLDT issued Php2,500 million five-year fixed rate corporate notes under a Notes Facility Agreement dated July 12, 2010 to mature on July 13, 2015. Proceeds from the facility will be used to finance capital expenditures and/or to refinance its loan obligations which were also used to finance capital expenditures for network expansion and improvement.

On July 13, 2010, Smart issued Php2,500 million five-year fixed rate corporate notes under a Notes Facility Agreement dated July 12, 2010 to mature on July 13, 2015. Proceeds from the facility will be used to finance Smart's capital expenditures for network improvement and expansion.

Approximately Php46,643 million principal amount of our consolidated outstanding long-term debt as at September 30, 2010 is scheduled to mature over the period from 2010 to 2013. Of this amount, Php26,345 million is attributable to Smart, Php20,174 million to PLDT, and the remainder to ePLDT.

For a complete discussion of our long-term debt, see *Note 20 – Interest-bearing Financial Liabilities – Long-term Debt* of the accompanying unaudited consolidated financial statements.

#### *Debt Covenants*

Our consolidated debt instruments contain restrictive covenants, including covenants that 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. Furthermore, certain of PLDT's debt instruments contain provisions wherein PLDT may be required to repurchase or prepay certain indebtedness in case of a change in control of PLDT.

Please see *Note 20 – Interest-bearing Financial Liabilities – Debt Covenants* of the accompanying unaudited consolidated financial statements for a detailed discussion of our debt covenants.

#### *Financing Requirements*

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

Consolidated cash dividend payments in the first nine months of 2010 amounted to Php40,947 million as compared with Php39,194 million paid to shareholders in the same period in 2009. On August 3, 2010, we declared a regular cash dividend of Php78 per share, representing an approximately 70% payout of our 2010 core earnings per share as at June 30, 2010. On August 4, 2009, we declared a regular cash dividend of Php77 per share and on March 2, 2010, we declared regular and special cash dividends of Php76 and Php65 per share, respectively, representing in aggregate approximately a 100% payout of our 2009 core earnings per share.

#### **Off-Statement of Financial Position Arrangements**

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

#### **Equity Financing**

PLDT raised Php12 million from the exercise by certain officers and executives of stock options in the first nine months of 2009. In addition, through our subscriber investment plan which provides postpaid fixed line subscribers the opportunity to buy shares of our 10% Cumulative Convertible Preferred Stock as part of the upfront payments collected from subscribers, PLDT raised Php2 million in each of the first nine months of 2010 and 2009 from this source.

As part of our goal to maximize returns to our shareholders, we obtained in 2008 an approval from the Board of Directors to conduct a share buyback program for up to five million PLDT common shares. As at September 30, 2010 and December 31, 2009, we had acquired a total of approximately 2.7 million shares of PLDT's common stock at a weighted average price of Php2,387 per share for a total consideration of Php6,405 million. Please see to *Note 8 – Earnings Per Common Share*, *Note 19 – Equity* and *Note 28 – Financial Assets and Liabilities* of the accompanying unaudited consolidated financial statements for further details.

## **Contractual Obligations and Commercial Commitments**

### *Contractual Obligations*

For a discussion of our consolidated contractual undiscounted obligations, see *Note 26 – Contractual Obligations and Commercial Commitments* of the accompanying unaudited consolidated financial statements.

### *Commercial Commitments*

As at September 30, 2010 and December 31, 2009, our outstanding consolidated commercial commitments, in the form of letters of credit, amounted to Php229 million and Php1,317 million, respectively. 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 currency exchange risk, interest rate risk, credit risk and capital management. The importance of managing these risks has significantly increased in light of considerable change and continuing volatility in both the Philippine and international financial markets. With a view to managing these risks, we have incorporated financial risk management functions in our organization, particularly in our treasury operations, equity issues and sales of certain assets.

For further discussions of these risks, see *Note 26 – Contractual Obligations and Commercial Commitments* and *Note 28 – Financial Assets and Liabilities* of the accompanying unaudited consolidated financial statements.

The following table sets forth the estimated consolidated fair values of our financial assets and liabilities recognized as at September 30, 2010 and June 30, 2010:

|   | Fair Values        |                   |
|---|--------------------|-------------------|
|   | September 30, 2010 | June 30, 2010     |
|   | (Unaudited)        |                   |
| <b>(in millions)</b>                                      |                    |                   |
| <b>Noncurrent Financial Assets</b>                        |                    |                   |
| Available-for-sale financial assets                       |                    |                   |
| Listed equity securities                                  | Php76              | Php67             |
| Unlisted equity securities                                | 64                 | 63                |
| Investments in debt securities                            | 493                | 485               |
| Advances and refundable deposits – net of current portion | 873                | 928               |
| Total noncurrent financial assets                         | 1,506              | 1,543             |
| <b>Current Financial Assets</b>                           |                    |                   |
| Cash and cash equivalents                                 | 26,902             | 28,878            |
| Short-term investments                                    | 3,366              | 698               |
| Investment in debt securities                             | 405                | –                 |
| Trade and other receivables - net                         | 15,171             | 15,415            |
| Derivative financial assets                               | 9                  | 5                 |
| Current portion of advances and refundable deposits       | 16                 | 16                |
| Total current financial assets                            | 45,869             | 45,012            |
| <b>Total Financial Assets</b>                             | <b>Php47,375</b>   | <b>Php46,555</b>  |
| <b>Noncurrent Financial Liabilities</b>                   |                    |                   |
| Interest-bearing financial liabilities                    | Php86,145          | Php86,731         |
| Derivative financial liabilities                          | 2,366              | 1,361             |
| Customers' deposits                                       | 1,576              | 1,395             |
| Deferred credits and other noncurrent liabilities         | 10,705             | 10,753            |
| Total noncurrent financial liabilities                    | 100,792            | 100,240           |
| <b>Current Financial Liabilities</b>                      |                    |                   |
| Accounts payable  | 17,636             | 14,995            |
| Accrued expenses and other current liabilities            | 28,371             | 26,923            |
| Interest-bearing financial liabilities                    | 12,720             | 11,148            |
| Dividends payable   | 2,139              | 1,852             |
| Total current financial liabilities                       | 60,866             | 54,918            |
| <b>Total Financial Liabilities</b>                        | <b>Php161,658</b>  | <b>Php155,158</b> |

The following table sets forth the amount of consolidated gains (losses) recognized for the financial assets and liabilities for the nine months ended September 30, 2010 and the six months ended June 30, 2010:

|  | September 30, 2010 | June 30, 2010     |
|--|--------------------|-------------------|
|  | (Unaudited)        |                   |
| <b>(in millions)</b>                                     |                    |                   |
| <b>Profit and Loss</b>                                   |                    |                   |
| Interest income  | Php914             | Php612            |
| Gains (losses) on derivative financial instruments – net | (495)              | 934               |
| Accretion on financial liabilities – net                 | (885)              | (567)             |
| Interest on loans and other related items                | (4,668)            | (3,142)           |
| <b>Other Comprehensive Income</b>                        |                    |                   |
| Net gains on available-for-sale financial assets         | 20                 | 8                 |
|  | <b>(Php5,114)</b>  | <b>(Php2,155)</b> |

### 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. The average inflation rate in the Philippines in the first nine months of 2010 was 4.1% as compared with 3.4% in the same period in 2009. We expect inflation to be steady until the end of the year.



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## PART II – OTHER INFORMATION

### *Reorganization of ePLDT*

On July 7, 2010, our Board of Directors approved the reorganization of the ePLDT Group into two business groups: (i) the ICT business group which provides data center services, internet and online gaming services and business solutions and applications; and (ii) the BPO business group which would cover customer relationship management or call center operations under SPi CRM and Content Solutions, Medical Billing and Coding and Medical Transcription services under SPi Technologies, Inc., or SPi. The BPO business group would be eventually transferred to PLDT subject to finalization of the terms and conditions thereof and execution of relevant agreements.

### *Transfer of PCEV's Equity Interest in Meralco*

On March 1, 2010, PCEV, Metro Pacific Investments Corporation, or MPIC, and Beacon Electric Asset Holdings, Inc., or Beacon, entered into an Omnibus Agreement, or OA. Beacon, formerly known as Rightlight Holdings, Inc., was organized with the sole purpose of holding the respective shareholdings in Meralco of PCEV and MPIC. PCEV and MPIC are Philippine affiliates of First Pacific and both held equity shares in Meralco, see *Note 10 – Investments in Associates and Joint Ventures* to the accompanying unaudited consolidated financial statements for further discussion. Under the OA, PCEV and MPIC have agreed to set out their mutual agreement in respect of, among other matters, the capitalization, organization, conduct of business and the extent of their participation in the management of the affairs of Beacon.

### *Investment in Beacon*

Prior to the transactions contemplated under the OA, MPIC beneficially owned the entire outstanding capital stock of Beacon consisting of 25,000 common shares of Beacon, with a total par value of Php25,000.

On April 29, 2010, the Philippine SEC approved Beacon's application to increase its authorized capital stock to Php5 billion consisting of 3 billion common shares with par value of Php1 per share and 2 billion preferred shares with par value of Php1 per share. The preferred shares of Beacon are non-voting, not convertible to common shares or any shares of any class of Beacon, have no pre-emptive rights to subscribe to any share or convertible debt securities or warrants issued or sold by Beacon. The preference shareholder is entitled to liquidation preference and yearly cumulative dividends at the rate of 7% of the issue value subject to: (a) availability of unrestricted retained earnings; and (b) dividend payment restrictions imposed by Beacon's bank creditors.

Under the OA, each of PCEV and MPIC agreed to subscribe to 1,156.5 million common shares of Beacon, for a subscription price of Php20 per share or a total of Php23,130 million. PCEV and MPIC also agreed that their resulting equity after such subscriptions and PCEV's purchase from MPIC of 12,500 Beacon common shares will be 50% each of the outstanding common shares of Beacon.

MPIC additionally agreed to subscribe to 801 million shares of Beacon's preferred stock for a subscription price of Php10 per share or a total of Php8,010 million.

The completion of the subscription of MPIC to 1,156.5 million common shares and 801 million preferred shares of Beacon was subject to the following conditions, all of which have been satisfied: (a) approval of MPIC's Board of Directors, which was obtained on March 1, 2010; (b) approval of the shareholders of First Pacific, which was obtained on March 30, 2010; and (c) full payment of the subscription price, which was made on March 30, 2010. Consequently, on March 30, 2010, MPIC completed its subscription to 1,156.5 million common shares of Beacon and approximately 801 million preferred shares of Beacon in consideration of: (1) the transfer of 163.6 million Meralco shares at a price of Php150 per share, or Php24,540 million in the aggregate; and (2) Php6,600 million in cash, as further described below in "Transfer of Meralco Shares to Beacon".

The completion of the subscription of PCEV to 1,156.5 million common shares of Beacon was subject to the following conditions, all of which have been satisfied: (a) PCEV Board of Directors' approval, which was obtained on March 1, 2010; (b) the approval of the shareholders of First Pacific, which was obtained on March 30, 2010; (c) the approval of the shareholders of PCEV, which was obtained on May 7, 2010; and (d) the full payment of the subscription price, which was made on May 12, 2010.

Although PCEV secured the approval of its shareholders only on May 7, 2010, such approval was deemed to be a formality as Smart owns 99.5% of PCEV's capital stock. Consequently, upon receipt of all other required approvals under the OA on March 30, 2010, including that of the shareholders of First Pacific, PCEV recognized as an asset the deposit for future stock subscription of Php23,130 million for its subscription to 1,156.5 million common shares of Beacon. The deposit for future stock subscription was eventually reclassified to investment account when Beacon's increase in authorized capital stock was approved by the Philippine SEC.

The subscription price of PCEV's and MPIC's subscription to Beacon shares was offset in full (in the case of PCEV) and in part (in the case of MPIC) against the consideration for the transfer of Meralco shares held by PCEV and MPIC as described in "Transfer of Meralco Shares to Beacon" section below. In addition, MPIC settled its remaining balance in cash. On May 12, 2010, PCEV also completed the purchase from MPIC of 12,500 shares or 50% of the 25,000 Beacon common shares originally owned by MPIC.

#### *Transfer of Meralco Shares to Beacon*

Alongside with the subscription to the Beacon shares described above, Beacon agreed to purchase 154.2 million and 163.6 million Meralco shares, or the Transferred Shares, from PCEV and MPIC, respectively, for a consideration of Php150 per share or a total of Php23,130 million for the PCEV Meralco shares and Php24,540 million for the MPIC Meralco shares.

The completion of the sale of the MPIC Meralco shares to Beacon was subject to the following conditions, all of which have been satisfied: (a) approval of MPIC's Board of Directors, which was obtained on March 1, 2010; (b) approval of the Board of Directors of First Pacific, which was obtained on March 1, 2010; (c) approval of the shareholders of First Pacific, which was obtained on March 30, 2010; and (d) release of the pledge over the MPIC Meralco shares, which was completed on March 30, 2010. Consequently, on March 30, 2010, MPIC transferred 163.6 million Meralco shares to Beacon at a price of Php150 per share for a total consideration of Php24,540 million.

The completion of the sale of the PCEV Meralco shares to Beacon was subject to the following conditions, all of which have been satisfied: (a) PCEV Board of Directors' approval, which was obtained on March 1, 2010; (b) the approval of the Board of Directors of First Pacific, which was obtained on March 1, 2010; (c) the approval of the shareholders of First Pacific, which was obtained on March 30, 2010; and (d) the approval of the shareholders of PCEV, which was obtained on May 7, 2010. Consequently, on May 12, 2010, PCEV transferred 154.2 million Meralco shares to Beacon at a price of Php150 per share for a total consideration of Php23,130 million.

The transfer of legal title to the Meralco shares was implemented through a special block sale/cross sale in the Philippine Stock Exchange.

Although PCEV secured the approval of its shareholders only on May 7, 2010, such approval was deemed to be a formality as Smart owns 99.5% of PCEV's capital stock. Consequently, upon receipt of all other required approvals under the OA on March 30, 2010, including that of the shareholders of First Pacific, PCEV recognized a Php15,084 million investment (initially recognized as deposit for future stock subscription, see discussion above) in Beacon representing the proportionate carrying cost of the 154.2 million Meralco shares transferred to Beacon under the OA. PCEV recognized a deferred gain of Php8,046 million for the difference between the Php23,130 million transfer price of the Meralco shares to Beacon and the Php15,084 million carrying amount in PCEV's books of the Meralco shares transferred. The deferred gain, presented as a reduction in PCEV's investment in Beacon, will only be realized upon the disposal of the investment to a third party.

Subject to rights over certain property dividends that may be declared or distributed in respect of the approximately 317.8 million Transferred Shares, which will be assigned to First Philippine Holdings Corporation, or FPHC, if the Call Option (as discussed below), is exercised, the rights, title and interest transferred to Beacon by MPIC and PCEV in respect of the approximately 317.8 million Transferred Shares includes: (a) all shares issued by Meralco by way of stock dividends on the Transferred Shares from March 1, 2010; (b) all property or cash dividends declared or paid on the Transferred Shares from March 1, 2010; (c) all other rights accruing on the Transferred Shares from March 1, 2010; and (d) the proceeds of all of the foregoing.

PCEV may, at some future time and under such terms and conditions as may be agreed by PCEV and Beacon, transfer to Beacon its remaining 68.8 million Meralco common shares.

#### *Call Option*

Under the OA, MPIC assigned its right to acquire the call option, or the Call Option, over 74.7 million common shares of Meralco held by FPHC, or the Option Shares, to Beacon. As a result of this assignment, Beacon and FPHC executed an Option Agreement dated March 1, 2010 pursuant to which FPHC granted the Call Option over the Option Shares to Beacon.

The Call Option was exercisable at the option of Beacon during the period from March 15, 2010 until midnight of May 15, 2010. The exercise price for the Option Shares was Php300 per share or an aggregate exercise price of Php22,410 million.

Beacon exercised the Call Option on March 30, 2010 and FPHC transferred the 74.7 million shares of Meralco common stock to Beacon in consideration of the payment by Beacon of Php22,410 million in cash on March 30, 2010.

Subject to rights over certain property dividends that may be declared or payable in respect of the 74.7 million shares of Meralco common stock, which are retained by FPHC following the Call Option exercise, the rights, title and interest transferred to Beacon by FPHC in respect of the Option Shares includes: (a) all shares issued by Meralco by way of stock dividends on the Option Shares from March 1, 2010; (b) all property or cash dividends declared or paid on the Transferred Shares from March 1, 2010; (c) all other rights accruing on the Transferred Shares from March 1, 2010; and (d) the proceeds of any sale or disposition of any of the foregoing.

#### *Property Dividends*

With respect to the approximately 317.8 million Transferred Shares, the remaining 68.8 million Meralco common shares held by PCEV and the 74.7 million Option Shares transferred by FPHC to Beacon pursuant to the Call Option, FPHC has the benefit of being assigned, or retaining in the case of the Option Shares, certain property dividends that may be declared on such shares.

#### *Governance Arrangements*

Beacon, PCEV and MPIC have also agreed on certain corporate governance matters, including Board composition, election of officers, shareholders' action, representation to the Meralco Board, nomination of the Meralco Board Committees, and nomination of Meralco officers. The corporate governance agreements and Beacon equity structure resulted in a jointly-controlled entity.

On March 30, 2010, Beacon also entered into an Php18,000 million ten-year corporate notes facility with First Metro Investment Corporation and PNB Capital and Investment Corporation as joint lead arrangers and various local financial institutions as noteholders. The proceeds of the notes facility partially financed the acquisition of Meralco shares by Beacon pursuant to its exercise of the Call Option. As at September 30, 2010, the amount drawn under this facility amounted to Php16,200 million (Php16,022 million, net of debt issuance cost of Php178 million); the remaining undrawn balance amounted to Php1,800 million.

As at September 30, 2010, Beacon held 393 million Meralco common shares representing approximately 35% equity interest in Meralco with market value of Php88,425 million based on a quoted price of Php225 per share.

#### **Related Party Transactions**

For a detailed discussion of the related party transactions, see *Note 24 – Related Party Transactions* of the accompanying unaudited consolidated financial statements.

**ANNEX – AGING OF ACCOUNTS RECEIVABLE**

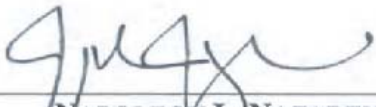
The following table shows the aging of our consolidated receivables as at September 30, 2010:

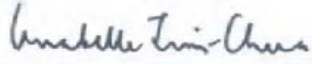
| <b>Type of Accounts Receivable</b>          | <b>Total</b>            | <b>Current</b>  | <b>31–60<br/>Days</b> | <b>61–90<br/>Days</b> | <b>Over 91<br/>Days</b> |
|---|-------------------------|-----------------|-----------------------|-----------------------|-------------------------|
| <b>(In Millions)</b>                        |                         |                 |                       |                       |                         |
| Corporate subscribers .....                 | Php8,692                | Php2,002        | Php972                | Php316                | Php5,402                |
| Retail subscribers .....                    | 8,587                   | 1,914           | 1,722                 | 659                   | 4,292                   |
| Foreign administrations .....               | 4,105                   | 1,347           | 1,224                 | 356                   | 1,178                   |
| Domestic carriers.....                      | 2,095                   | 151             | 174                   | 171                   | 1,599                   |
| Dealers, agents and others .....            | 4,868                   | 4,233           | 60                    | 50                    | 525                     |
| <b>Total</b>                                | <b>Php28,347</b>        | <b>Php9,647</b> | <b>Php4,152</b>       | <b>Php1,552</b>       | <b>Php12,996</b>        |
| Less: Allowance for doubtful accounts ..... | <u>13,176</u>           |                 |                       |                       |                         |
| <b>Total Receivables - net .....</b>        | <b><u>Php15,171</u></b> |                 |                       |                       |                         |

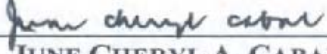
**SIGNATURES**

Pursuant to the requirements of the Securities Regulation Code, the registrant has duly caused this report for the first nine months of 2010 to be signed on its behalf by the undersigned thereunto duly authorized.

Registrant: **PHILIPPINE LONG DISTANCE TELEPHONE COMPANY**

Signature and Title:   
\_\_\_\_\_  
**NAPOLEON L. NAZARENO**  
President and Chief Executive Officer

Signature and Title:   
\_\_\_\_\_  
**ANABELLE LIM-CHUA**  
Senior Vice President and Treasurer  
(Principal Financial Officer)

Signature and Title:   
\_\_\_\_\_  
**JUNE CHERYL A. CABAL**  
First Vice President and Controller  
(Principal Accounting Officer)

Date: November 4, 2010



**PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED FINANCIAL STATEMENTS**

AS AT SEPTEMBER 30, 2010 (UNAUDITED) AND DECEMBER 31, 2009 (AUDITED)  
AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

**PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**  
**(in million pesos, except par value and number of shares)**

|  | September 30,<br>2010 | December 31,<br>2009 |
|--|-----------------------|----------------------|
|  | (Unaudited)           | (Audited)            |
| <b><u>ASSETS</u></b>   |                       |                      |
| <b>Noncurrent Assets</b>   |                       |                      |
| Property, plant and equipment – net (Notes 3, 5, 9, 20 and 28)   | 158,033               | 161,256              |
| Investments in associates and joint ventures (Notes 3, 4, 5, 10 and 28)  | 23,303                | 22,233               |
| Available-for-sale financial assets (Notes 6 and 28)   | 140                   | 134                  |
| Investment in debt securities (Notes 11 and 28) – net of current portion   | 478                   | 462                  |
| Investment properties (Notes 3, 9, 12 and 28)  | 1,098                 | 1,210                |
| Goodwill and intangible assets (Notes 3, 13, 14, 21 and 28)  | 12,402                | 13,024               |
| Deferred income tax assets – net (Notes 3, 4, 7 and 28)  | 6,401                 | 7,721                |
| Prepayments – net of current portion (Notes 3, 5, 18, 25, 26 and 28)   | 8,863                 | 8,663                |
| Advances and refundable deposits – net of current portion (Note 28)  | 1,206                 | 1,102                |
| <b>Total Noncurrent Assets</b>   | <b>211,924</b>        | <b>215,805</b>       |
| <b>Current Assets</b>  |                       |                      |
| Cash and cash equivalents (Notes 15 and 28)  | 26,902                | 38,319               |
| Short-term investments (Note 28)   | 3,366                 | 3,824                |
| Current portion of investment in debt securities (Notes 11 and 28)   | 405                   | –                    |
| Trade and other receivables – net (Notes 3, 5, 16, 24 and 28)  | 15,171                | 14,729               |
| Inventories and supplies (Notes 3, 4, 5, 17 and 28)  | 2,230                 | 2,165                |
| Derivative financial assets (Note 28)  | 9                     | 6                    |
| Current portion of prepayments (Notes 18 and 28)   | 4,897                 | 5,098                |
| Current portion of advances and refundable deposits (Note 28)  | 192                   | 202                  |
| <b>Total Current Assets</b>  | <b>53,172</b>         | <b>64,343</b>        |
| <b>TOTAL ASSETS</b>  | <b>265,096</b>        | <b>280,148</b>       |
| <b><u>EQUITY AND LIABILITIES</u></b>   |                       |                      |
| <b>Equity</b>  |                       |                      |
| Preferred stock, Php10 par value per share, authorized - 822,500,000 shares;<br>issued and outstanding - 441,738,582 shares as at September 30, 2010 and<br>441,631,062 shares as at December 31, 2009 (Notes 8, 19 and 28)  | 4,417                 | 4,416                |
| Common stock, Php5 par value per share, authorized - 234,000,000 shares;<br>issued - 189,480,477 shares and outstanding - 186,797,521 shares as at<br>September 30, 2010; and issued - 189,480,260 shares and outstanding -<br>186,797,304 shares as at December 31, 2009 (Notes 8, 19 and 28) | 947                   | 947                  |
| Treasury stock - 2,682,956 shares as at September 30, 2010 and December 31, 2009<br>(Notes 8, 19 and 28)   | (6,405)               | (6,405)              |
| Capital in excess of par value (Note 13)   | 62,891                | 62,890               |
| Retained earnings (Notes 8 and 19)   | 28,445                | 37,744               |
| Other comprehensive income (Note 6)  | (1,605)               | (1,017)              |
| <b>Total Equity Attributable to Equity Holders of PLDT</b>   | <b>88,690</b>         | <b>98,575</b>        |
| Non-controlling interests  | 405                   | 550                  |
| <b>TOTAL EQUITY</b>  | <b>89,095</b>         | <b>99,125</b>        |



**PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION *(continued)***  
**(in million pesos, except par value and number of shares)**

|  | September 30,<br>2010 | December 31,<br>2009 |
|--|-----------------------|----------------------|
|  | <b>(Unaudited)</b>    | <b>(Audited)</b>     |
| <b>Noncurrent Liabilities</b>  |                       |                      |
| Interest-bearing financial liabilities – net of current portion<br>(Notes 3, 4, 5, 9, 20, 23, 26 and 28) | <b>80,782</b>         | 86,079               |
| Deferred income tax liabilities – net (Notes 3, 4, 7 and 28)   | <b>1,604</b>          | 1,321                |
| Derivative financial liabilities (Notes 26 and 28)   | <b>2,366</b>          | 2,751                |
| Pension and other employee benefits (Notes 3, 5, 23, 25, 26 and 28)                                      | <b>1,468</b>          | 374                  |
| Customers' deposits (Notes 26 and 28)  | <b>2,221</b>          | 2,166                |
| Deferred credits and other noncurrent liabilities (Notes 3, 9, 13, 14, 21, 23 and 28)                    | <b>13,447</b>         | 14,438               |
| <b>Total Noncurrent Liabilities</b>  | <b>101,888</b>        | 107,129              |
| <b>Current Liabilities</b>   |                       |                      |
| Accounts payable (Notes 22, 24, 26 and 28)   | <b>19,626</b>         | 19,601               |
| Accrued expenses and other current liabilities<br>(Notes 3, 10, 13, 20, 21, 23, 24, 25, 26, 27 and 28)   | <b>35,161</b>         | 35,446               |
| Provision for assessments (Notes 3, 26, 27 and 28)   | <b>1,555</b>          | 1,555                |
| Current portion of interest-bearing financial liabilities (Notes 3, 4, 5, 9, 20, 23, 26 and 28)          | <b>12,720</b>         | 12,714               |
| Dividends payable (Notes 19, 26 and 28)  | <b>2,139</b>          | 1,749                |
| Income tax payable (Notes 7 and 28)  | <b>2,912</b>          | 2,829                |
| <b>Total Current Liabilities</b>   | <b>74,113</b>         | 73,894               |
| <b>TOTAL LIABILITIES</b>   | <b>176,001</b>        | 181,023              |
| <b>TOTAL EQUITY AND LIABILITIES</b>  | <b>265,096</b>        | 280,148              |

*See accompanying Notes to Consolidated Financial Statements.*

**PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**  
(in million pesos, except earnings per common share amounts)

|   | Nine Months Ended<br>September 30, |                | Three Months Ended<br>September 30, |               |
|---|------------------------------------|----------------|-------------------------------------|---------------|
|   | 2010                               | 2009           | 2010                                | 2009          |
|   | (Unaudited)                        |                |                                     |               |
| <b>REVENUES</b>   |                                    |                |                                     |               |
| Service revenues (Notes 3 and 4)  | 106,716                            | 108,277        | 34,560                              | 35,406        |
| Non-service revenues (Notes 3, 4 and 5)   | 1,556                              | 1,693          | 505                                 | 486           |
|   | <b>108,272</b>                     | <b>109,970</b> | <b>35,065</b>                       | <b>35,892</b> |
| <b>EXPENSES</b>   |                                    |                |                                     |               |
| Depreciation and amortization (Notes 3, 4 and 9)                                  | 19,953                             | 19,266         | 6,899                               | 6,133         |
| Compensation and employee benefits (Notes 3, 5 and 25)                            | 16,834                             | 17,149         | 5,587                               | 5,606         |
| Repairs and maintenance (Notes 12, 17 and 24)                                     | 6,723                              | 6,238          | 2,211                               | 1,992         |
| Selling and promotions  | 3,855                              | 4,263          | 1,188                               | 1,424         |
| Cost of sales (Notes 5, 17, 24 and 26)  | 3,561                              | 3,871          | 1,172                               | 1,308         |
| Professional and other contracted services (Note 24)                              | 3,408                              | 2,795          | 1,106                               | 701           |
| Rent (Notes 3 and 26)   | 3,386                              | 3,011          | 1,213                               | 961           |
| Taxes and licenses (Note 27)  | 2,015                              | 1,994          | 712                                 | 620           |
| Asset impairment (Notes 3, 4, 5, 9, 10, 16, 17 and 28)                            | 1,534                              | 3,221          | 314                                 | 2,268         |
| Communication, training and travel  | 1,321                              | 1,343          | 474                                 | 438           |
| Insurance and security services (Note 24)   | 909                                | 926            | 356                                 | 284           |
| Amortization of intangible assets (Notes 3 and 14)                                | 268                                | 281            | 90                                  | 94            |
| Other expenses (Note 24)  | 1,149                              | 1,157          | 293                                 | 368           |
|   | <b>64,916</b>                      | <b>65,515</b>  | <b>21,615</b>                       | <b>22,197</b> |
|   | <b>43,356</b>                      | <b>44,455</b>  | <b>13,450</b>                       | <b>13,695</b> |
| <b>OTHER INCOME (EXPENSES)</b>  |                                    |                |                                     |               |
| Foreign exchange gains – net (Notes 4, 9 and 28)                                  | 1,667                              | 232            | 1,726                               | 524           |
| Equity share in net earnings of associates and joint ventures<br>(Notes 4 and 10) | 1,419                              | 311            | 538                                 | 375           |
| Interest income (Notes 4 and 5)   | 914                                | 1,291          | 302                                 | 392           |
| Gains (losses) on derivative financial instruments – net (Notes 4 and 28)         | (495)                              | (534)          | (1,429)                             | 1,097         |
| Financing costs – net (Notes 4, 5, 9, 20 and 28)                                  | (5,051)                            | (4,753)        | (1,600)                             | (1,636)       |
| Other income  | 1,222                              | 901            | 668                                 | 185           |
|   | <b>(324)</b>                       | <b>(2,552)</b> | <b>205</b>                          | <b>937</b>    |
| <b>INCOME BEFORE INCOME TAX</b> (Note 4)  | <b>43,032</b>                      | <b>41,903</b>  | <b>13,655</b>                       | <b>14,632</b> |
| <b>PROVISION FOR INCOME TAX</b> (Notes 3, 4 and 7)                                | <b>10,974</b>                      | <b>11,219</b>  | <b>3,218</b>                        | <b>4,219</b>  |
| <b>NET INCOME FOR THE PERIOD</b> (Note 4)   | <b>32,058</b>                      | <b>30,684</b>  | <b>10,437</b>                       | <b>10,413</b> |
| <b>ATTRIBUTABLE TO:</b>   |                                    |                |                                     |               |
| Equity holders of PLDT (Notes 4, 6 and 8)   | 31,988                             | 30,018         | 10,309                              | 10,298        |
| Non-controlling interests (Note 4)  | 70                                 | 666            | 128                                 | 115           |
|   | <b>32,058</b>                      | <b>30,684</b>  | <b>10,437</b>                       | <b>10,413</b> |
| <b>Earnings Per Share For The Period Attributable to Common Equity</b>            |                                    |                |                                     |               |
| <b>Holders of PLDT</b> (Note 8)   |                                    |                |                                     |               |
| Basic   | 169.38                             | 158.70         | 54.55                               | 54.48         |
| Diluted   | 169.38                             | 158.68         | 54.61                               | 54.48         |

*See accompanying Notes to Consolidated Financial Statements.*

**PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(in million pesos)

|  | Nine Months Ended<br>September 30, |        | Three Months Ended<br>September 30, |        |
|--|------------------------------------|--------|-------------------------------------|--------|
|  | 2010                               | 2009   | 2010                                | 2009   |
|  | (Unaudited)                        |        |                                     |        |
| <b>NET INCOME FOR THE PERIOD</b> (Note 4)                      | <b>32,058</b>                      | 30,684 | <b>10,437</b>                       | 10,413 |
| <b>OTHER COMPREHENSIVE INCOME</b> (Note 6)                     |                                    |        |                                     |        |
| Net gains on available-for-sale financial assets:              |                                    |        |                                     |        |
| Gains from changes in fair value recognized during the period  | 19                                 | 1      | 12                                  | 3      |
| Losses removed from other comprehensive income taken to income | 17                                 | 1      | 12                                  | 3      |
| Foreign currency translation differences of subsidiaries       | 2                                  | -      | -                                   | -      |
| Total Other Comprehensive Income                               | (773)                              | (274)  | (849)                               | (120)  |
| <b>TOTAL COMPREHENSIVE INCOME FOR THE PERIOD</b>               | <b>31,304</b>                      | 30,411 | <b>9,600</b>                        | 10,296 |
| <b>ATTRIBUTABLE TO:</b>  |                                    |        |                                     |        |
| Equity holders of PLDT   | 31,400                             | 29,748 | 9,636                               | 10,190 |
| Non-controlling interests                                      | (96)                               | 663    | (36)                                | 106    |
|  | <b>31,304</b>                      | 30,411 | <b>9,600</b>                        | 10,296 |

*See accompanying Notes to Consolidated Financial Statements.*

**PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**  
(in million pesos)

|   | Preferred Stock | Common Stock | Treasury Stock | Stock Options Issued | Capital in Excess of Par Value | Retained Earnings | Other Comprehensive Income | Total Equity Attributable to Equity Holders of PLDT | Non-controlling Interests | Total Equity   |
|---|-----------------|--------------|----------------|----------------------|--------------------------------|-------------------|----------------------------|---|---------------------------|----------------|
| <b>Balances as at January 1, 2009</b>                         | <b>4,415</b>    | <b>947</b>   | <b>(4,973)</b> | <b>6</b>             | <b>68,337</b>                  | <b>37,177</b>     | <b>(378)</b>               | <b>105,531</b>                                      | <b>1,438</b>              | <b>106,969</b> |
| Total comprehensive income for the period (Notes 4, 6 and 8): |                 |              |                |                      |                                |                   |                            |   |                           |                |
| Net income for the period (Notes 4 and 8)                     | -               | -            | -              | -                    | -                              | 30,018            | (270)                      | 29,748  | 663                       | 30,411         |
| Other comprehensive income (Note 6)                           | -               | -            | -              | -                    | -                              | -                 | (270)                      | (270)   | (3)                       | (273)          |
| Cash dividends (Note 19)                                      | -               | -            | -              | -                    | -                              | (39,136)          | -                          | (39,136)  | (436)                     | (39,572)       |
| Issuance of capital stock – net of conversion (Note 19)       | -               | -            | -              | -                    | 4                              | -                 | -                          | 4   | -                         | 4              |
| Exercised option shares (Note 25)                             | -               | -            | -              | (5)                  | 17                             | -                 | -                          | 12  | -                         | 12             |
| Acquisition of treasury stocks (Notes 2, 8, 19 and 25)        | -               | -            | (1,431)        | -                    | -                              | -                 | -                          | (1,431)   | (1,436)                   | (2,867)        |
| Business combinations and others (Note 13)                    | -               | -            | -              | -                    | (5,479)                        | -                 | -                          | (5,479)   | 693                       | (4,786)        |
| <b>Balances as at September 30, 2009 (Unaudited)</b>          | <b>4,415</b>    | <b>947</b>   | <b>(6,404)</b> | <b>1</b>             | <b>62,879</b>                  | <b>28,059</b>     | <b>(648)</b>               | <b>89,249</b>                                       | <b>922</b>                | <b>90,171</b>  |
| <b>Balances as at January 1, 2010</b>                         | <b>4,416</b>    | <b>947</b>   | <b>(6,405)</b> | <b>-</b>             | <b>62,890</b>                  | <b>37,744</b>     | <b>(1,017)</b>             | <b>98,575</b>                                       | <b>550</b>                | <b>99,125</b>  |
| Total comprehensive income for the period (Notes 4, 6 and 8): |                 |              |                |                      |                                |                   |                            |   |                           |                |
| Net income for the period (Notes 4 and 8)                     | -               | -            | -              | -                    | -                              | 31,988            | (588)                      | 31,400  | (96)                      | 31,304         |
| Other comprehensive income (Note 6)                           | -               | -            | -              | -                    | -                              | -                 | (588)                      | (588)   | (166)                     | (754)          |
| Cash dividends (Note 19)                                      | -               | -            | -              | -                    | -                              | (41,287)          | -                          | (41,287)  | (50)                      | (41,337)       |
| Issuance of capital stock – net of conversion (Note 19)       | 1               | -            | -              | -                    | 1                              | -                 | -                          | 2   | -                         | 2              |
| Acquisition of treasury stocks (Note 2)                       | -               | -            | -              | -                    | -                              | -                 | -                          | -   | (6)                       | (6)            |
| Business combinations and others (Note 13)                    | -               | -            | -              | -                    | -                              | -                 | -                          | -   | 7                         | 7              |
| <b>Balances as at September 30, 2010 (Unaudited)</b>          | <b>4,417</b>    | <b>947</b>   | <b>(6,405)</b> | <b>-</b>             | <b>62,891</b>                  | <b>28,445</b>     | <b>(1,605)</b>             | <b>88,690</b>                                       | <b>405</b>                | <b>89,095</b>  |

*See accompanying Notes to Consolidated Financial Statements.*

**PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in million pesos)

|   | Nine Months Ended September 30, |          |
|---|---------------------------------|----------|
|   | 2010                            | 2009     |
|   | (Unaudited)                     |          |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                                 |          |
| Income before income tax (Note 4)   | 43,032                          | 41,903   |
| Adjustments for:  |                                 |          |
| Depreciation and amortization (Notes 3, 4 and 9)  | 19,953                          | 19,266   |
| Interest on loans and other related items – net (Notes 4, 5, 9, 20 and 28)              | 4,130                           | 3,865    |
| Asset impairment (Notes 3, 4, 5, 9, 10, 14, 16, 17 and 28)                              | 1,534                           | 3,221    |
| Incentive plans (Notes 3, 5 and 25)   | 1,061                           | 1,320    |
| Accretion on financial liabilities – net (Notes 5, 20 and 28)                           | 885                             | 778      |
| Losses on derivative financial instruments – net (Notes 4 and 28)                       | 495                             | 534      |
| Amortization of intangible assets (Notes 3 and 14)                                      | 268                             | 281      |
| Pension benefit costs (Notes 3, 5 and 25)   | 197                             | 1,001    |
| Losses (gains) on disposal of property, plant and equipment (Note 9)                    | (552)                           | 93       |
| Interest income (Notes 4 and 5)   | (914)                           | (1,291)  |
| Equity share in net earnings of associates and joint ventures (Notes 4 and 10)          | (1,419)                         | (311)    |
| Foreign exchange gains – net (Notes 4, 9 and 28)  | (1,667)                         | (232)    |
| Others  | (144)                           | (245)    |
| Operating income before changes in assets and liabilities                               | 66,859                          | 70,183   |
| Decrease (increase) in:   |                                 |          |
| Trade and other receivables   | (2,322)                         | (8,514)  |
| Inventories and supplies  | 96                              | (358)    |
| Prepayments   | (350)                           | (1,278)  |
| Advances and refundable deposits  | (27)                            | 287      |
| Increase (decrease) in:   |                                 |          |
| Accounts payable  | 195                             | 1,157    |
| Accrued expenses and other current liabilities  | 3,031                           | 5,974    |
| Pension and other employee benefits   | (4,579)                         | (488)    |
| Customers' deposits   | 55                              | 22       |
| Other noncurrent liabilities  | 52                              | (70)     |
| Net cash generated from operations  | 63,010                          | 66,915   |
| Income taxes paid   | (8,984)                         | (10,589) |
| Net cash provided by operating activities   | 54,026                          | 56,326   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                                 |          |
| Proceeds from:  |                                 |          |
| Maturity of short-term investments  | 3,565                           | 8,808    |
| Disposal of property, plant and equipment (Note 9)                                      | 123                             | 735      |
| Disposal of investment properties (Note 12)   | 36                              | 12       |
| Disposal of available-for-sale financial assets   | 10                              | –        |
| Redemption of investment in debt securities   | –                               | 4,005    |
| Interest received   | 929                             | 1,194    |
| Dividends received  | 445                             | 8        |
| Payments for:   |                                 |          |
| Purchase of subsidiaries – net of cash acquired (Note 13)                               | (10)                            | (6,941)  |
| Acquisition of intangibles (Notes 13 and 14)  | (11)                            | (18)     |
| Purchase of investment in debt securities   | (403)                           | (3,572)  |
| Short-term investments  | (3,120)                         | (3,613)  |
| Purchase of investments in associates (Note 10)   | –                               | (18,701) |
| Interest paid – capitalized to property, plant and equipment (Notes 4, 5, 9, 20 and 28) | (538)                           | (528)    |
| Additions to property, plant and equipment (Notes 4 and 9)                              | (16,385)                        | (17,536) |
| Decrease in advances and refundable deposits  | (143)                           | (10)     |
| Net cash used in investing activities   | (15,502)                        | (36,157) |

**PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)**  
**(in million pesos)**

|   | Nine Months Ended September 30, |                 |
|---|---------------------------------|-----------------|
|   | 2010                            | 2009            |
|   | (Unaudited)                     |                 |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                 |                                 |                 |
| Proceeds from availment of long-term debt (Note 20)                         | 7,246                           | 31,989          |
| Availment of long-term financing for capital expenditures                   | 2,490                           | 7,551           |
| Proceeds from issuance of capital stock                                     | 2                               | 14              |
| Payments for acquisition of treasury shares (Notes 8, 19 and 28)            | (6)                             | (1,729)         |
| Payments of obligations under finance lease                                 | (29)                            | (21)            |
| Payments of debt issuance costs (Note 20)                                   | (112)                           | (151)           |
| Settlements of derivative financial instruments (Note 28)                   | (969)                           | (1,637)         |
| Payments of notes payable (Note 20)   | (2,274)                         | (270)           |
| Settlement of long-term financing for capital expenditures                  | (2,495)                         | (6,671)         |
| Interest paid – net of capitalized portion (Notes 5, 20 and 28)             | (4,124)                         | (3,748)         |
| Payments of long-term debt (Note 20)  | (8,458)                         | (14,930)        |
| Cash dividends paid (Note 19)   | (40,947)                        | (39,194)        |
| Proceeds from notes payable (Note 20)                                       | –                               | 2,000           |
| Net cash used in financing activities                                       | <b>(49,676)</b>                 | <b>(26,797)</b> |
| <b>EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b> | <b>(265)</b>                    | <b>(119)</b>    |
| <b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>                            | <b>(11,417)</b>                 | <b>(6,747)</b>  |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>                     | <b>38,319</b>                   | <b>33,684</b>   |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>                           | <b>26,902</b>                   | <b>26,937</b>   |

*See accompanying Notes to Consolidated Financial Statements.*

# PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 1. Corporate Information

The Philippine Long Distance Telephone Company, or PLDT, or Parent Company, was incorporated under the old Corporation Law of the Philippines (Act 1459, as amended) on November 28, 1928, following the merger of four telephone companies under common U.S. ownership. Under its amended Articles of Incorporation, PLDT's corporate term is currently limited through 2028. In 1967, effective control of PLDT was sold by the General Telephone and Electronics Corporation, then a major shareholder since PLDT's incorporation, to a group of Filipino businessmen. In 1981, in furtherance of the then existing policy of the Philippine government to integrate the Philippine telecommunications industry, PLDT purchased substantially all of the assets and liabilities of the Republic Telephone Company, which at that time was the second largest telephone company in the Philippines. In 1998, the First Pacific Company Limited, or First Pacific, through its Philippine and other affiliates, collectively the First Pacific Group, acquired a significant interest in PLDT. On March 24, 2000, NTT Communications Corporation, or NTT Communications, through its wholly-owned subsidiary NTT Communications Capital (UK) Ltd., or NTT-UK, became PLDT's strategic partner with approximately 15% economic and voting interest in the issued and outstanding common stock of PLDT at that time. Simultaneous with NTT Communications' investment in PLDT, the latter acquired 100% of Smart Communications, Inc., or Smart. On March 14, 2006, NTT DoCoMo, Inc., or NTT DoCoMo, acquired from NTT Communications approximately 7% of PLDT's then outstanding common shares held by NTT Communications with NTT Communications retaining ownership of approximately 7% of PLDT's common shares. Since March 14, 2006, NTT DoCoMo has made additional purchases of shares of PLDT and together with NTT Communications beneficially owned approximately 21% of PLDT's outstanding common stock as at September 30, 2010. NTT Communications and NTT DoCoMo are subsidiaries of NTT Holding Company. On February 28, 2007, Metro Pacific Asset Holdings, Inc., a Philippine affiliate of First Pacific, completed the acquisition of an approximately 46% interest in Philippine Telecommunications Investment Corporation, or PTIC, a shareholder of PLDT. This investment in PTIC represents an attributable interest of approximately 6% of the then outstanding common shares of PLDT and thereby raised First Pacific Group's beneficial ownership to approximately 28% of PLDT's outstanding common stock as at that date. First Pacific Group had beneficial ownership of approximately 26% in PLDT's outstanding common stock as at September 30, 2010.

The common shares of PLDT are listed and traded on the Philippine Stock Exchange, or PSE. On October 19, 1994, an American Depositary Receipt, or ADR, facility was established, pursuant to which Citibank N.A., as the depository, issued ADRs evidencing American Depositary Shares, or ADSs, with each ADS representing one PLDT common share with a par value of Php5 per share. Effective February 10, 2003, PLDT appointed JP Morgan Chase Bank as successor depository for PLDT's ADR facility. The ADSs are listed on the New York Stock Exchange, or NYSE, in the United States and are traded on the NYSE under the symbol "PHI". As at September 30, 2010, there were approximately 51 million ADSs outstanding.

PLDT and our Philippine-based fixed line and wireless subsidiaries operate under the jurisdiction of the Philippine National Telecommunications Commission, or NTC, which jurisdiction extends, among other things, to approving major services offered and certain rates charged to customers.

We are the leading telecommunications service provider in the Philippines. Through our principal business segments: wireless, fixed line and information and communications technology – we offer the largest and most diversified range of telecommunications services across the Philippines' most extensive fiber optic backbone and wireless, fixed line and satellite networks.

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

## 2. Summary of Significant Accounting Policies

### Basis of Preparation

Our consolidated financial statements have been prepared under the historical cost basis except for derivative financial instruments, available-for-sale financial assets and investment properties that have been measured at fair value.

Our 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, 2010 are not necessarily indicative of the results of operations that may be expected for the full year.

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

### Basis of Consolidation

Our unaudited consolidated financial statements include the financial statements of PLDT and the following subsidiaries (collectively, the "PLDT Group") as at September 30, 2010:

| Name of Subsidiary   | Place of Incorporation | Principal Business Activity   | Percentage of Ownership |          |
|--|------------------------|---|-------------------------|----------|
|  |                        |   | Direct                  | Indirect |
| <b>Wireless</b>  |                        |   |                         |          |
| Smart:   | Philippines            | Cellular mobile services  | 100.0                   | –        |
| Smart Broadband, Inc., or SBI, and Subsidiaries, or SBI Group  | Philippines            | Internet broadband distribution   | –                       | 100.0    |
| Primeworld Digital System, Inc., or PDSI   | Philippines            | Cellular and internet broadband distribution services   | –                       | 100.0    |
| I-Contacts Corporation, or I-Contacts  | Philippines            | Customer interaction solutions  | –                       | 100.0    |
| Wolfpac Mobile, Inc., or Wolfpac   | Philippines            | Mobile applications development and services  | –                       | 100.0    |
| Wireless Card, Inc., or WCI  | Philippines            | Promotion of the sale and/or patronage of debit and/or charge cards   | –                       | 100.0    |
| Smarthub, Inc., or SHI   | Philippines            | Development and sale of software, maintenance and support services  | –                       | 100.0    |
| Smart Money Holdings Corporation, or SMHC:   | Cayman Islands         | Investment company  | –                       | 100.0    |
| Smart Money, Inc., or SMI  | Cayman Islands         | Mobile commerce solutions marketing   | –                       | 100.0    |
| Telecoms Solutions, Inc., or TSI   | Mauritius              | Mobile commerce platforms   | –                       | 100.0    |
| Far East Capital Limited and Subsidiary  | Cayman Islands         | Cost effective offshore financing and risk management activities for Smart  | –                       | 100.0    |
| PH Communications Holdings Corporation, or PHC   | Philippines            | Investment company  | –                       | 100.0    |
| Francom Holdings, Inc., or FHI:  | Philippines            | Investment company  | –                       | 100.0    |
| Connectivity Unlimited Resource Enterprise, Inc., or CURE  | Philippines            | Cellular mobile services  | –                       | 100.0    |
| Chikka Holdings Limited, or Chikka, and Subsidiaries, or Chikka Group  | British Virgin Islands | Mobile applications development and services  | –                       | 100.0    |
| PLDT Communications and Energy Ventures, Inc., or PCEV, (formerly known as Pilipino Telephone Corporation, or Piltel) and Subsidiaries, or PCEV Group* | Philippines            | Investment company  | –                       | 99.5     |
| SmartConnect Holdings Pte. Ltd., or SCH:   | Singapore              | Investment company  | –                       | 100.0    |
| SmartConnect Global Pte. Ltd., or SGP  | Singapore              | International trade of satellites and Global System for Mobile Communication, or GSM, enabled global telecommunications | –                       | 100.0    |
| 3rd Brand Pte. Ltd., or 3rd Brand  | Singapore              | Solutions and systems integration services  | –                       | 85.0     |
| Blue Ocean Wireless, or BOW  | Isle of Man            | Delivery of GSM communication capability for the maritime sector  | –                       | 51.0     |
| 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                    | –        |
| <b>Fixed Line</b>  |                        |   |                         |          |
| PLDT Clark Telecom, Inc., or ClarkTel  | Philippines            | Telecommunications services   | 100.0                   | –        |
| PLDT Subic Telecom, Inc., or SubicTel  | Philippines            | Telecommunications services   | 100.0                   | –        |
| PLDT Global Corporation, or PLDT Global, and Subsidiaries, or PLDT Global Group  | British Virgin Islands | Telecommunications services   | 100.0                   | –        |
| Smart-NTT Multimedia, Inc., or SNMI  | Philippines            | Data and network services   | 100.0                   | –        |



| Name of Subsidiary   | Place of Incorporation | Principal Business Activity   | Percentage of Ownership |          |
|--|------------------------|---|-------------------------|----------|
|  |                        |   | Direct                  | Indirect |
| PLDT-Philcom, Inc. (formerly known as Philcom Corporation), or Philcom, and Subsidiaries, or Philcom Group | Philippines            | Telecommunications services   | 100.0                   | –        |
| PLDT-Maratel, Inc., or Maratel   | Philippines            | Telecommunications services   | 97.8                    | –        |
| Bonifacio Communications Corporation, or BCC   | Philippines            | Telecommunications, infrastructure and related value-added services, or VAS   | 75.0                    | –        |
| <b>Information and Communications Technology, or ICT</b>   |                        |   |                         |          |
| ePLDT, Inc., or ePLDT:   | Philippines            | Information and communications infrastructure for Internet-based services, e-commerce, customer interaction solutions and IT-related services | 100.0                   | –        |
| SPi Technologies, Inc., or SPi, and Subsidiaries, or SPi Group   | Philippines            | Knowledge processing solutions  | –                       | 100.0    |
| SPi CRM, Inc., or SPi CRM (formerly ePLDT Ventus, Inc.)**  | Philippines            | Customer interaction solutions  | –                       | 100.0    |
| Infocom Technologies, Inc., or Infocom   | Philippines            | Internet access services  | –                       | 99.6     |
| BayanTrade, Inc. (formerly BayanTrade Dotcom, Inc.), or BayanTrade, and Subsidiaries, or BayanTrade Group  | Philippines            | Internet-based purchasing, IT consulting and professional services  | –                       | 93.5     |
| Digital Paradise, Inc., or Digital Paradise  | Philippines            | Internet access services  | –                       | 75.0     |
| netGames, Inc., or netGames  | Philippines            | Publisher of online games   | –                       | 57.8     |
| Level Up! (Philippines), Inc., or Level Up!  | Philippines            | Publisher of online games   | –                       | 57.8     |

\* On August 17, 2009, Smart acquired the cellular mobile telephone business of PCEV.

\*\*On April 8, 2010, SPi CRM, Parlance Systems, Inc., or Parlance, and Vocativ Systems, Inc., or Vocativ, were merged wherein SPi CRM became the surviving entity.

### ***Basis of Consolidation***

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the PLDT Group obtains control, and continue to be consolidated until the date that such control ceases.

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

Non-controlling interest shares in losses even if the losses exceed the non-controlling equity interest in the subsidiary.

A change in the ownership interest of a subsidiary, without loss of control, is accounted for as an equity transaction.

If the PLDT Group loses control over a subsidiary, it: (a) derecognizes the assets (including goodwill) and liabilities of the subsidiary; (b) derecognizes the carrying amount of any non-controlling interest; (c) derecognizes the cumulative translation differences recorded in equity; (d) recognizes the fair value of the consideration received; (e) recognizes the fair value of any investment retained; (f) recognizes any surplus or deficit in profit or loss; and (g) reclassifies the parent's share of components previously recognized in other comprehensive income to profit or loss.

### **PCEV's Share Buyback Program**

PCEV's Board of Directors approved three share buyback programs during its meetings on November 3, 2008, March 2, 2009 and August 3, 2009. For all three programs, the buyback was done through the trading facilities of the PSE via open market purchases, block trades or other modes subject to compliance with applicable laws, rules and regulations. Number of shares approved for repurchase under the buyback programs were 58 million, 25 million and 61.5 million for the programs approved on November 3, 2008, March 2, 2009 and August 3, 2009, respectively. The program approved on November 3, 2008 was completed in January 2009 at a total cost of Php403 million, while the program approved on March 2, 2009 was completed in March 2009 at a total cost of Php188 million. The program approved on August 3, 2009 is still ongoing and will continue until the number of shares earmarked for the program has been fully repurchased or until such time as PCEV's Board of Directors determines otherwise. The most recent share buyback program was undertaken to accommodate minority

shareholders who may not have had the opportunity to participate in the tender offer of Smart due to various constraints. The maximum price under this program is Php8.50 per share. As at September 30, 2010, approximately 3.6 million shares at a cost of Php29.8 million have been repurchased under the third buyback program.

As at September 30, 2010 and December 31, 2009, cumulative shares repurchased under the share buyback programs totaled approximately 86.6 million and 85.8 million at an aggregate cost of Php620 million and Php614 million, respectively, which reduced the amount of non-controlling interests for the same amount.

### **Reorganization of ePLDT**

On July 7, 2010, our Board of Directors approved the reorganization of the ePLDT Group into two business groups: (i) the ICT business group which provides data center services, internet and online gaming services and business solutions and applications; and (ii) the BPO business group which would cover customer relationship management or call center operations under SPi CRM and Content Solutions, Medical Billing and Coding and Medical Transcription services under SPi. The BPO business group would be eventually transferred to PLDT subject to finalization of the terms and conditions thereof and execution of relevant agreements.

### **Corporate Merger of Vocativ, Parlance and SPi CRM**

On June 26, 2009, ePLDT's Board of Directors approved the plan for merger of its wholly-owned subsidiaries, Vocativ and Parlance, as the absorbed companies, and SPi CRM, as the surviving entity. The Articles and Plan of Merger was approved by the Philippine Securities and Exchange Commission, or Philippine SEC, on April 8, 2010. The merger did not have any impact on the consolidated financial statements of PLDT Group.

### **Statement of Compliance**

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

### **Changes in Accounting Policies and Disclosures**

Our accounting policies are consistent with those of the previous financial year except for the adoption of the following amendments and improvements to existing PFRSs and new interpretation as at January 1, 2010:

- *Amendment to PFRS 2, Share-based Payment;*
- *Improvements to PFRS 5, Noncurrent Assets Held-for-Sale and Discontinued Operations;*
- *Amendment to Philippine Accounting Standards, or PAS 39, Financial Instruments: Recognition and Measurement – Eligible Hedged Items;*
- *Philippine Interpretation IFRIC 17, Distributions of Non-Cash Assets to Owners; and*
- *Improvements to PFRSs (2009)*

Our adoption of such amendments and improvements to existing PFRSs and new interpretation did not have any effect on our financial position and performance.

The changes introduced by such amendments and improvements are as follows:

***Amendment to PFRS 2, Share-based Payment.*** The amendments clarify how an individual subsidiary in a group should account for share-based payment arrangements in its own financial statements. It further states that an entity that receives goods or services in a share-based payment arrangement must account for these goods or services no matter which entity in the group settles the transaction, and regardless of whether the transaction is equity-settled or cash-settled.

***Improvements to PFRS 5, Noncurrent Assets Held-for-Sale and Discontinued Operations.*** When a subsidiary is held for sale, all of its assets and liabilities will be classified as held-for-sale under PFRS 5, even when the entity retains a non-controlling interest in the subsidiary after the sale.

***Amendment to PAS 39, Financial Instruments: Recognition and Measurement – Eligible Hedged Items.***

Amendment to *PAS 39* addresses the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. The amendment clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as a hedged item.

***Philippine Interpretation IFRIC 17, Distributions of Non-Cash Assets to Owners.*** This interpretation provides guidance on non-reciprocal distribution of assets by an entity to its owners acting in their capacity as owners, including distributions of non-cash assets and those giving the shareholders a choice of receiving non-cash assets or cash, provided that: (a) all owners of the same class of equity instruments are treated equally; and (b) the non-cash assets distributed are not ultimately controlled by the same party or parties both before and after the distribution, and as such, excluding transactions under common control.

**Improvements to PFRSs**

The Financial Reporting Standards Council, or FRSC, approved in its meeting in May 2009 the adoption of Improvements to International Financial Reporting Standards, or IFRSs, issued by the International Accounting Standards Board, or IASB, in April 2009. There are separate transitional provisions for each standard which are all effective beginning January 1, 2010.

- ***PFRS 2, Share-based Payment.*** The amendment clarifies that the contribution of a business on formation of a joint venture and combinations under common control are not within the scope of *PFRS 2* even though they are out of scope of Revised *PFRS 3*.
- ***PFRS 5, Noncurrent Assets Held-for-Sale and Discontinued Operations.*** The amendment clarifies that the disclosures required in respect of noncurrent assets or disposal groups classified as held for sale or discontinued operations are only those set out in *PFRS 5*. The disclosure requirements of other PFRSs only apply if specifically required for such noncurrent assets or discontinued operations.

It also clarifies that the general requirements of *PAS 1, Presentation of Financial Statements*, still apply, particularly paragraphs 15 (to achieve fair presentation) and 125 (sources of estimation and uncertainty) of *PAS 1*.

- ***PFRS 8, Operating Segments.*** The amendment clarifies that segment assets and liabilities need only be reported when those assets and liabilities are included in measures that are used by the chief operating decision maker.
- ***PAS 1, Presentation of Financial Statements.*** The terms of a liability that could result, at anytime, in its settlement by the issuance of equity instruments at the option of the counterparty do not affect its classification.
- ***PAS 7, Statement of Cash Flows.*** The amendment explicitly states that only expenditure that results in a recognized asset can be classified as a cash flow from investing activities.
- ***PAS 17, Leases.*** The amendment removes the specific guidance on classifying land as lease so that only the general guidance remains.
- ***PAS 36, Impairment of Assets.*** The amendment clarifies that the largest unit permitted for allocating goodwill acquired in a business combination is the operating segment, as defined in *PFRS 8*, before aggregation for reporting purposes.
- ***PAS 38, Intangible Assets.*** The amendment clarifies that if an intangible asset acquired in a business combination is identifiable only with another intangible asset, the acquirer may recognize the group of intangible assets as a single asset provided the individual assets have similar useful lives. It also clarifies that the valuation techniques presented for determining the fair value of intangible assets acquired in a business combination that are not traded in active markets are only examples and are not restrictive on the methods that can be used.

- ***PAS 39, Financial Instruments: Recognition and Measurement.*** The amendment clarifies that a prepayment option is considered closely related to the host contract when the exercise price of a prepayment option reimburses the lender up to the approximate present value of lost interest for the remaining term of the host contract. The amendment also clarifies that the scope exemption for contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date, applies only to binding forward contracts, and not derivative contracts where further actions by either party are still to be taken. It also clarifies that gains or losses on cash flow hedges of a forecast transaction that subsequently results in the recognition of a financial instrument or on cash flow hedges of recognized financial instruments should be reclassified in the period that the hedged forecast cash flows affect profit or loss.
- ***Philippine Interpretation IFRIC 9, Reassessment of Embedded Derivatives.*** The improvement clarifies that it does not apply to possible reassessment, at the date of acquisition, to embedded derivatives in contracts acquired in a combination between entities or businesses under common control or the formation of a joint venture.
- ***Philippine Interpretation IFRIC 16, Hedges of a Net Investment in a Foreign Operation.*** The improvement states that, in a hedge of a net investment in a foreign operation, qualifying hedging instruments may be held by any entity or entities within the group, including the foreign operation itself, as long as the designation, documentation and effectiveness requirements of *PAS 39* that relate to a net investment hedge, are satisfied.

The adoption of amendments and improvements to existing PFRSs and a new interpretation that require retrospective restatement had no impact on our comparative consolidated financial statements.

## **Significant Accounting Policies**

### ***Business Combinations and Goodwill***

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value, and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer has the option to measure the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred.

When we acquire a business, we assess the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquirer's previously held equity interest in the acquiree is remeasured to fair value as at the acquisition date through profit and loss.

Any contingent consideration to be transferred by the acquirer will be recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability will be recognized in accordance with *PAS 39* and charged to profit or loss. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity.

Goodwill is initially measured at cost being the excess of the consideration transferred over the fair values of net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss.

After 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 that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill forms part of a cash-generating unit 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.

Business combinations involving entities under common control are accounted for by applying the pooling of interest method. The assets and liabilities of the combining entities are reflected at their carrying amounts reported in the consolidated financial statements of the controlling holding company. Any difference between the consideration paid and the share capital of the “acquired” entity is reflected within equity as capital in excess of par value. The income statement reflects the results of the combining entities for the full year, irrespective of when the combination takes place. Comparatives are presented as if the entities had always been combined since the date the entities were under common control.

### ***Investments in Associates***

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

Under the equity method, an investment in an associate is carried in our consolidated statement of financial position 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 nor individually tested for impairment. Our consolidated income statement reflects our share in the results of operations of our associates. Where there has been a change recognized directly in the equity of the associate, we recognize our share in such change and disclose this, when applicable, in our consolidated statement of comprehensive income and changes in equity. Unrealized gains and losses resulting from our transactions with and among our associates are eliminated to the extent of our interest in those associates.

Our share in the profit and losses of our associates is shown on the face of our consolidated income statement. This is the profit or losses attributable to equity holders of the associate and therefore is profit or losses after tax and net of non-controlling interest in the subsidiaries of the associates.

Our reporting dates and that of our associates are identical and our associates’ accounting policies conform to those used by us for like transactions and events in similar circumstances. Where necessary, adjustments are made to bring such accounting policies in line with those of PLDT Group.

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

Upon loss of significant influence over the associate, we measure and recognize any retaining investment at its fair value. Any difference between the carrying amounts of our investment in the associate upon loss of significant influence, and the fair value of the remaining investment and proceeds from disposal, is recognized in profit or loss.

### ***Investments in Joint Ventures***

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

Adjustments are made in our consolidated financial statements to eliminate our share of unrealized gains and losses on transactions between PLDT and our jointly controlled entity. The joint venture is carried at equity method until the date on which we cease to have joint control over the jointly controlled entity.

Upon loss of joint control and provided the former jointly controlled entity does not become a subsidiary or associate, we measure and recognize our remaining investment at fair value. Any difference between the carrying amount of the former jointly controlled entity upon loss of joint control, and the fair value of the remaining investment and proceeds from disposal, is recognized in profit or loss. When the remaining investment constitutes significant influence, it is accounted for as investment in an associate.

### ***Foreign Currency Transactions and Translations***

Our consolidated financial statements are presented in Philippine peso, which is also the Parent Company's functional currency. The Philippine peso is the currency of the primary economic environment in which we operate. This is also the currency that mainly influences the revenue from and cost of rendering products and services. Each entity in the PLDT Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

The functional and presentation currency of the entities under PLDT Group (except for SCH, SGP, 3rd Brand, BOW, SMHC, SMI, TSI, Mabuhay Satellite, PLDT Global, SPi and certain of its subsidiaries, certain subsidiaries of Chikka, and certain subsidiaries of BayanTrade) is the Philippine peso.

Transactions in foreign currencies are initially recorded in the functional currency rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional closing rate of exchange prevailing at the end of the reporting period. All differences are recognized in our consolidated income statement except for foreign exchange differences that qualify as capitalizable borrowing costs for qualifying assets. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operation and translated at the closing rate.

The functional currency of SMHC, SMI, TSI, Mabuhay Satellite, PLDT Global, SPi and certain of its subsidiaries, and certain subsidiaries of Chikka is the U.S. dollar; and Singapore dollar for SCH, SGP, 3rd Brand, BOW, and certain subsidiaries of BayanTrade. As at the reporting date, the assets and liabilities of these subsidiaries are translated into Philippine peso at the rate of exchange prevailing at the end of the reporting period, and income and expenses of these subsidiaries are translated monthly using the weighted average exchange rate for the month. The exchange differences arising on translation are recognized as a separate component of other comprehensive income as cumulative translation adjustments. On disposal of these subsidiaries, the amount of deferred cumulative translation adjustments recognized in other comprehensive income relating to subsidiaries are recognized in our consolidated income statement.

Foreign exchange gains or losses of PLDT and our Philippine-based subsidiaries are treated as taxable income or deductible expenses in the period such exchange gains or losses are realized.

### ***Financial Assets***

#### ***Initial recognition***

Financial assets are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. We determine the classification of financial assets at initial recognition and, where allowed and appropriate, reevaluate the designation of such assets at each financial year-end.

Financial assets are recognized initially at fair value plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way purchases) are recognized on the trade date, i.e., the date that we commit to purchase or sell the asset.

Our financial assets include cash and cash equivalents, short-term investments, trade and other receivables, quoted and unquoted equity and debt securities, advances and refundable deposits, and derivative financial assets.

#### *Subsequent measurement*

The subsequent measurement of financial assets depends on the classification as follows:

##### *Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss include financial assets held-for-trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held-for-trading if they are acquired for the purpose of selling in the near term. Derivative assets, including separated embedded derivatives are also classified as held-for-trading unless they are designated as effective hedging instruments. Financial assets at fair value through profit or loss are carried in our consolidated statement of financial position at fair value with gains or losses recognized in our consolidated income statement under “Gains (losses) on derivative financial instruments – net” for derivative instruments and “Other income” for non-derivative financial assets. Interest earned and dividends received from investment at fair value through profit or loss are recognized in our consolidated income statement under “Interest income” and “Other income”, respectively.

Financial assets may be designated at initial recognition as at fair value through profit or loss if any of the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on them on a different bases; (ii) the assets are part of a group of financial assets which are managed and their performance are evaluated on a fair value basis, in accordance with a documented risk management strategy and information about the company is provided internally on that basis to the entity’s key management personnel; or (iii) the financial assets contain one or more embedded derivatives that would need to be separately recorded.

Derivatives embedded in host contracts are accounted for as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value. These embedded derivatives are measured at fair value with gains or losses arising from changes in fair value recognized in our consolidated income statement. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

##### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments and are not quoted in an active market. Such financial assets are carried at amortized cost using the effective interest rate, or EIR, method. This method uses an EIR that exactly discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset. Gains and losses are recognized in our consolidated income statement when the loans and receivables are derecognized or impaired, as well as through the amortization process. Interest earned or incurred is recorded in “Interest income” in our consolidated income statement. Assets in this category are included in the current assets except for maturities greater than 12 months after the end of the reporting period, which are classified as noncurrent assets.

##### *Held-to-maturity investments*

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity when we have the positive intention and ability to hold it to maturity. After initial measurement, held-to-maturity investments are measured at amortized cost using the EIR method. Gains or losses are recognized in our consolidated income statement when the investments are derecognized or impaired, as well as through the amortization process. Interest earned or incurred is recorded in “Interest income” in our consolidated income statement. Assets in this category are included in the current assets except for maturities greater than 12 months after the end of the reporting period, which are classified as noncurrent assets.

### *Available-for-sale financial assets*

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. They are purchased and held indefinitely and may be sold in response to liquidity requirements or changes in market conditions. After initial measurement, available-for-sale financial assets are measured at fair value with unrealized gains or losses recognized in other comprehensive income account until the investment is derecognized, at which time the cumulative gain or loss recorded in other comprehensive income reserve account is recognized in our consolidated income statement; or determined to be impaired, at which time the cumulative loss recorded in other comprehensive income reserve account is recognized in our consolidated income statement. Interest earned on holding available-for-sale debt securities are included under “Interest income” using the EIR in our consolidated income statement. Dividends earned on holding available-for-sale equity investments are recognized in our consolidated income statement under “Other income” when the right of the payment has been established. These financial assets are included under noncurrent assets unless we intend to dispose of the investment within 12 months of the end of the reporting period.

### ***Financial Liabilities***

#### *Initial recognition*

Financial liabilities are classified as financial liabilities at fair value through profit or loss, other financial liabilities, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. We determine the classification of our financial liabilities at initial recognition.

Financial liabilities are recognized initially at fair value and in the case of other financial liabilities, inclusive of directly attributable transaction costs.

Our financial liabilities include accounts payable, accrued expenses and other current liabilities, interest-bearing financial liabilities, customers’ deposits, derivative financial liabilities, dividends payable, and accrual for long-term capital expenditures included under “Deferred credits and other noncurrent liabilities” account.

#### *Subsequent measurement*

The subsequent measurement of financial liabilities depends on their classification as follows:

#### *Financial liabilities at fair value through profit or loss*

Financial liabilities at fair value through profit or loss include financial liabilities held-for-trading and financial liabilities designated upon initial recognition at fair value through profit or loss. Financial liabilities are classified as held-for-trading if they are acquired for the purpose of repurchasing in the near term. Derivative liabilities, including separated embedded derivatives are also classified as held-for-trading unless they are designated as effective hedging instruments. Financial liabilities at fair value through profit and loss are carried in our consolidated statement of financial position at fair value with gains or losses recognized in our consolidated income statement under “Gains (losses) on derivative financial instruments – net” for derivative instruments and “Other income” for non-derivative financial liabilities.

Financial liabilities may be designated at initial recognition as at fair value through profit or loss if any of the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognizing gains or losses on them on a different bases; (ii) the liabilities are part of a group of financial liabilities which are managed and their performance are evaluated on a fair value basis, in accordance with a documented risk management strategy and information about the company is provided internally on that basis to the entity’s key management personnel; or (iii) the financial liabilities contain one or more embedded derivatives that would need to be separately recorded.

#### *Other financial liabilities*

After initial recognition, other financial liabilities are subsequently measured at amortized cost using the EIR method.



Gains and losses are recognized in our consolidated income statement when the liabilities are derecognized as well as through the EIR amortization process. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are integral part of the EIR. The EIR amortization is included under “Financing costs – net” in our consolidated income statement.

#### *Offsetting of financial instruments*

Financial assets and financial liabilities are offset and the net amount is reported in our consolidated statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

#### *Fair value of financial instruments*

The fair value of financial instruments that are actively traded in organized financial markets is determined by reference to quoted market prices at the close of business at the end of the reporting period. For financial instruments where there is no active market, fair value is determined using valuation techniques. Such techniques may include using recent arm’s length market transactions; reference to the current fair value of another instrument that is substantially the same; discounted cash flow analysis or other valuation models.

#### *Amortized cost of financial instruments*

Amortized cost is computed using the EIR method less any allowance for impairment and principal repayment or reduction. The calculation takes into account any premium or discount on acquisition and includes transaction costs and fees that are an integral part of EIR.

#### *“Day 1” difference*

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

#### ***Impairment of Financial Assets***

We assess at the end of each reporting period whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred “loss event”) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtor or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that the debtor will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

#### *Financial assets carried at amortized cost*

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial asset’s original EIR. If a financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR.

For financial assets carried at amortized cost, we first assess whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If we determine that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, we include the asset in a group of financial assets with similar credit risk characteristics and collectively assess them 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.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized under “Asset impairment” in our consolidated income statement. Interest income continues to be accrued on the reduced carrying amount based on the original EIR of the asset. The financial asset together with the associated allowance are written-off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to us. If, in a subsequent period, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. Any subsequent reversal of an impairment loss is recognized in our consolidated income statement, to the extent that the carrying value of the asset does not exceed its original amortized cost at the reversal date. If a future write-off is later recovered, the recovery is recognized in profit or loss.

#### *Available-for-sale financial assets*

For available-for-sale financial assets, we assess at the end of each reporting period whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale financial assets, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. When a decline in the fair value of an available-for-sale financial asset has been recognized in other comprehensive income reserve account and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized in other comprehensive income reserve account is reclassified from other comprehensive income reserve account to profit or loss as a reclassification adjustment even though the financial asset has not been derecognized. The amount of the cumulative loss that is reclassified from other comprehensive income account to profit or loss is the difference between the acquisition cost (net of any principal repayment and amortization) and current fair value, less any impairment loss on that financial asset previously recognized in profit or loss. Impairment losses recognized in profit or loss for an investment in an equity instrument are not reversed in profit or loss. Subsequent increases in the fair value after impairment are recognized directly in other comprehensive income account.

In the case of debt instruments classified as available-for-sale financial assets, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose of measuring impairment loss. Such accrual is recorded as part of “Interest income” in our consolidated income statement. If, in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in our consolidated income statement, the impairment loss is reversed in profit or loss.

#### ***Derecognition of Financial Assets and Liabilities***

##### *Financial assets*

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

When we have transferred the rights to receive cash flows from an asset or have entered into a “pass-through” arrangement, and have neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, a new 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 the consideration that we could be required to repay.

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

#### *Financial liabilities*

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

When 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 carrying amount of a financial liability extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognized in profit or loss.

#### ***Derivative Financial Instruments and Hedging***

##### *Initial recognition and subsequent measurement*

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 remeasured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial 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 “Gains (losses) on derivative financial instruments – net” in our consolidated income statement.

The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of long-term currency swaps, foreign currency options and interest rate swap contracts is determined using applicable valuation techniques. See *Note 28 – Financial Assets and Liabilities*.

For the purpose of hedge accounting, hedges are classified as: (1) fair value hedges when hedging the exposure to changes in the fair value of a recognized financial asset or liability or an unrecognized firm commitment (except for foreign-currency risk); or (2) cash flow hedges when hedging exposure to variability in cash flows that is neither attributable to a particular risk associated with a recognized financial asset or liability or a highly probable forecast transaction or the foreign-currency risk in an unrecognized firm commitment; or (3) hedges of a net investment in a foreign operation.

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

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

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

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

#### *Cash flow hedges*

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

Amounts taken to other comprehensive income are transferred to our consolidated income statement when the hedged transaction affects our consolidated income statement, 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 other comprehensive income 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 other comprehensive income are transferred to our consolidated income statement. 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 other comprehensive income remain in other comprehensive income until the forecast transaction or firm commitment occurs.

#### *Hedges of a net investment in a foreign operation*

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 in other comprehensive income while any gains or losses relating to the ineffective portion are recognized in our consolidated income statement. On disposal of the foreign operation, the cumulative value of any such gains or losses recognized in other comprehensive income is transferred to our consolidated income statement.

#### ***Property, Plant and Equipment***

Property, plant and equipment, except for land, is stated at cost less accumulated depreciation and amortization and any accumulated impairment losses. Cost includes the cost of replacing part of the property, plant and equipment when the cost is incurred, if the recognition criteria are met. Likewise, when a major inspection is performed, its cost is recognized in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are recognized in our consolidated income statement as incurred. The present value of the expected cost of the decommissioning of the asset after use is included in the cost of the respective assets if the recognition criteria for a provision are met. Land is stated at cost less any impairment in value.

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

Depreciation and amortization are calculated on a straight-line basis over the estimated useful lives of the assets. The estimated useful lives used in depreciating our property, plant and equipment are disclosed in *Note 9 – Property, Plant and Equipment*.

The asset's residual value, estimated useful life and depreciation and amortization method are reviewed at least at each financial year-end to ensure that the period 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, capitalizable borrowing costs and other direct costs. Property under construction is not depreciated until such time that the relevant assets are completed and available for its intended use.

### ***Borrowing Costs***

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

All other borrowing costs are expensed as incurred.

### ***Asset Retirement Obligations***

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

### ***Investment Properties***

Investment properties are initially measured at cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met and excludes the cost of day-to-day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at fair value, which have been determined based on the latest valuations performed by an independent firm of appraisers. Gains or losses arising from changes in the fair values of investment properties are included in our consolidated income statement in the period in which they arise. Where an entity is unable to determine the fair value of an investment properties under construction, but expects to be able to determine its fair value on completion, the investment under construction will be measured at cost until such time that fair value can be determined or construction is completed.

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

### ***Intangible Assets***

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

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

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 our consolidated income statement when the asset is derecognized.

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

### ***Research and Development Costs***

Research costs are expensed as incurred. Development expenditure on an individual project is recognized as an intangible asset when we can demonstrate: (1) the technical feasibility of completing the intangible asset so that it will be available for use or sale; (2) our intention to complete and our ability to use or sell the asset; (3) how the asset will generate future economic benefits; (4) the availability of resources to complete the asset; and (5) the ability to measure reliably the expenditure during development.

Following initial recognition of the development expenditure as an asset, the cost model is applied requiring the asset to be carried at cost less any accumulated amortization and accumulated impairment losses. Amortization of the asset begins when development is complete and the asset is available for use. It is amortized over the period of expected future benefit. During the period of development, the asset is tested for impairment annually.

### ***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 incurred in bringing each items of inventories and supplies to its present location are accounted using the weighted average method. Net realizable value is determined by either estimating the selling price in the ordinary course of the business less the estimated cost to sell or determining the prevailing replacement costs.

## ***Impairment of Non-Financial Assets***

### *Property, plant and equipment*

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 of an asset's or cash-generating unit's fair value less costs to sell or its value in use, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent from those of other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing the value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining the fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multipliers, quoted share prices for publicly traded subsidiaries or other available fair value indicators. Impairment losses of continuing operations are recognized in our consolidated income statement.

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 the recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If this is the case, the carrying amount of the asset is increased to its recoverable amount. The increase cannot exceed the carrying amount that would have been determined, net of depreciation and amortization, had no impairment loss been recognized for the asset in prior periods. Such reversal is recognized in our consolidated income statement. After such reversal, the depreciation and amortization charges are adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining economic useful life.

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

### *Goodwill*

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

If there is incomplete allocation of goodwill acquired in a business combination to cash generating units, or group of cash generating units, an impairment testing of goodwill is only carried out when impairment indicators exist. Where impairment indicators exist, impairment testing of goodwill is performed at a level at which the acquirer can reliably test for impairment.

### *Intangible assets*

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

### *Investments in associates and joint ventures*

We determine at the end of each reporting period whether there is any objective evidence that our investments in associates and joint ventures are impaired. If this is the case, the amount of impairment is calculated as the difference between the recoverable amount of the investments in associates and joint ventures, and its carrying amount. The amount of impairment loss is recognized in our consolidated income statement.

### ***Investment in Debt Securities***

Investment in debt securities are government securities which are carried at amortized cost using the EIR method. Interest earned from these securities is recognized as “Interest income” in our consolidated income statement.

### ***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 for which there is an insignificant risk of change in value.

### ***Short-term Investments***

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

### ***Trade and Other Receivables***

Trade and other receivables, categorized as loans and receivables, are recognized initially at fair value and subsequently measured at amortized cost using the EIR method, less provision for impairment.

A provision for impairment of trade and other receivables is established when there is objective evidence that we will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset’s carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in our consolidated income statement.

When a trade and other receivable is uncollectible, it is written-off against the allowance account for trade and other receivables. Subsequent recoveries of amounts previously written-off are recognized as income in our consolidated income statement.

### ***Revenue Recognition***

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

#### ***Service Revenues***

##### ***Subscriptions***

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



### *Air time, traffic and VAS*

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 calls terminating in their territories. Revenues related to products and VAS are recognized upon delivery of the product or service.

### *Knowledge processing solutions and customer interaction solutions*

Revenue is recognized when it is probable that the economic benefits associated with the transactions will flow to us and the amount of revenue can be measured reliably. Advance customer receipts that have not been recognized as revenue are recorded as advances from customers and presented as a liability in our consolidated statement of financial position. If the fee is not measurable, 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.

Our wireless segment operates two loyalty points programmes, one for *Smart Money* cardholders and another for subscribers of *Smart Gold*, *Smart Buddy* and *SmartBro*. The loyalty programme for *Smart Money* allows cardholders, upon enrollment, to accumulate points when they use their card for purchases, *Smart Load* payments, and reloads for Smart's prepaid cards, *SmartBro* prepaid Airtime and *Smart Money Cash Load*. The points for the programme can then be redeemed for airtime or load wallet. On the other hand, the loyalty programme for Smart's cellular and broadband subscribers allows postpaid subscribers to accumulate points for billed transactions and prepaid subscribers for reloads or top-ups and VAS, and international direct dialing usage and tenure in the network for both postpaid and prepaid subscribers. The points for the loyalty programme for the subscribers can then be redeemed, upon registration, for bill rebates, discounts on cellular phonekit purchases, on-network short messaging services or internet surf time. Redemption for both programmes are subject to a minimum number of points being required. Consideration received is allocated between the services sold and the points issued, with the consideration allocated to the points equal to their fair value. Fair value of the points is determined by applying statistical analysis. The fair value of the points issued are deferred and recognized as revenue when the points are redeemed.

### *Non-service Revenues*

#### *Handset and equipment sales*

Sale 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 EIR. The majority of interest income represents interest earned from cash and cash equivalents, short-term investments and investment in debt securities.

### *Expenses*

Expenses are recognized as incurred.

## ***Provisions***

We recognize provision when we have present obligation, legal or constructive, as a result of past event, 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 our consolidated income statement, net of any reimbursements. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as interest expense.

## ***Retirement Benefits***

### *Defined benefit pension plans*

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

The defined benefit asset or liability comprises the present value of the defined benefit obligation (using a discount rate based on government bonds), less past service cost and actuarial gains and losses not yet recognized, and less the fair value of plan assets out of which the obligations are to be settled directly. Plan assets are assets that are held by a long-term employee benefit fund and are not available to our creditors nor can they be paid directly to us. Fair value is based on market price information and in the case of quoted securities, it is the published bid price. The value of any defined benefit asset recognized is restricted to the sum of any past service cost and actuarial gains and losses not yet recognized, and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

### *Defined contribution plans*

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

## ***Other Long-Term Employee Benefits***

Our liabilities arising from 2010 to 2012 Long-term Incentive Plan, or 2010 to 2012 LTIP, are determined using the projected unit credit method. Employee benefit costs include current service cost, interest cost, actuarial gains and losses and past service costs. Past service costs and actuarial gains and losses are recognized immediately.

The long-term employee benefit liability comprises the present value of the defined benefit obligation (using a discount rate based on government bonds) at the end of the reporting period.

## ***Share-Based Payment Transactions***

### *Cash-settled transactions*

Our 2007 to 2009 LTIP grants share appreciation rights, or SARs, to our eligible key executives and advisors. Under the 2007 to 2009 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 our consolidated income statement for the period.

### ***Leases***

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at 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 of the lease only if one of the following applies: (a) there is a change in contractual terms, other than a renewal or extension of the agreement; (b) a renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term; (c) there is a change in the determination of whether the fulfillment is dependent on a specified asset; or (d) there is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios (a), (c) or (d) and the date of renewal or extension period for scenario (b).

*As a Lessor.* Leases where we retain substantially all the risks and benefits of ownership of the asset are classified as operating leases. Any initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same bases as rental income. Rental income is recognized in our consolidated income statement on a straight-line basis over the lease term.

All other leases are classified as finance leases. At the inception of the finance lease, the asset subject to lease agreement is derecognized and lease receivable is recognized. Interest income is accrued over the lease term.

*As a Lessee.* Leases where the lessor retains substantially all the risks and benefits of ownership of the assets are classified as operating leases. Operating lease payments are recognized as expense in our consolidated income statement on a straight-line basis over the lease term. All other leases are classified as finance leases.

A finance lease gives rise to the recognition of a leased asset and finance lease liability. 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. Interest expense is recognized over the lease term.

## ***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 end of the reporting period.

### *Deferred income tax*

Deferred income tax is provided using the balance sheet liability method on all temporary differences at the end of the reporting period 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 interest in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is possible that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognized for all deductible temporary differences, carryforward benefit of unused tax credits from excess minimum corporate income tax, or MCIT, over regular corporate income tax, or RCIT, and unused net operating loss carry over, or NOLCO, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carryforward benefit of unused tax credits and unused tax losses can be utilized except: (1) when the deferred income 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 income 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.

The carrying amount of deferred income tax assets is reviewed at the end of each reporting period 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 the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will allow the deferred income tax assets 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 end of the reporting period.

Deferred income tax relating to items recognized in other comprehensive income account is included in the statement of comprehensive income and not in our consolidated income statement.

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

### ***Contingencies***

Contingent liabilities are not recognized in our consolidated financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized in the consolidated financial statements but are disclosed in the notes to the consolidated financial statements when an inflow of economic benefits is probable.

### ***Events After the End of the Reporting Period***

Post quarter-end events that provide additional information about our financial position at the end of the reporting period (adjusting events) are reflected in the unaudited consolidated financial statements. Post quarter-end events that are not adjusting events are disclosed in the notes to the unaudited consolidated financial statements when material.

### ***Equity***

Preferred and common stocks are measured at par value for all shares issued. Incremental costs incurred directly attributable to the issuance of new shares are shown in equity as a deduction from proceeds, net of tax. Proceeds and/or fair value of considerations received in excess of par value are recognized as capital in excess of par value.

Treasury stocks are our own equity instruments which are reacquired and recognized at cost and presented as reduction in equity. No gain or loss is recognized in our consolidated income statement on the purchase, sale, reissuance or cancellation of our own equity instruments. Any difference between the carrying amount and the consideration upon reissuance or cancellation of shares is recognized as capital in excess of par value.

Change in the ownership interest of a subsidiary, without loss of control, is accounted for as an equity transaction and any impact is presented as part of capital in excess of par value.

Retained earnings represent our net accumulated earnings less cumulative dividends declared.

Other comprehensive income comprise items of income and expense, including reclassification adjustments, that are not recognized in profit or loss as required or permitted by other PFRS.

Non-controlling interests represent the equity interests in MKTC, DGCI, BOW, PCEV, Level Up!, Mabuhay Satellite, 3rd Brand, Maratel, BCC, Digital Paradise, netGames, Chikka, BayanTrade and Infocom not held directly by PLDT or indirectly through one of our subsidiary.

### **New Accounting Standards and Interpretations to Existing Standards Effective Subsequent to September 30, 2010**

We will adopt the following revised standards and interpretations enumerated below when these become effective. All of these standards have already been approved by the FRSC but has yet to be approved by the Board of Accountancy of the Professional Regulations Commission, with the exception of *Philippine Interpretation IFRIC 15, Agreements for Construction of Real Estate*. Except as otherwise indicated, we do not expect the adoption of these revised standards and amendments to PFRS to have a significant impact on our consolidated financial statements.

#### **Effective 2011**

***Revised PAS 24, Related Party Disclosures.*** The standard has been revised to simplify the identification of related party relationship and re-balance the extent of disclosures of transactions between related parties based on the costs to preparers and the benefits to users in having this information available in consolidated financial statements. Also, the revised standard provides a partial exemption from the disclosure requirements for government-related entities. This interpretation is applied retrospectively and is applicable for annual periods beginning on or after January 1, 2011.

***Amendment to PAS 32, Classification of Rights Issues.*** The definition of a financial liability in the standard has been amended to classify right issues (and certain options or warrants) as equity instruments if: (a) the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, and (b) the instruments are used to acquire fixed number of the entity's own equity instruments for a fixed amount in any currency. This standard is applied retrospectively and is applicable for annual periods beginning on or after February 1, 2010.

***Amendment to IFRIC 14, Prepayments of a Minimum Funding Requirement.*** The interpretation has been amended to permit an entity to treat the prepayment of a minimum funding requirement as an asset. The amendment should be applied to the beginning of the earliest period presented in the first financial statements in which the entity applied the original interpretation. This interpretation is applied retrospectively and is applicable for annual periods beginning on or after January 1, 2011.

***Philippine Interpretation IFRIC 19, Extinguishing Financial Liabilities with Equity Instrument.*** The interpretation clarifies that equity instruments issued to a creditor to extinguish a financial liability are consideration paid. As a result, the financial liability is derecognized and the equity instruments issued are treated as consideration paid to extinguish that financial liability. The interpretation states that equity instruments issued in a debt for equity swap should be measured at the fair value of the equity instruments issued, if this can be determined reliably. If the fair value of the equity instruments issued is not reliably determinable, the equity instruments should be measured by reference to the fair value of the financial liability extinguished as of the date of extinguishment. Any difference between the carrying amount of the financial liability that is extinguished and the

fair value of the equity instruments issued is recognized immediately in profit or loss. This interpretation is applied retrospectively and is applicable for annual periods beginning on or after July 1, 2010 from the beginning of the earliest comparative period presented.

### **Improvements to PFRSs**

The FRSC approved in its meeting in July 2010 the adoption of Improvements to IFRS issued by the IASB in May 2010. There are separate transitional provisions for each standard which are all effective beginning January 1, 2011.

- ***PFRS 3, Business Combinations.*** The improvements include: (a) clarification that the amendments to *PFRS 7, Financial Instruments: Disclosures*, *PAS 32, Financial Instruments: Presentation*, and *PAS 39, Financial Instruments: Recognition and Measurement*, that eliminate the exemption for contingent consideration, do not apply to contingent consideration that arose from business combinations whose acquisition dates precede the application of *PFRS 3* (as revised in 2008); (b) guidance that the choice of measuring non-controlling interests at fair value or at the proportionate share of the acquiree's net assets applies only to instruments that represent present ownership interests and entitle their holders to a proportionate share of the net assets in the event of liquidation. All other components of non-controlling interest are measured at fair value unless another measurement basis is required by PFRS; and (c) clarification that the application guidance in *PFRS 3* applies to all share-based payment transactions that are part of a business combination, including un-replaced and voluntarily replaced share-based payment awards. These interpretations are applied prospectively.
- ***PFRS 7, Financial Instruments.*** The amendment emphasizes the interaction between quantitative and qualitative disclosures about the nature and extent of risks associated with financial instruments. This interpretation is applied retrospectively.
- ***PAS 1, Presentation of Financial Instruments.*** The amendment clarifies that an entity will present an analysis of other comprehensive income for each component of equity, either in the statement of changes in equity or in the notes to the financial statements. This interpretation is applied retrospectively.
- ***PAS 27, Consolidated and Separate Financial Statements.*** The improvement clarifies that the consequential amendments from *PAS 27* made to *PAS 21, The Effect of Changes in Foreign Exchange Rates*, *PAS 28, Investments in Associates*, and *PAS 31, Interests in Joint Ventures*, apply prospectively for annual periods beginning on or after July 1, 2009, or earlier when *PAS 27* is applied earlier. This interpretation is applied retrospectively.
- ***PAS 34, Interim Financial Reporting.*** The amendment provides guidance how to apply disclosure principles in *PAS 34* and add disclosure requirements around: (a) the circumstances likely to affect fair values of financial instruments and their classification; (b) transfers of financial instruments between different levels of the fair value hierarchy; (c) changes in classification of financial assets; and (d) changes in contingent liabilities and assets. This interpretation is applied retrospectively.
- ***Philippine Interpretation IFRIC 13, Customer Loyalty Programmes.*** The amendment clarifies the meaning of fair value in the context of measuring award credits under customer loyalty programmes.

### **Effective 2012**

***Philippine Interpretation IFRIC 15, Agreements for Construction of Real Estate.*** This interpretation covers accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. This interpretation requires that revenue on construction of real estate be recognized only upon completion, except when such contract qualifies as construction contract to be accounted for under *PAS 11, Construction Contracts*, or involves rendering of services in which case revenue is recognized based on stage of completion. Contracts involving provision of services with the construction materials and where the risks and reward of ownership are transferred to the buyer on a continuous basis will also be accounted for based on stage of completion.

## Effective 2013

***PFRS 9, Financial Instruments: Classification and Measurement (Phase I)***. Phase I introduces new requirements for classifying and measuring financial assets. Other phases are currently being deliberated to expand *PFRS 9* to include classifications and measurement of financial liabilities, derecognition of financial instruments, impairment, and hedge accounting. The objective is to replace *PAS 39* in its entirety by the end of 2010.

*PFRS 9 (Phase I)* is applicable to all financial assets within the scope of *PAS 39*. At initial recognition, all financial assets (including hybrid contracts with a financial asset host) are measured at fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs.

Subsequent to initial recognition, financial assets that are debt instruments are classified at amortized cost or fair value on the basis of both: (a) the entity's business model for managing the financial assets; and (b) the contractual cash flow characteristic of the financial asset. Debt instrument may be subsequently measured at amortized cost if: (a) the asset is held within a business model whose objective is to hold the assets to collect the contractual cash flows; and (b) the contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal outstanding. All other debt instruments are subsequently measured at fair value.

All financial assets that are equity investments are measured at fair value either through other comprehensive income or profit or loss. This is an irrevocable choice the entity makes by instrument unless the equity investments are held for trading, in which case, they must be measured at fair value through profit or loss.

This standard is applied retrospectively and is applicable for annual periods beginning on or after January 1, 2013 with certain exceptions and requires comparative figures to be restated. Earlier application is permitted.

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

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

#### *Judgments*

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

##### *Determination of functional currency*

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

The presentation currency of the PLDT Group is the Philippine peso. Based on the economic substance of the underlying circumstances relevant to the PLDT Group, the functional currency of all entities under PLDT Group is the Philippine peso except for SMHC, SMI, TSI, BOW, Mabuhay Satellite, PLDT Global, SPi and certain of its subsidiaries, and certain subsidiaries of Chikka, which is the U.S. dollar; and Singapore dollar for SCH, SGP, 3rd Brand, and certain subsidiaries of BayanTrade.

### *Leases*

As a lessee, we have various lease agreements in respect of our certain equipment and properties. We evaluate whether significant risks and rewards of ownership of the leased properties are transferred to us (finance lease) or retained by the lessor (operating lease) based on *PAS 17* which requires us to make judgments and estimates of transfer of risk and rewards of ownership of the leased properties. Total lease expense arising from operating leases amounted to Php3,386 million and Php3,011 million for the nine months ended September 30, 2010 and 2009, respectively. Total finance lease obligations as at September 30, 2010 and December 31, 2009 amounted to Php42 million and Php64 million, respectively. See *Note 20 – Interest-bearing Financial Liabilities*, *Note 26 – Contractual Obligations and Commercial Commitments* and *Note 28 – Financial Assets and Liabilities*.

### *Significant influence in Manila Electric Company, or Meralco, on which PCEV has less than 20% ownership*

Under *PAS 28, Investments in Associates*, significant influence must be present and currently exercisable over an investee to account any interest in that investee as investment in an associate and carried at equity method of accounting. If an investor holds, directly or indirectly, less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.

On March 30, 2010, following the transfer of PCEV's Meralco shares to Beacon Electric Asset Holdings, Inc., or Beacon, PCEV's direct ownership in Meralco was reduced to approximately 6% from approximately 20%. Beacon is a jointly controlled entity of PCEV and Metro Pacific Investment Company, or MPIC, for the purpose of consolidating the ownership interest of PCEV and MPIC in Meralco. The decrease in PCEV's direct ownership in Meralco, however, did not result to a change in PCEV's representation to the Meralco Board of Directors. Prior to the transfer of approximately 14% interest in Meralco to Beacon, PCEV has three out of 11 Board of Directors seats in Meralco. Based on the Omnibus Agreement, or OA, among PCEV, MPIC and Beacon, both PCEV and MPIC agreed that an equal number of Meralco nominee directors shall be chosen from each list of nominees provided by PCEV and MPIC. If the number of Meralco Nominee Directors for Beacon is an odd number, the remaining one Meralco Nominee Director shall be chosen alternatively first from the list of nominees provided by MPIC and then from the list provided by PCEV. The total Beacon ownership in Meralco entitles it to nominate three Board of Directors seats, two of which are the Chairman of the Board and President of PCEV. On this basis, PCEV has retained significant influence over Meralco despite having less than 20% ownership interest. See *Note 10 – Investments in Associates and Joint Ventures*.

### *Estimates and Assumptions*

The key estimates and assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities recognized in the consolidated financial statements within the next financial period are discussed as follows:

#### *Asset impairment*

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

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



The preparation of estimated future cash flows involves significant estimations and assumptions. While we believe that our assumptions are appropriate and reasonable, significant changes in our assumptions may materially affect our assessment of recoverable values and may lead to future additional impairment charges under PFRS. Total impairment charges (including provision for doubtful account receivables and write-down of inventories and supplies) for the nine months ended September 30, 2010 and 2009 amounted to Php1,534 million and Php3,221 million, respectively. See *Note 4 – Operating Segment Information*, *Note 5 – Income and Expenses* and *Note 10 – Investments in Associates and Joint Ventures*.

The carrying values of our property, plant and equipment, investments in associates and joint ventures, goodwill and intangible assets, trade and other receivables, inventories and supplies and prepayments are separately disclosed in *Notes 9, 10, 14, 16, 17 and 18*, respectively.

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

The total depreciation and amortization of property, plant and equipment amounted to Php19,953 million and Php19,266 million for the nine months ended September 30, 2010 and 2009, respectively. Total carrying values of property, plant and equipment, net of accumulated depreciation and amortization, amounted to Php158,033 million and Php161,256 million as at September 30, 2010 and December 31, 2009, respectively. See *Note 4 – Operating Segment Information* and *Note 9 – Property, Plant and Equipment*.

#### *Determining the fair value of investment properties*

We have adopted the fair value approach in determining the carrying value of our investment properties. We opted to rely on independent appraisers in determining the fair values of our investment properties, and such fair values were determined based on recent prices of similar properties, with adjustments to reflect any changes in economic conditions since the date of those transactions. The amounts and timing of recorded changes in fair value for any period would differ if we made different judgments and estimates or utilized a different basis for determining fair value. Annual appraisal of investment properties is performed every December 31.

Total carrying values of our investment properties as at September 30, 2010 and December 31, 2009 amounted to Php1,098 million and Php1,210 million, respectively. See *Note 12 – Investment Properties*.

#### *Goodwill and intangible assets*

Our consolidated financial statements and financial performance reflect acquired businesses after the completion of the respective acquisition. We account for the acquired businesses using the acquisition method starting January 1, 2009 and purchase method for prior period acquisitions, which both require extensive use of accounting judgments and estimates to allocate the purchase price to the fair market values of the acquiree's identifiable assets and liabilities and contingent liabilities, if any, at the acquisition date. Any excess in the purchase price over the estimated fair market values of the net assets acquired is recorded as goodwill in our consolidated statement of financial position. Thus, the numerous judgments made in estimating the fair market value to be assigned to the acquiree's assets and liabilities can materially affect our financial performance.

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

The total amortization of intangible assets amounted to Php268 million and Php281 million for the nine months ended September 30, 2010 and 2009, respectively. Total carrying values of goodwill and intangible assets as at September 30, 2010 and December 31, 2009 amounted to Php12,402 million and Php13,024 million, respectively. See *Note 13 – Business Combinations and Acquisition of Non-Controlling Interests* and *Note 14 – Goodwill and Intangible Assets*.

#### *Recognition of deferred income tax assets and liabilities*

We review the carrying amounts of deferred income tax assets at the end of each reporting period and reduce these to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred income tax assets to be utilized. Our assessment on the recognition of deferred income tax assets on deductible temporary differences is based on the level and timing of forecasted taxable income of the subsequent reporting periods. This forecast is based on our past results and future expectations on revenues and expenses as well as future tax planning strategies. However, there is no assurance that we will generate sufficient taxable income to allow all or part of our deferred income tax assets to be utilized. We also review the level of projected gross margin for the use of Optional Standard Deduction, or OSD, and assess the future tax consequences for the recognition of deferred income tax assets and deferred income tax liabilities. Based on Smart and some of its subsidiaries' projected gross margin, they expect to use the OSD method in the foreseeable future.

Based on the above assessment, our consolidated unrecognized deferred income tax assets due to insufficient taxable income as at September 30, 2010 and December 31, 2009 amounted to Php1,847 million and Php1,236 million, respectively. In addition, as at September 30, 2010 and December 31, 2009, our unrecognized net deferred income tax assets for items which would not result to future tax consequences when using the OSD method amounted to Php2,869 million and Php3,296 million, respectively. Total consolidated provision for deferred income tax amounted to Php1,621 million while total consolidated benefit from deferred income tax amounted to Php572 million for the nine months ended September 30, 2010 and 2009, respectively. Total consolidated net deferred income tax assets as at September 30, 2010 and December 31, 2009 amounted to Php6,401 million and Php7,721 million, respectively, while total consolidated net deferred income tax liabilities as at September 30, 2010 and December 31, 2009 amounted to Php1,604 million and Php1,321 million, respectively. See *Note 4 – Operating Segment Information* and *Note 7 – Income Tax*.

#### *Estimating allowance for doubtful accounts*

If we assessed that there is an objective evidence that an impairment loss has been incurred in our trade and other receivables, we estimate the allowance for doubtful accounts related to our trade and other receivables that are specifically identified as doubtful of collection. The amount of allowance is evaluated by management on the basis of factors that affect the collectibility of the accounts. In these cases, we use judgment based on the best available facts and circumstances, including but not limited to, the length of our relationship with the customer and the customer's credit status based on third party credit reports and known market factors, to record specific reserves for customers against amounts due in order to reduce our receivables to amounts that we expect to collect. These specific reserves are reevaluated and adjusted as additional information received affect the amounts estimated.

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

Total asset impairment provision for trade and other receivables recognized in our consolidated statements of income amounted to Php1,256 million and Php1,311 million for the nine months ended September 30, 2010 and 2009, respectively. Trade and other receivables, net of asset impairment, amounted to Php15,171 million and Php14,729 million as at September 30, 2010 and December 31, 2009, respectively. See *Note 4 – Operating Segment Information, Note 5 – Income and Expenses, Note 16 – Trade and Other Receivables and Note 28 – Financial Assets and Liabilities.*

#### *Estimating net realizable value of inventories and supplies*

We write down the cost of inventories whenever the net realizable value of inventories becomes lower than cost due to damage, physical deterioration, obsolescence, change in price levels or other causes. The lower of cost and net realizable value of inventories is reviewed on a periodic basis. Inventory items identified to be obsolete and unusable are written-off and charged as expense in our consolidated income statement.

Total write-down of inventories and supplies recognized for the nine months ended September 30, 2010 and 2009 amounted to Php42 million and Php167 million, respectively. The carrying values of inventories and supplies amounted to Php2,230 million and Php2,165 million as at September 30, 2010 and December 31, 2009, respectively. See *Note 4 – Operating Segment Information, Note 5 – Income and Expenses and Note 17 – Inventories and Supplies.*

#### *Share-based payment transactions*

Our 2007 to 2009 LTIP grants SARs to our eligible key executives and advisors. Under the 2007 to 2009 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 our consolidated income statement. The estimates and assumptions are described in *Note 25 – Share-based Payments and Employee Benefits* and include, among other things, annual stock volatility, risk-free interest rate, dividends yield, the remaining life of options, and the fair value of common stock. While management believes that the estimates and assumptions used are reasonable and appropriate, significant differences in our actual experience or significant changes in the estimates and assumptions may materially affect the stock compensation costs charged to operations. The fair value of the 2007 to 2009 LTIP recognized as expense for the nine months ended September 30, 2009 amounted to Php1,320 million. As at December 31, 2009, outstanding 2007 to 2009 LTIP liability amounted to Php4,582 million, which was paid in April 2010. See *Note 5 – Income and Expenses, Note 23 – Accrued Expenses and Other Current Liabilities and Note 25 – Share-based Payments and Employee Benefits.*

#### *Estimation of pension benefit costs and other employee benefits*

The cost of defined benefit plans and present value of the pension obligation are determined using projected unit credit method. Actuarial valuation includes making various assumptions which consists, among other things, discount rates, expected rates of return on plan assets, rates of compensation increases and mortality rates. See *Note 25 – Share-based Payments and Employee Benefits.* 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 present value of the defined benefit obligation and the fair value of plan assets at that date. These excess actuarial gains and losses are recognized over the expected average remaining working lives of the employees participating in the plan. Due to complexity of valuation, the underlying assumptions and its long-term nature, a defined benefit obligation is highly sensitive to changes in assumptions. 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 cost for pension and other retirement obligations. All assumptions are reviewed at year-end.

Total consolidated pension benefit costs amounted to Php197 million and Php1,001 million for the nine months ended September 30, 2010 and 2009, respectively. Unrecognized net actuarial loss as at September 30, 2010 and December 31, 2009 amounted to Php2,458 million and Php2,474 million, respectively. As at September 30, 2010 and December 31, 2009, the prepaid benefit costs amounted to Php5,309 million and Php5,414 million, respectively. As at September 30, 2010 and December 31, 2009, the accrued benefit costs amounted to Php390 million and Php359 million, respectively. See *Note 5 – Income and Expenses*, *Note 18 – Prepayments* and *Note 25 – Share-based Payments and Employee Benefits*.

The new LTIP, or 2010 to 2012 LTIP, has been presented to and approved by the Executive Compensation Committee, or ECC, and Board of Directors, and is based on profit targets with the Performance Cycle. The cost of 2010 to 2012 LTIP is determined using the projected unit credit method based on prevailing discount rates and profit targets. 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 cost for other employee benefits. All assumptions are reviewed monthly. Total outstanding liability and fair value of 2010 to 2012 LTIP cost for the nine month ended September 30, 2010 amounted to Php1,061 million. See *Note 25 – Shared-based Payments and Employee Benefits*.

#### *Provision for asset retirement obligations*

Provision for asset retirement obligations are recognized in the period in which they are incurred if a reasonable estimate of fair value can be made. This requires an estimation of the cost to restore/dismantle on a per square meter basis, depending on the location, and is based on the best estimate of the expenditure required to settle the obligation at the future restoration/dismantlement date, discounted 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 Php1,311 million and Php1,204 million as at September 30, 2010 and December 31, 2009, respectively. See *Note 21 – Deferred Credits and Other Noncurrent Liabilities*.

#### *Provision for legal contingencies and tax assessments*

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 our counsel handling the defense in these matters and is based upon our analysis of potential results. We currently do not believe these proceedings will have a material adverse effect on our consolidated financial statements. It is possible, however, that future financial performance could be materially affected by changes in our estimates or effectiveness of our strategies relating to these proceedings and assessments. See *Note 27 – Provisions and Contingencies*.

#### *Revenue recognition*

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

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

Revenues under a multiple element arrangement specifically applicable to our fixed line and wireless businesses are split into separately identifiable components and recognized when the related components are delivered in order to reflect the substance of the transaction. The fair value of components is determined using verifiable objective evidence.

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

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

#### *Determination of fair values of financial assets and liabilities*

Where the fair value of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using valuation techniques including the discounted cash flows model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Total fair values of financial assets and liabilities as at September 30, 2010 amounted to Php47,375 million and Php161,658 million, respectively, while the total fair values of financial assets and liabilities as at December 31, 2009 amounted to Php58,225 million and Php165,063 million, respectively. See *Note 28 – Financial Assets and Liabilities*.

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#### **4. Operating Segment Information**

Operating segments are components of the PLDT Group that engage in business activities from which they may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of PLDT Group), which operating results are regularly reviewed by the chief operating decision maker to make decisions about how resources are to be allocated to each of the segments and to assess their performances, and for which discrete financial information is available.

For management purposes, we are organized into business units based on our products and services and have three reportable operating segments as follows:

- **Wireless** – wireless telecommunications services provided through our cellular service providers namely, Smart, PCEV (on August 17, 2009, Smart acquired the cellular business of PCEV) and CURE; SBI, BOW, Airborne Access and PDSI, our wireless broadband service providers; Wolfpac and Chikka Group, our wireless content operators; and ACeS Philippines, our satellite operator;
- **Fixed Line** – fixed line telecommunications services primarily provided by PLDT. We also provide fixed line services through PLDT's subsidiaries ClarkTel, SubicTel, Philcom, Maratel, SBI, PDSI, BCC and PLDT Global, all of which together account for approximately 4% of our consolidated fixed line subscribers; and
- **ICT** – information and communications infrastructure and services for internet applications, internet protocol-based solutions and multimedia content delivery provided by ePLDT and BayanTrade Group; knowledge processing solutions provided by the SPi Group; customer interaction solutions provided by SPi CRM, (on April 8, 2010, SPi CRM, Parlance and Vocativ were merged wherein SPi CRM became the surviving entity); internet access and online gaming services provided by Infocom, Digital Paradise, netGames and Level Up!; and e-commerce, and IT-related services provided by other investees of ePLDT, as discussed in *Note 10 – Investments in Associates and Joint Ventures*.

The chief operating decision maker and management monitor the operating results of each business unit separately for purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on net income for the period; earnings before interest, taxes and depreciation and amortization, or EBITDA; EBITDA margin; and core income. Net income for the period is measured consistent with consolidated net income in the consolidated financial statements.

EBITDA is measured as net income excluding depreciation and amortization, amortization of intangible assets, asset impairment on noncurrent assets, financing costs, interest income, equity share in net earnings (losses) of associates and joint ventures, foreign exchange gains (losses) – net, gains (losses) on derivative financial instruments – net, provision for (benefit from) income tax and other nonrecurring gains (losses) – net.

EBITDA margin pertains to EBITDA divided by service revenues.

Core income for the period is measured as net income attributable to equity holders of PLDT, excluding foreign exchange gains (losses) – net, gains (losses) on derivative financial instruments – net, excluding hedge cost, asset impairment on noncurrent assets, other nonrecurring gains (losses), net of tax effect of aforementioned adjustments, as applicable, and similar adjustments to equity share in net earnings (losses) of associates and joint ventures.

Transfer prices between operating segments are on an arm's length basis similar to transactions with third parties. Segment revenues, segment expenses and segment results include transfers between business segments. These transfers are eliminated upon full consolidation.

The segment revenues, net income for the period, assets, liabilities, and other segment information of our reportable operating segments are as follows:

|   | Wireless           | Fixed Line     | ICT           | Inter-segment<br>Transactions | Consolidated   |
|---|--------------------|----------------|---------------|-------------------------------|----------------|
|   | (in million pesos) |                |               |                               |                |
| <b>As at and for the nine months ended September 30, 2010 (Unaudited)</b>                             |                    |                |               |                               |                |
| <b>Revenues</b>   |                    |                |               |                               |                |
| External customer:  | 70,946             | 30,094         | 7,232         | –                             | 108,272        |
| Service revenues  | 69,876             | 29,828         | 7,012         | –                             | 106,716        |
| Non-service revenues (Note 5)   | 1,070              | 266            | 220           | –                             | 1,556          |
| Inter-segment transactions:   | 569                | 6,949          | 1,029         | (8,547)                       | –              |
| Service revenues  | 569                | 6,949          | 892           | (8,410)                       | –              |
| Non-service revenues  | –                  | –              | 137           | (137)                         | –              |
| <b>Total revenues</b>   | <b>71,515</b>      | <b>37,043</b>  | <b>8,261</b>  | <b>(8,547)</b>                | <b>108,272</b> |
| <b>Results</b>  |                    |                |               |                               |                |
| Depreciation and amortization (Notes 3 and 9)   | 10,127             | 9,267          | 559           | –                             | 19,953         |
| Asset impairment (Notes 3, 5, 9, 16, 17, 18 and 28)   | 486                | 982            | 66            | –                             | 1,534          |
| Equity share in net earnings of associates and joint ventures (Note 10)                               | 1,285              | –              | 134           | –                             | 1,419          |
| Interest income (Note 5)  | 520                | 382            | 26            | (14)                          | 914            |
| Financing costs – net (Notes 5, 9, 20 and 28)   | 1,992              | 2,941          | 132           | (14)                          | 5,051          |
| Provision for (benefit from) income tax (Notes 3 and 7)   | 8,983              | 2,011          | (20)          | –                             | 10,974         |
| Net income for the period / Segment profit for the period   | 26,597             | 5,071          | 390           | –                             | 32,058         |
| EBITDA for the period   | 44,323             | 18,189         | 1,135         | 166                           | 63,813         |
| EBITDA margin for the period  | 63%                | 49%            | 14%           | –                             | 60%            |
| Core income for the period  | 26,242             | 4,686          | 495           | –                             | 31,423         |
| <b>Assets and liabilities</b>   |                    |                |               |                               |                |
| Operating assets  | 103,446            | 189,711        | 15,611        | (73,376)                      | 235,392        |
| Investments in associates and joint ventures (Notes 3, 5, 10 and 28)                                  | 22,428             | –              | 875           | –                             | 23,303         |
| Deferred income tax assets – net (Notes 3, 7 and 28)  | 192                | 6,019          | 190           | –                             | 6,401          |
| <b>Total assets</b>   | <b>126,066</b>     | <b>195,730</b> | <b>16,676</b> | <b>(73,376)</b>               | <b>265,096</b> |
| Operating liabilities   | 83,577             | 104,447        | 4,075         | (17,702)                      | 174,397        |
| Deferred income tax liabilities – net (Notes 3, 7 and 28)   | 1,032              | 22             | 240           | 310                           | 1,604          |
| <b>Total liabilities</b>  | <b>84,609</b>      | <b>104,469</b> | <b>4,315</b>  | <b>(17,392)</b>               | <b>176,001</b> |
| <b>Other segment information</b>  |                    |                |               |                               |                |
| Capital expenditures (including capitalized interest)   | 9,137              | 7,278          | 508           | –                             | 16,923         |
| <b>As at December 31, 2009 (Audited) and for the nine months ended September 30, 2009 (Unaudited)</b> |                    |                |               |                               |                |
| <b>Revenues</b>   |                    |                |               |                               |                |
| External customer:  | 71,749             | 30,877         | 7,344         | –                             | 109,970        |
| Service revenues  | 70,483             | 30,703         | 7,091         | –                             | 108,277        |
| Non-service revenues (Note 5)   | 1,266              | 174            | 253           | –                             | 1,693          |
| Inter-segment transactions:   | 719                | 7,511          | 1,042         | (9,272)                       | –              |
| Service revenues  | 719                | 7,511          | 866           | (9,096)                       | –              |
| Non-service revenues  | –                  | –              | 176           | (176)                         | –              |
| <b>Total revenues</b>   | <b>72,468</b>      | <b>38,388</b>  | <b>8,386</b>  | <b>(9,272)</b>                | <b>109,970</b> |

|  | Wireless | Fixed Line | Inter-segment |              | Consolidated |
|--|----------|------------|---------------|--------------|--------------|
|  |          |            | ICT           | Transactions |              |
| (in million pesos)   |          |            |               |              |              |
| <b>Results</b>   |          |            |               |              |              |
| Depreciation and amortization (Notes 3 and 9)                                    | 9,836    | 8,777      | 570           | 83           | 19,266       |
| Asset impairment (Notes 3, 5, 9, 16, 17, 18 and 28)                              | 1,133    | 2,060      | 28            | –            | 3,221        |
| Financing costs – net (Notes 5, 9, 20 and 28)                                    | 1,938    | 2,710      | 128           | (23)         | 4,753        |
| Interest income (Note 5)   | 976      | 318        | 20            | (23)         | 1,291        |
| Equity share in net earnings (losses) of associates and joint ventures (Note 10) | 276      | (72)       | 107           | –            | 311          |
| Provision for income tax (Notes 3 and 7)   | 9,253    | 1,804      | 162           | –            | 11,219       |
| Net income for the period / Segment profit for the period                        | 25,858   | 4,663      | 165           | (2)          | 30,684       |
| EBITDA for the period  | 44,521   | 20,254     | 846           | 124          | 65,745       |
| EBITDA margin for the period   | 63%      | 53%        | 11%           | –            | 61%          |
| Core income for the period   | 24,430   | 6,360      | 163           | (2)          | 30,951       |
| <b>Assets and liabilities</b>  |          |            |               |              |              |
| Operating assets   | 107,880  | 206,385    | 16,297        | (80,368)     | 250,194      |
| Investments in associates and joint ventures (Notes 3, 5, 10 and 28)             | 21,440   | –          | 793           | –            | 22,233       |
| Deferred income tax assets – net (Notes 3, 7 and 28)                             | 187      | 7,346      | 188           | –            | 7,721        |
| Total assets   | 129,507  | 213,731    | 17,278        | (80,368)     | 280,148      |
| Operating liabilities  | 96,194   | 111,294    | 4,574         | (32,360)     | 179,702      |
| Deferred income tax liabilities – net (Notes 3, 7 and 28)                        | 640      | 21         | 328           | 332          | 1,321        |
| Total liabilities  | 96,834   | 111,315    | 4,902         | (32,028)     | 181,023      |
| <b>Other segment information</b>   |          |            |               |              |              |
| Capital expenditures (including capitalized interest)                            | 10,592   | 7,047      | 425           | –            | 18,064       |

The following table shows the reconciliation of our consolidated EBITDA to consolidated net income:

|   | Nine Months Ended September 30, |          |
|---|---------------------------------|----------|
|   | 2010                            | 2009     |
| (Unaudited)   |                                 |          |
| (in million pesos)  |                                 |          |
| Consolidated EBITDA   | <b>63,813</b>                   | 65,745   |
| Amortization of intangible assets (Notes 3 and 14)                      | <b>(268)</b>                    | (281)    |
| Depreciation and amortization (Notes 3 and 9)                           | <b>(19,953)</b>                 | (19,266) |
| Asset impairment:   |                                 |          |
| Inventories and supplies (Notes 3, 5 and 17)                            | <b>(42)</b>                     | (167)    |
| Investments in associates and joint ventures (Notes 3, 5 and 10)        | <b>(78)</b>                     | (381)    |
| Property, plant and equipment (Notes 3, 5 and 9)                        | <b>(104)</b>                    | (58)     |
| Trade and other receivables (Notes 3, 5 and 16)                         | <b>(1,256)</b>                  | (1,311)  |
| Prepayments and others (Notes 3, 5, 18 and 26)                          | <b>(54)</b>                     | (1,304)  |
| Consolidated operating profit for the period                            | <b>42,058</b>                   | 42,977   |
| Foreign exchange gains – net (Notes 9 and 28)                           | <b>1,667</b>                    | 232      |
| Equity share in net earnings of associates and joint ventures (Note 10) | <b>1,419</b>                    | 311      |
| Interest income (Note 5)  | <b>914</b>                      | 1,291    |
| Losses on derivative financial instruments – net (Note 28)              | <b>(495)</b>                    | (534)    |
| Financing costs – net (Notes 5, 9, 20 and 28)                           | <b>(5,051)</b>                  | (4,753)  |
| Other nonrecurring gains – net  | <b>2,520</b>                    | 2,379    |
| Consolidated income before income tax                                   | <b>43,032</b>                   | 41,903   |
| Provision for income tax (Notes 3 and 7)                                | <b>10,974</b>                   | 11,219   |
| Consolidated net income for the period                                  | <b>32,058</b>                   | 30,684   |

The following table shows the reconciliation of our consolidated core income to our consolidated net income:

|  | Nine Months Ended September 30, |         |
|--|---------------------------------|---------|
|  | 2010                            | 2009    |
|  | (Unaudited)                     |         |
|  | (in million pesos)              |         |
| Consolidated core income for the period  | 31,423                          | 30,951  |
| Foreign exchange gains – net (Notes 9 and 28)                                    | 1,678                           | 232     |
| Losses on derivative financial instruments – net, excluding hedge cost (Note 28) | (137)                           | (62)    |
| Asset impairment on noncurrent assets  | (232)                           | (1,743) |
| Adjustment on equity share in net earnings of associates and joint ventures      | (282)                           | (66)    |
| Net tax effect of aforementioned adjustments                                     | (462)                           | 706     |
| Net income for the period attributable to equity holders of PLDT (Note 8)        | 31,988                          | 30,018  |
| Net income for the period attributable to non-controlling interests              | 70                              | 666     |
| Consolidated net income for the period   | 32,058                          | 30,684  |

The following table presents our revenues for the period from external customers by category of products and services:

|   | Nine Months Ended September 30, |         |
|---|---------------------------------|---------|
|   | 2010                            | 2009    |
|   | (Unaudited)                     |         |
|   | (in million pesos)              |         |
| <b>Wireless services</b>  |                                 |         |
| Service revenues:   |                                 |         |
| Cellular  | 64,250                          | 65,418  |
| Broadband   | 4,781                           | 3,899   |
| Satellite and others  | 845                             | 1,166   |
|   | 69,876                          | 70,483  |
| Non-service revenues:   |                                 |         |
| Sale of cellular handsets, cellular SIM-packs and broadband data modems | 1,070                           | 1,266   |
| Total wireless revenues   | 70,946                          | 71,749  |
| <b>Fixed line services</b>  |                                 |         |
| Services revenues:  |                                 |         |
| Local exchange  | 11,472                          | 11,612  |
| International long distance   | 3,982                           | 4,764   |
| National long distance  | 3,369                           | 4,960   |
| Data and other network  | 10,800                          | 9,069   |
| Miscellaneous   | 205                             | 298     |
|   | 29,828                          | 30,703  |
| Non-service revenues:   |                                 |         |
| Sale of computers   | 266                             | 174     |
| Total fixed line revenues   | 30,094                          | 30,877  |
| <b>ICT services</b>   |                                 |         |
| Service revenues:   |                                 |         |
| Knowledge processing solutions  | 3,876                           | 3,837   |
| Customer interaction solutions  | 1,757                           | 2,011   |
| Internet and online gaming  | 757                             | 808     |
| Data center and others  | 622                             | 435     |
|   | 7,012                           | 7,091   |
| Non-service revenues:   |                                 |         |
| Point-product-sales   | 220                             | 253     |
| Total ICT revenues  | 7,232                           | 7,344   |
| Total products and services from external customers                     | 108,272                         | 109,970 |



Disclosure of the geographical distribution of our revenues from external customers and the geographical location of our total assets are not provided since the majority of our consolidated revenues are derived from our operations within the Philippines.

In each of the nine months ended September 30, 2010 and 2009, no revenue transactions with a single external customer accounted for 10% or more of our consolidated revenues from external customers.

## 5. Income and Expenses

### *Non-service Revenues*

|  | Nine Months Ended September 30, |       |
|--|---------------------------------|-------|
|  | 2010                            | 2009  |
|  | (Unaudited)                     |       |
|  | (in million pesos)              |       |
| Sale of computers, cellular handsets, cellular SIM-packs and broadband data modems | 1,336                           | 1,440 |
| Point-product-sales  | 220                             | 253   |
| (Note 4)   | <b>1,556</b>                    | 1,693 |

### *Compensation and Employee Benefits*

|  | Nine Months Ended September 30, |        |
|--|---------------------------------|--------|
|  | 2010                            | 2009   |
|  | (Unaudited)                     |        |
|  | (in million pesos)              |        |
| Salaries and other employee benefits   | 15,374                          | 14,710 |
| Incentive plans (Notes 3 and 25)       | 1,061                           | 1,320  |
| Manpower rightsizing program           | 202                             | 118    |
| Pension benefit costs (Notes 3 and 25) | 197                             | 1,001  |
|  | <b>16,834</b>                   | 17,149 |

### *Cost of Sales*

|   | Nine Months Ended September 30, |       |
|---|---------------------------------|-------|
|   | 2010                            | 2009  |
|   | (Unaudited)                     |       |
|   | (in million pesos)              |       |
| Cost of computers, cellular handsets, cellular SIM-packs sold and broadband data modems | 3,137                           | 3,393 |
| Cost of point-product-sales   | 330                             | 358   |
| Cost of satellite air time and terminal units (Notes 24 and 26)                         | 94                              | 120   |
|   | <b>3,561</b>                    | 3,871 |

### *Asset Impairment*

|   | Nine Months Ended September 30, |       |
|---|---------------------------------|-------|
|   | 2010                            | 2009  |
|   | (Unaudited)                     |       |
|   | (in million pesos)              |       |
| Trade and other receivables (Notes 3 and 16)                  | 1,256                           | 1,311 |
| Property, plant and equipment (Notes 3 and 9)                 | 104                             | 58    |
| Investments in associates and joint ventures (Notes 3 and 10) | 78                              | 381   |
| Inventories and supplies (Notes 3 and 17)                     | 42                              | 167   |
| Prepayments and others (Notes 3 and 18)                       | 54                              | 1,304 |
| (Note 4)  | <b>1,534</b>                    | 3,221 |

### Interest Income

|  | Nine Months Ended September 30, |       |
|--|---------------------------------|-------|
|  | 2010                            | 2009  |
|  | (Unaudited)                     |       |
|  | (in million pesos)              |       |
| Interest income on other loans and receivables       | 859                             | 1,175 |
| Interest income on fair value through profit or loss | 34                              | 83    |
| Interest income on held-to-maturity investments      | 21                              | 33    |
| (Note 4)   | <b>914</b>                      | 1,291 |

### Financing Costs – net

|   | Nine Months Ended September 30, |       |
|---|---------------------------------|-------|
|   | 2010                            | 2009  |
|   | (Unaudited)                     |       |
|   | (in million pesos)              |       |
| Interest on loans and other related items (Notes 20 and 28) | 4,668                           | 4,393 |
| Accretion on financial liabilities – net (Notes 20 and 28)  | 885                             | 778   |
| Financing charges   | 36                              | 110   |
| Capitalized interest (Note 9)                               | (538)                           | (528) |
| (Note 4)  | <b>5,051</b>                    | 4,753 |

Interest expense for short-term borrowings for the nine months ended September 30, 2010 and 2009 amounted to Php11 million and Php24 million, respectively.

## 6. Other Comprehensive Income

The movements of other comprehensive income under equity of our consolidated statements of financial position are as follows:

|   | Foreign<br>currency<br>translation | Available-for-<br>sale financial<br>assets | Total Other<br>Comprehensive<br>Income<br>Attributable to<br>Equity Holders<br>of PLDT | Non-controlling<br>interests | Total Other<br>Comprehensive<br>Income |
|---|------------------------------------|--|--|------------------------------|--|
|   | (in million pesos)                 |  |  |                              |  |
| Balance at January 1, 2009                          | (401)                              | 23   | (378)  | 178                          | (200)                                  |
| Other comprehensive income for the period           | (271)                              | 1  | (270)  | (3)                          | (273)                                  |
| <b>Balance as at September 30, 2009 (Unaudited)</b> | <b>(672)</b>                       | <b>24</b>                                  | <b>(648)</b>   | <b>175</b>                   | <b>(473)</b>                           |
| Balance at January 1, 2010                          | (1,043)                            | 26   | (1,017)  | (163)                        | (1,180)                                |
| Other comprehensive income for the period           | (607)                              | 19   | (588)  | (166)                        | (754)                                  |
| <b>Balance as at September 30, 2010 (Unaudited)</b> | <b>(1,650)</b>                     | <b>45</b>                                  | <b>(1,605)</b>   | <b>(329)</b>                 | <b>(1,934)</b>                         |

## 7. Income Tax

The net components of consolidated deferred income tax assets (liabilities) recognized in our consolidated statements of financial position are as follows:

|                                     | September 30,<br>2010 | December 31,<br>2009 |
|-------------------------------------|-----------------------|----------------------|
|                                     | (Unaudited)           | (Audited)            |
|                                     | (in million pesos)    |                      |
| Net deferred income tax assets      | 6,401                 | 7,721                |
| Net deferred income tax liabilities | (1,604)               | (1,321)              |

The components of our consolidated net deferred income tax assets (liabilities) are as follows:

|   | September 30,<br>2010 | December 31,<br>2009 |
|---|-----------------------|----------------------|
|   | (Unaudited)           | (Audited)            |
|   | (in million pesos)    |                      |
| Net deferred income tax assets:   |                       |                      |
| Accumulated provision for doubtful accounts   | 2,946                 | 2,708                |
| Unearned revenues   | 2,676                 | 3,412                |
| Unamortized past service pension costs  | 2,654                 | 2,974                |
| Unrealized foreign exchange losses  | 922                   | 1,291                |
| Provision for impaired assets   | 778                   | 767                  |
| Derivative financial instruments  | 710                   | 825                  |
| Accumulated write-down of inventories to net realizable values                        | 291                   | 293                  |
| NOLCO   | 136                   | 44                   |
| Asset impairment  | 24                    | 24                   |
| MCIT  | 24                    | 21                   |
| Capitalized taxes and duties – net of amortization                                    | (201)                 | (246)                |
| Capitalized foreign exchange differential – net of depreciation                       | (396)                 | (495)                |
| Pension and other employee benefits   | (1,387)               | (891)                |
| Undepreciated capitalized interest charges  | (2,754)               | (2,976)              |
| Others  | (22)                  | (30)                 |
|   | 6,401                 | 7,721                |
| Net deferred income tax liabilities:  |                       |                      |
| Unearned revenues   | 593                   | 1,047                |
| Pension and other employee benefits   | 23                    | 100                  |
| Fair value adjustment on fixed assets   | (311)                 | (332)                |
| Undepreciated capitalized interest charges  | (313)                 | (536)                |
| Intangible assets and fair value adjustments on assets acquired – net of amortization | (407)                 | (478)                |
| Unrealized foreign exchange gains   | (1,169)               | (879)                |
| Others  | (20)                  | (243)                |
|   | (1,604)               | (1,321)              |

Movements of our consolidated net deferred income tax assets (liabilities) are as follows:

|  | <b>September 30,<br/>2010</b> | December 31,<br>2009 |
|--|-------------------------------|----------------------|
|  | <b>(Unaudited)</b>            | (Audited)            |
|  | (in million pesos)            |                      |
| Net deferred income tax assets – balance at beginning of period                    | <b>7,721</b>                  | 9,605                |
| Net deferred income tax liabilities – balance at beginning of period               | <b>(1,321)</b>                | (1,288)              |
| Net balance at beginning of period   | <b>6,400</b>                  | 8,317                |
| Provision for deferred income tax (Note 3)   | <b>(1,621)</b>                | (656)                |
| Business combinations (Note 13)  | –                             | (349)                |
| Excess MCIT deducted against RCIT due  | –                             | (766)                |
| Others   | <b>18</b>                     | (146)                |
| Net balance at end of period   | <b>4,797</b>                  | 6,400                |
| Net deferred income tax assets – balance at end of period (Notes 3, 4 and 28)      | <b>6,401</b>                  | 7,721                |
| Net deferred income tax liabilities – balance at end of period (Notes 3, 4 and 28) | <b>(1,604)</b>                | (1,321)              |

The analysis of our consolidated net deferred income tax assets are as follows:

|  | <b>September 30,<br/>2010</b> | December 31,<br>2009 |
|--|-------------------------------|----------------------|
|  | <b>(Unaudited)</b>            | (Audited)            |
|  | (in million pesos)            |                      |
| Deferred income tax assets:                                    |                               |                      |
| Deferred income tax assets to be recovered after 12 months     | <b>8,054</b>                  | 9,565                |
| Deferred income tax assets to be recovered within 12 months    | <b>3,323</b>                  | 3,605                |
|  | <b>11,377</b>                 | 13,170               |
| Deferred income tax liabilities:                               |                               |                      |
| Deferred income tax liabilities to be settled after 12 months  | <b>(4,066)</b>                | (4,793)              |
| Deferred income tax liabilities to be settled within 12 months | <b>(910)</b>                  | (656)                |
|  | <b>(4,976)</b>                | (5,449)              |
| Net deferred income tax assets (Notes 3, 4 and 28)             | <b>6,401</b>                  | 7,721                |

The analysis of our consolidated net deferred income tax liabilities are as follows:

|  | <b>September 30,<br/>2010</b> | December 31,<br>2009 |
|--|-------------------------------|----------------------|
|  | <b>(Unaudited)</b>            | (Audited)            |
|  | (in million pesos)            |                      |
| Deferred income tax assets:                                    |                               |                      |
| Deferred income tax assets to be recovered after 12 months     | <b>636</b>                    | 1,161                |
| Deferred income tax assets to be recovered within 12 months    | <b>43</b>                     | 20                   |
|  | <b>679</b>                    | 1,181                |
| Deferred income tax liabilities:                               |                               |                      |
| Deferred income tax liabilities to be settled after 12 months  | <b>(2,130)</b>                | (2,289)              |
| Deferred income tax liabilities to be settled within 12 months | <b>(153)</b>                  | (213)                |
|  | <b>(2,283)</b>                | (2,502)              |
| Net deferred income tax liabilities (Notes 3, 4 and 28)        | <b>(1,604)</b>                | (1,321)              |

Provision for corporate income tax for the period consists of:

|                   | <b>Nine Months Ended September 30,</b> |             |
|-------------------|--|-------------|
|                   | <b>2010</b>                            | <b>2009</b> |
|                   | (Unaudited)                            |             |
|                   | (in million pesos)                     |             |
| Current           | <b>9,353</b>                           | 11,791      |
| Deferred (Note 3) | <b>1,621</b>                           | (572)       |
|                   | <b>10,974</b>                          | 11,219      |

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

|   | <b>Nine Months Ended September 30,</b> |             |
|---|--|-------------|
|   | <b>2010</b>                            | <b>2009</b> |
|   | (Unaudited)                            |             |
|   | (in million pesos)                     |             |
| Provision for income tax at the applicable statutory tax rates                | <b>12,910</b>                          | 12,571      |
| Tax effects of:   |  |             |
| Non-deductible expenses   | <b>235</b>                             | 107         |
| Loss (gains) subject to lower tax rate  | <b>(51)</b>                            | 204         |
| Income subject to final tax   | <b>(318)</b>                           | (410)       |
| Income not subject to income tax  | <b>(417)</b>                           | (1,858)     |
| Equity share in net earnings of associates and joint ventures                 | <b>(426)</b>                           | (93)        |
| Difference between OSD and itemized deductions                                | <b>(1,091)</b>                         | (2,707)     |
| Net movement in unrecognized deferred income tax assets and other adjustments | <b>132</b>                             | 3,405       |
| Actual provision for corporate income tax                                     | <b>10,974</b>                          | 11,219      |

The RCIT rate for domestic corporations and both resident and non-resident foreign corporations in the Philippines increased from 32% to 35% effective November 1, 2005 and was reduced to 30% effective January 1, 2009.

On December 18, 2008, the Bureau of Internal Revenue, or BIR, issued Revenue Regulation No. 16-2008 which implemented the provisions of Republic Act 9504, or R.A. 9504 on OSD. This regulation allowed both individual and corporate tax payers to use OSD in computing their taxable income. For corporations, they may elect a standard deduction in an amount equivalent to 40% of gross income, as provided by law, in lieu of the itemized allowed deductions.

For the nine months ended September 30, 2010, Smart and Wolfpac opted to use OSD in computing their taxable income. Consolidated tax benefit from the availment of OSD amounted to Php1,091 million. For the nine months ended September 30, 2009, Smart, PCEV and Wolfpac availed of the OSD option with a consolidated tax benefit of Php2,707 million.

The availment of OSD affected the recognition of several deferred tax assets and liabilities in which the related income and expense are not considered in determining gross income for income tax purposes. Smart and some of its subsidiaries forecast that they will continue to avail of the OSD, such that, the manner by which it will recover or settle the underlying assets and liabilities for which the deferred tax assets and liabilities were initially recognized, would not result to any future tax consequence under the OSD method. Accordingly, as at September 30, 2010 and December 31, 2009, our unrecognized net deferred income tax assets amounted to Php2,869 million and Php3,296 million, respectively. See *Note 3 – Management’s Use of Judgments, Estimates and Assumptions*.

The breakdown of our consolidated deductible temporary differences, carry forward benefits of unused tax credits from excess of MCIT over RCIT, and NOLCO (excluding those not recognized due to the adoption of OSD) for which no deferred income tax assets were recognized and the equivalent amount of unrecognized deferred income tax assets are as follows:

|  | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|--|--------------------------------------|-----------------------------------|
|  | (in million pesos)                   |                                   |
| NOLCO  | 2,963                                | 2,341                             |
| Unrealized foreign exchange losses                             | 1,628                                | 33                                |
| Accumulated provision for doubtful accounts                    | 1,118                                | 894                               |
| Provisions for other assets                                    | 220                                  | 163                               |
| Unearned revenues  | 204                                  | 188                               |
| Accumulated write-down of inventories to net realizable values | 132                                  | 261                               |
| Fixed asset impairment   | 111                                  | 111                               |
| Pension and other employee benefits                            | 61                                   | 44                                |
| MCIT   | 26                                   | 19                                |
| Derivative financial instruments                               | 18                                   | 19                                |
| Operating lease and others                                     | 3                                    | 3                                 |
| Intangibles  | (332)                                | -                                 |
|  | <b>6,152</b>                         | <b>4,076</b>                      |
| Consolidated unrecognized deferred income tax assets (Note 3)  | <b>1,847</b>                         | <b>1,236</b>                      |

Our consolidated deferred income tax assets have been recorded to the extent that such consolidated deferred income tax assets are expected to be utilized against sufficient future taxable profit. Deferred income tax assets related to the preceding table were not recognized as we believe that future taxable profit will not be sufficient to realize these deductible temporary differences and carry forward benefits of unused tax credits from excess of MCIT over RCIT, and NOLCO in the future.

The breakdown of our consolidated excess MCIT and NOLCO as at September 30, 2010 is as follows:

| Date Incurred  | Expiry Date       | MCIT               | NOLCO |
|--|-------------------|--------------------|-------|
|  |                   | (in million pesos) |       |
| December 31, 2007                                    | December 31, 2010 | 3                  | 567   |
| December 31, 2008                                    | December 31, 2011 | 15                 | 612   |
| December 31, 2009                                    | December 31, 2012 | 19                 | 980   |
| September 30, 2010                                   | December 31, 2013 | 13                 | 1,217 |
|  |                   | 50                 | 3,376 |
| Consolidated tax benefits                            |                   | 50                 | 1,024 |
| Consolidated unrecognized deferred income tax assets |                   | (26)               | (888) |
| Consolidated recognized deferred income tax assets   |                   | 24                 | 136   |

#### *Registration with Subic Bay Freeport and Clark Special Economic Zone*

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.

With the transfer of Mabuhay Satellite's leasehold rights over the parcel of land where its satellite facility within the Subic Bay Freeport Zone is located as discussed on *Note 9 – Property, Plant and Equipment*, the registration of Mabuhay Satellite as a Subic Bay Freeport Enterprise was cancelled on July 1, 2010. Mabuhay Satellite is now subject to 30% RCIT on taxable income or 2% MCIT on total gross income, whichever is higher.

*Registration with Philippine Economic Zone Authority, or PEZA*

SPi is registered 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.

SPi CRM is registered as an ecozone export enterprise to develop and operate a customer interaction solutions that serves local and overseas clients by providing customer relationship management services.

As registered PEZA enterprises, SPi and SPi CRM are entitled to certain tax and non-tax incentives which include, among other things, tax and duty-free importations, exemption from local tax and 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.

Parlance, which is now merged into SPi CRM, was previously registered with the Board of Investments, or BOI, and became entitled to the same tax incentive provided to SPi CRM as set out earlier. Parlance's ITH incentive under BOI expired on May 31, 2010 and its registration with PEZA was approved on April 30, 2010.

Two of its facilities (SPi CRM Iloilo and SPi CRM Pasig) will continue to enjoy ITH incentive as a BOI registered entity in PEZA registered locations. ITH incentive commenced in March 2005 up to February 2011 and August 2006 up to July 2012 for SPi CRM Iloilo and SPi CRM Pasig, respectively. In relation to this, they are required to comply with specific terms and conditions stated in their PEZA Supplemental Agreement.

Another two locations of SPi CRM, where registration with PEZA is still being processed, are subject to regular corporate income tax effective June 2010 for SPi CRM Jupiter and from commencement of operations for SPi CRM Dumaguete. SPi CRM is also subject to other local and national taxes as provided for by the local municipalities and the Bureau of Internal Revenues, respectively.

SHI was registered with the PEZA as an Ecozone information technology enterprise on a non-pioneer status last July 31, 2009. Under the terms of registration, SHI is entitled to certain tax and non-tax incentives which include, among other things, an income tax holiday, or ITH, for four years starting June 2009.

*Registration with BOI*

On January 3, 2007, the BOI approved ePLDT's application for pioneer status as a new IT service firm in the field of services related to Internet Data Center for its new data center facility. ePLDT was granted a six-year ITH for its new data center facility from 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 education project. Accordingly, the ITH period was extended from four years to six years and expired in January 2009. Level Up! is now subject to 30% RCIT on taxable income or 2% MCIT on total gross income, whichever is higher.

Wolfpac is registered with the BOI as a new IT service firm in the field of an application service provider on a non-pioneer status. Under the terms of its registration, it is entitled to certain tax and non-tax incentives which include, among other things, an ITH for four years starting February 2004. On November 29, 2007, the BOI approved Wolfpac's application for a one-year extension of ITH incentive on the basis that the capital equipment to labor ratio did not exceed US\$10 thousand to one direct labor employee, as provided under Article 39 of Executive Order 226. The approved additional ITH is for the period from February 13, 2008 to February 12, 2009 and was not further extended. As such, Wolfpac is now subject to 30% RCIT on taxable income or 2% MCIT on total gross income, whichever is higher.

SBI is registered with the BOI on a pioneer status, namely as: (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 registration, SBI is entitled to certain tax and non-tax incentives which include, among other things, an ITH for six years. As at September 30, 2010, only the BOI registration for nationwide broadband wireless access continues to enjoy the ITH incentive, which will expire in July 2011.

Consolidated income derived from non-registered activities with Economic Zone and BOI is subject to the RCIT rate enacted as at the end of the reporting period.

Consolidated tax incentives that were availed from registration with Economic Zone and BOI for the nine months ended September 30, 2010 and 2009 amounted to Php650 million and Php935 million, respectively.

## 8. Earnings Per Common Share

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

|  | Nine Months Ended September 30,          |                  |           |           |
|--|--|------------------|-----------|-----------|
|  | 2010                                     |                  | 2009      |           |
|  | Basic                                    | Diluted          | Basic     | Diluted   |
|  | (Unaudited)                              |                  |           |           |
|  | (in million pesos)                       |                  |           |           |
| Consolidated net income for the period attributable to equity holders of PLDT (Note 4)             | 31,988                                   | 31,988           | 30,018    | 30,018    |
| Dividends on preferred shares (Note 19)  | (348)                                    | (348)            | (347)     | (347)     |
| Consolidated net income for the period attributable to common equity holders of PLDT               | <b>31,640</b>                            | <b>31,640</b>    | 29,671    | 29,671    |
|  | (in thousands, except per share amounts) |                  |           |           |
| Outstanding common shares at beginning of period   | 186,797                                  | 186,797          | 187,484   | 187,484   |
| Effect of issuance of common shares during the period (Note 19)                                    | -  | -                | 12        | 12        |
| Effect of purchase of treasury stock during the period (Note 19)                                   | -  | -                | (541)     | (541)     |
| Average incremental number of shares under executive stock option plan, or ESOP, during the period | -  | -                | -         | 20        |
| Common shares equivalent of Preferred Stock Series VI deemed dilutive (Notes 20 and 26)            | -  | -                | -         | 4         |
| Weighted average number of common shares for the period  | <b>186,797</b>                           | <b>186,797</b>   | 186,955   | 186,979   |
| Earnings per share for the period attributable to common equity holders of PLDT                    | <b>Php169.38</b>                         | <b>Php169.38</b> | Php158.70 | Php158.68 |

Basic EPS is calculated by dividing our consolidated net income for the period attributable to common equity holders of PLDT (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.

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 income and expenses on preferred shares. Outstanding stock options will have a dilutive effect only when the average market price of the underlying common share during the period exceeds the exercise price of the stock option.

Convertible preferred shares are deemed dilutive when required dividends declared on each series of convertible preferred shares divided by the number of equivalent common shares, assuming such convertible preferred shares are converted to common shares, decreases the basic EPS. As such, the diluted EPS is calculated by dividing our consolidated net income attributable to common shareholders (consolidated net income, adding back any dividends and/or other charges recognized for 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 excluding the weighted average number of common shares held as treasury shares, and including the common share equivalent arising from the conversion of the dilutive convertible preferred shares.



Series VI Convertible Preferred Stocks in 2009 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 the ESOP and treasury shares, and compared against the basic EPS. Since the amount of dividends on Series A to HH in 2010 and Series A to EE in 2009 over its equivalent number of common shares increased the basic EPS, these Convertible Preferred Stock were deemed anti-dilutive.

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.

In 2008, the Board of Directors approved a share buyback program of up to five million shares of PLDT's common stock, representing approximately 3% of PLDT's total outstanding shares of common stock. As at September 30, 2010 and December 31, 2009, we had acquired a total of approximately 2.7 million shares of PLDT's common stock representing approximately 1% of PLDT's outstanding shares of common stock at a weighted average price of Php2,387 per share for a total consideration of Php6,405 million in accordance with the share buyback program. The effect of the acquisition of shares of PLDT's common stock pursuant to the share buyback program was considered in the computation of our basic and diluted earnings per common share for the nine months ended September 30, 2010 and 2009. See *Note 19 – Equity* and *Note 28 – Financial Assets and Liabilities* for further discussion.

## 9. Property, Plant and Equipment

This account consists of:

|  | Cable and wire facilities | Central office equipment | Cellular facilities | Buildings and improvements | Vehicles, furniture and other network equipment | Communications satellite | Information origination and termination equipment | Land and land improvements | Property under construction | Total          |
|--|---------------------------|--------------------------|---------------------|----------------------------|---|--------------------------|---|----------------------------|-----------------------------|----------------|
| (in million pesos)   |                           |                          |                     |                            |   |                          |   |                            |                             |                |
| <b>As at December 31, 2008 (Audited)</b>                                       |                           |                          |                     |                            |   |                          |   |                            |                             |                |
| Cost   | 115,980                   | 83,562                   | 76,229              | 21,040                     | 34,816  | 9,581                    | 8,251   | 2,527                      | 25,234                      | 377,220        |
| Accumulated depreciation, impairment and amortization                          | (58,380)                  | (62,644)                 | (43,419)            | (8,173)                    | (28,742)  | (8,675)                  | (6,588)   | (273)                      | –                           | (216,894)      |
| <b>Net book value</b>  | <b>57,600</b>             | <b>20,918</b>            | <b>32,810</b>       | <b>12,867</b>              | <b>6,074</b>                                    | <b>906</b>               | <b>1,663</b>                                      | <b>2,254</b>               | <b>25,234</b>               | <b>160,326</b> |
| <b>Year Ended December 31, 2009 (Audited)</b>                                  |                           |                          |                     |                            |   |                          |   |                            |                             |                |
| Net book value at beginning of year  | 57,600                    | 20,918                   | 32,810              | 12,867                     | 6,074   | 906                      | 1,663   | 2,254                      | 25,234                      | 160,326        |
| Additions  | 1,834                     | 513                      | 4,040               | 316                        | 1,970   | 149                      | 225   | 67                         | 19,091                      | 28,205         |
| Disposals/Retirements  | (530)                     | (6)                      | (843)               | (6)                        | (107)   | (463)                    | (3)   | (5)                        | (1,228)                     | (3,191)        |
| Translation differences charged directly to cumulative translation adjustments | 3                         | (2)                      | –                   | (10)                       | (13)  | (47)                     | –   | –                          | –                           | (69)           |
| Acquisition through business combinations (Note 13)                            | 1,348                     | 194                      | 141                 | 186                        | 104   | –                        | 420   | 105                        | (10)                        | 2,488          |
| Impairment losses recognized during the year                                   | –                         | –                        | (96)                | (54)                       | (17)  | –                        | (418)   | (49)                       | –                           | (634)          |
| Reclassifications/Transfers (Note 12)  | 6,949                     | 2,776                    | 8,404               | 326                        | 386   | –                        | 110   | (184)                      | (19,029)                    | (262)          |
| Depreciation and amortization  | (8,793)                   | (3,381)                  | (9,013)             | (1,151)                    | (2,176)   | (545)                    | (542)   | (6)                        | –                           | (25,607)       |
| <b>Net book value at end of year (Note 3)</b>                                  | <b>58,411</b>             | <b>21,012</b>            | <b>35,443</b>       | <b>12,474</b>              | <b>6,221</b>                                    | <b>–</b>                 | <b>1,455</b>                                      | <b>2,182</b>               | <b>24,058</b>               | <b>161,256</b> |
| <b>As at December 31, 2009 (Audited)</b>                                       |                           |                          |                     |                            |   |                          |   |                            |                             |                |
| Cost   | 126,327                   | 87,517                   | 83,451              | 21,693                     | 35,282  | 966                      | 8,940   | 2,458                      | 24,058                      | 390,692        |
| Accumulated depreciation, impairment and amortization                          | (67,916)                  | (66,505)                 | (48,008)            | (9,219)                    | (29,061)  | (966)                    | (7,485)   | (276)                      | –                           | (229,436)      |
| <b>Net book value (Note 3)</b>   | <b>58,411</b>             | <b>21,012</b>            | <b>35,443</b>       | <b>12,474</b>              | <b>6,221</b>                                    | <b>–</b>                 | <b>1,455</b>                                      | <b>2,182</b>               | <b>24,058</b>               | <b>161,256</b> |
| <b>Period Ended September 30, 2010 (Unaudited)</b>                             |                           |                          |                     |                            |   |                          |   |                            |                             |                |
| Net book value at beginning of period (Note 3)                                 | 58,411                    | 21,012                   | 35,443              | 12,474                     | 6,221   | –                        | 1,455   | 2,182                      | 24,058                      | 161,256        |
| Additions  | 1,247                     | 411                      | 1,707               | 252                        | 1,722   | –                        | 143   | –                          | 11,480                      | 16,962         |
| Disposals/Retirements  | (2)                       | (38)                     | (56)                | (12)                       | (54)  | –                        | –   | –                          | (2)                         | (164)          |
| Translation differences charged directly to cumulative translation adjustments | –                         | 5                        | –                   | (5)                        | (19)  | –                        | –   | –                          | (2)                         | (21)           |
| Impairment losses recognized during the period (Notes 3, 4 and 5)              | –                         | –                        | –                   | (12)                       | –   | –                        | (92)  | –                          | –                           | (104)          |
| Reclassifications/Transfers (Note 12)  | 826                       | 948                      | 4,126               | 623                        | 244   | –                        | 85  | 33                         | (6,828)                     | 57             |
| Depreciation and amortization (Notes 3 and 4)                                  | (5,900)                   | (2,842)                  | (7,241)             | (1,490)                    | (2,092)   | –                        | (387)   | (1)                        | –                           | (19,953)       |
| <b>Net book value at end of period (Note 3)</b>                                | <b>54,582</b>             | <b>19,496</b>            | <b>33,979</b>       | <b>11,830</b>              | <b>6,022</b>                                    | <b>–</b>                 | <b>1,204</b>                                      | <b>2,214</b>               | <b>28,706</b>               | <b>158,033</b> |

|   | Cable and wire facilities | Central office equipment | Cellular facilities | Buildings and improvements | Vehicles, furniture and other network equipment | Communications satellite | Information origination and termination equipment | Land and land improvements | Property under construction | Total     |
|---|---------------------------|--------------------------|---------------------|----------------------------|---|--------------------------|---|----------------------------|-----------------------------|-----------|
| (in million pesos)                                    |                           |                          |                     |                            |   |                          |   |                            |                             |           |
| As at September 30, 2010 (Unaudited)                  |                           |                          |                     |                            |   |                          |   |                            |                             |           |
| Cost  | 128,396                   | 88,751                   | 88,807              | 22,293                     | 36,456  | 966                      | 9,099   | 2,492                      | 28,706                      | 405,966   |
| Accumulated depreciation, impairment and amortization | (73,814)                  | (69,255)                 | (54,828)            | (10,463)                   | (30,434)  | (966)                    | (7,895)   | (278)                      | –                           | (247,933) |
| Net book value (Note 3)                               | 54,582                    | 19,496                   | 33,979              | 11,830                     | 6,022   | –                        | 1,204   | 2,214                      | 28,706                      | 158,033   |

Substantially, all our telecommunications equipment are 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 20 – Interest-bearing Financial Liabilities*.

Interest and net foreign exchange losses capitalized to property, plant and equipment that qualified as borrowing costs for the period are as follows:

|                              | Nine Months Ended September 30, |      |
|------------------------------|---------------------------------|------|
|                              | 2010                            | 2009 |
|                              | (Unaudited)                     |      |
|                              | (in million pesos)              |      |
| Interest (Note 5)            | 538                             | 528  |
| Foreign exchange gains – net | –                               | 65   |

Average interest capitalization rates of approximately 7% and 6% were used for the nine months ended September 30, 2010 and 2009, respectively.

As at September 30, 2010 and December 31, 2009, our undepreciated capitalized net foreign exchange losses which qualified as borrowing costs amounted to Php1,447 million and Php1,799 million, respectively.

The useful lives of our assets are estimated as follows:

|   |              |
|---|--------------|
| Cable and wire facilities                         | 5 – 25 years |
| Central office equipment                          | 3 – 20 years |
| Cellular facilities                               | 3 – 10 years |
| Buildings   | 25 years     |
| Building improvements                             | 3 – 5 years  |
| Vehicles, furniture and other network equipment   | 3 – 10 years |
| Communications satellite                          | 15 years     |
| Information origination and termination equipment | 3 – 5 years  |
| Land and land improvements                        | 10 years     |

Property, plant and equipment include the net carrying value of capitalized vehicles, furniture and other network equipment under financing leases amounting to Php7 million and Php24 million as at September 30, 2010 and December 31, 2009, respectively. See *Note 20 – Interest-bearing Financial Liabilities*.

*Satellite Wholesale Lease and Purchase Agreement, or SWLPA, and Operations Management Agreement, or OMA, between Mabuhay Satellite and Asia Broadcast Satellite Holdings, Ltd.*

On October 22, 2009, Mabuhay Satellite entered into SWLPA and OMA with Asia Broadcast Satellite Holdings, Ltd., or ABS, a Bermuda company engaged in the satellite business, involving the wholesale lease by ABS of the Agila 2 satellite from Mabuhay Satellite and, upon the satisfaction of various conditions precedent, the purchase by ABS of the business of Mabuhay Satellite.

Under the SWLPA, Mabuhay Satellite, in exchange for a total consideration of US\$12.5 million, or Php580 million, will: (i) lease to ABS the Agila 2 satellite; (ii) assign the customer contracts to ABS; and (iii) transfer to ABS the Mabuhay Satellite's ground control facilities, employees, leasehold rights, other assets and the Agila 2 satellite. The term of the lease is for a period starting from the effective date of SWLPA to the earlier of: (a) the end of life of Agila 2 satellite; or (b) the date when Mabuhay Satellite assigns, transfers and conveys to ABS all of its rights, title and interest in the Agila 2 satellite. As part of the wholesale lease, Mabuhay Satellite is required to assign to ABS all its rights, title, interest, benefits and obligations in the customer contracts attached to all transponders that are covered by the SWLPA.

Under the OMA, after the closing of the agreement but prior to the transfer and conveyance of the ground control facilities to ABS pending the receipt of International Traffic in Arms Regulations approval, the parties agree that Mabuhay Satellite will operate and manage the Agila 2 satellite, the transponders and the ground control facilities for and on behalf of ABS. Mabuhay Satellite is required to provide the operations and management services for and in consideration of: (a) one-time payment by ABS to Mabuhay Satellite of the amount of US\$500 thousand, or Php23 million; and (b) the reimbursement by ABS to Mabuhay Satellite of the amount equivalent to the actual expenses, costs, losses and liabilities incurred by Mabuhay Satellite in providing the services.

As at December 31, 2009, all significant closing conditions had been secured. On January 18, 2010, Mabuhay Satellite, ABS and Asia Broadcast Satellite, Ltd., formally executed a Conditions Precedent Waiver and First Closing Confirmation, confirming that the first closing was deemed to have occurred effective December 31, 2009. First Closing means the date when the assignment of customer contracts to ABS became effective and the approval or confirmation of SWLPA by stockholders of Mabuhay Satellite representing at least 2/3 of its outstanding capital stock was obtained. Following the confirmation of first closing, the wholesale lease of transponders by Mabuhay Satellite to ABS was considered as a finance lease and the transaction was recognized as sale of satellite for a total consideration of US\$9.9 million, or Php460 million, including the cost of customer contracts as at December 31, 2009.

On July 1, 2010, Mabuhay Satellite, ABS and Broadband Broadcast Services Pte. Ltd., or BBS, executed a Conditions Precedent Waiver and Second Closing Confirmation, confirming that the second closing was deemed to have occurred on July 1, 2010. Second Closing means that date when transfer to BBS of Mabuhay Satellite's ground control facilities, employees, leasehold rights and other assets and the transfer of ABS of the Agila 2 satellite became effective. Following the confirmation of second closing, the OMA was terminated.

#### *Impairment of BOW's Property and Equipment*

In December 2009, impairment losses were recognized on BOW's property and equipment in the amount of Php524 million. The impairment losses resulted from the annual asset impairment test comparing the recoverable amount of the asset against its carrying value. The recoverable amount was determined based on value in use calculation using cash flow projections covering a five-year period from 2010 to 2014. The pre-tax discount rate applied to cash flow projections is 8.7% and cash flows beyond the five-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. See *Note 14 – Goodwill and Intangible Assets*.

#### *Impairment of Smart's Payphone Business*

In September 2010, Smart recognized impairment losses on its public telephone equipment in the amount of Php92 million. Smart engaged a third party contractor to operate and maintain its payphone business. Prior to the engagement, an impairment test was done to assess the net cash flows from the business. The result showed that the future net cash flows were not enough to recover the carrying value of the related assets over its useful life. The recoverable amount was determined based on value in use calculation using cash flow projections covering a three-year period from 2011 to 2013, the end of the assets' useful lives. The pre-tax discount rate applied to cash flow projections is 7%.

## 10. Investments in Associates and Joint Ventures

This account consists of:

|  | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|--|--------------------------------------|-----------------------------------|
|  | (in million pesos)                   |                                   |
| Carrying Value of Investments in Associates:                         |                                      |                                   |
| Meralco  | 6,681                                | 21,420                            |
| Philweb Corporation, or Philweb                                      | 830                                  | 750                               |
| ACeS International Limited, or AIL                                   | –                                    | –                                 |
|  | <b>7,511</b>                         | 22,170                            |
| Carrying Value of Investments in Joint Ventures:                     |                                      |                                   |
| Beacon   | 15,636                               | –                                 |
| Mobile Payment Solutions Pte. Ltd., or MPSPL                         | 111                                  | –                                 |
| ePDS, Inc., or ePDS  | 45                                   | 43                                |
| PLDT Italy S.r.l., or PLDT Italy                                     | –                                    | 20                                |
|  | <b>15,792</b>                        | 63                                |
| Total carrying value of investments in associates and joint ventures | <b>23,303</b>                        | 22,233                            |

Movements in the cost of investments are as follows:

|  | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|--|--------------------------------------|-----------------------------------|
|  | (in million pesos)                   |                                   |
| Balance at beginning of period   | 24,170                               | 4,346                             |
| Additions during the period (including transfer of interests in Meralco to Beacon) | 15,209                               | 21,555                            |
| Transfer of investment in Meralco to Beacon  | (14,767)                             | –                                 |
| Business combinations (Note 13)  | –                                    | (821)                             |
| Dissolution of Mabuhay Space Holdings Limited, or MSHL                             | –                                    | (887)                             |
| Translation and other adjustments  | (54)                                 | (23)                              |
| Balance at end of period   | <b>24,558</b>                        | 24,170                            |

Movements in the accumulated impairment losses are as follows:

|  | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|--|--------------------------------------|-----------------------------------|
|  | (in million pesos)                   |                                   |
| Balance at beginning of period               | 1,906                                | 2,903                             |
| Impairment for the period (Notes 3, 4 and 5) | 78                                   | –                                 |
| Business combinations (Note 13)              | –                                    | (97)                              |
| Dissolution of MSHL                          | –                                    | (887)                             |
| Translation and other adjustments            | (9)                                  | (13)                              |
| Balance at end of period                     | <b>1,975</b>                         | 1,906                             |

Movements in the accumulated equity share in net earnings (losses) of associates and joint ventures are as follows:

|   | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|---|--------------------------------------|-----------------------------------|
|   | (in million pesos)                   |                                   |
| Balance at beginning of period  | (31)                                 | (269)                             |
| Equity share in net earnings (losses) of associates and joint ventures for the period (Note 4): | 1,419                                | 2                                 |
| Meralco   | 733                                  | 398                               |
| Beacon  | 552                                  | –                                 |
| Philweb   | 113                                  | 152                               |
| ePDS  | 21                                   | 21                                |
| BayanTrade  | –                                    | (5)                               |
| PLDT Italy  | –                                    | (98)                              |
| BOW   | –                                    | (466)                             |
| Translation and other adjustments   | 89                                   | 3                                 |
| Transfer of share in net earnings to Beacon   | (316)                                | –                                 |
| Dividends   | (441)                                | (357)                             |
| Business combinations (Note 13)   | –                                    | 590                               |
| Balance at end of period  | 720                                  | (31)                              |

### *Investments in Associates*

#### *PCEV's Acquisition of Shares in Meralco*

On March 12, 2009, First Philippine Holdings Corporation, or FPHC, First Philippine Utilities Corporation, or FPUC, and Lopez, Inc., (collectively, the Lopez Group) and PLDT entered into an investment and cooperation agreement under which: (a) PLDT acquired, through PCEV as its designated affiliate, 223 million shares in Meralco representing approximately 20% of Meralco's outstanding shares of common stock, for a cash consideration of Php20,070 million, or Php90 per share; and (b) PLDT and the Lopez Group agreed on certain governance matters, including the right of PLDT or its assignee to nominate certain senior management officers and members of the board of directors and board committees of Meralco.

As part of the transaction, PCEV and FPUC also entered into an exchangeable note agreement under which PCEV purchased an exchangeable note dated April 20, 2009, issued by FPUC, with a face value of Php2,000 million, exchangeable into approximately 22.2 million shares of common stock of Meralco, which form part of the 223 million shares or approximately 20% of Meralco's voting common shares to be acquired by PCEV in the transaction. The exchange option was exercised simultaneously with the acquisition of such shares by PCEV. PCEV recognized a derivative asset of Php563 million on April 20, 2009 for the exchange option feature of the agreement. The residual amount of Php1,437 million was allocated as the value of the host contract of the exchangeable note. The derivative asset was subsequently carried at fair value through profit or loss while the host contract was carried at amortized cost using effective interest rate.

On July 14, 2009, PCEV completed its acquisition of 223 million shares in Meralco for a cash consideration of Php18,070 million for the purchase of approximately 200.8 million shares and the conversion into approximately 22.2 million shares of an exchangeable note issued by FPUC with a market value, including its derivative option, of Php3,286 million. Thus, the investment in 223 million shares in Meralco was recorded at Php21,356 million and a gain of Php1,286 million was recognized on the exchangeable note, representing the mark-to-market gains of Php1,170 million from the derivative option and the amortization of the note's discount of Php116 million. The acquisition of the shares was implemented through a special block sale/cross sale executed at the PSE.

PCEV engaged the services of an independent appraiser to determine the fair value of Meralco's specific identifiable assets and liabilities and allocate the purchase price of PCEV's investment in Meralco among the identified assets and liabilities based on fair value. Based on the final purchase price allocation, the difference of Php9,672 million between PCEV's share on the total fair value of Meralco's specific identifiable assets and liabilities and the total cost of PCEV's investments was allocated as follows: (a) Php1,517 million for utility, plant and others; (b) Php320 million for investment properties; (c) Php36 million for investments in associates and joint ventures; (d) Php1,286 million for intangible assets particularly for franchise; (e) Php137 million for contingent liability; and (f) Php6,650 million for goodwill.

On March 30, 2010, PCEV reduced its investment in Meralco by Php15,084 million, the proportionate carrying amount of the 154.2 million Meralco shares sold and transferred to Beacon for a consideration of Php23,130 million, see discussion under “Transfer of PCEV’s Equity Interest in Meralco” section. PCEV will continue to use the equity method to account for its remaining investment in 68.8 million of Meralco’s common shares, see *Note 3 – Management’s Use of Judgments, Estimates and Assumptions*. As at September 30, 2010, the carrying value of investment in Meralco amounted to Php6,681 million with the market value of Php15,480 million based on quoted price of Php225 per share.

#### *Investment of ePLDT in Philweb*

In May 2006, ePLDT subscribed to newly issued common shares of Philweb, an internet-based online gaming company, equivalent to 20% of the total outstanding capital stock of Philweb at a price of Php0.020 per share or an aggregate amount of Php503 million. Of the total subscription price, Php428 million was paid by ePLDT on the closing date. A 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 remaining unpaid balance of Php50 million will be paid upon the lapse of certain post-closing price adjustment periods. The total unpaid subscription price of Php75 million was recorded as part of “Others” in the “Accrued expenses and other current liabilities” in our consolidated statement of financial position. See *Note 23 – Accrued Expenses and Other Current Liabilities*.

In October 2006, ePLDT acquired an additional 8,038 million shares of Philweb at a price of Php0.026 per share or an aggregate amount of Php209 million. This represents an additional 6.2% of the outstanding shares of Philweb, raising ePLDT’s total equity stake to 26.87%. As at September 30, 2010 and December 31, 2009, ePLDT’s equity interest in Philweb is 26.4%.

Philweb is primarily engaged in internet-based online gaming, through its appointment as Principal Technology Service Provider under the Marketing Consultancy Agreement for Internet Sports Betting and Internet Casino with the Philippine Amusement and Gaming Corporation, or PAGCOR. As at December 31, 2009, Philweb offers Internet Sports Betting in over 180 PAGCOR Internet Sports Betting Stations and over 180 Internet Casino Stations nationwide. As at September 30, 2010 and December 31, 2009, the market value of ePLDT’s investment in Philweb, based on quoted share price, amounted to Php5,040 million and Php6,134 million, respectively.

#### *Investment of ACeS Philippines in AIL*

As at September 30, 2010, ACeS Philippines had a 36.99% investment in AIL, a company incorporated under the laws of Bermuda. AIL owns the Garuda I Satellite and the related system control equipment in Batam, Indonesia.

AIL has incurred recurring significant operating losses, negative operating cash flows, and significant levels of debt. The financial condition of AIL was partly due to the National Service Providers’, or NSPs, inability to generate the amount of revenues originally expected as the growth in subscriber numbers has been significantly lower than budgeted. These factors raised substantial doubt about AIL’s ability to continue as a going concern. On this basis, we recognized a full impairment provision of Php1,896 million in respect of our investment in AIL in 2003.

Unrecognized share in net losses of AIL amounted to Php26 million and Php11 million for the nine months ended September 30, 2010 and 2009, respectively. Share in net cumulative losses amounting to Php3,640 million and Php3,820 million as at September 30, 2010 and December 31, 2009, respectively, were not recognized as we do not have any legal or constructive obligation for such losses and have not made any payments on behalf of AIL.

See *Note 24 – Related Party Transactions* and *Note 26 – Contractual Obligations and Commercial Commitments* for further details as to the contractual relationships with respect to AIL.

### *Summarized Financial Information of Associates*

The following tables present the summarized financial information of our investments in associates in conformity with PFRS for equity investees in which we have significant influence:

|   | September 30,<br>2010 | December 31,<br>2009 |
|---|-----------------------|----------------------|
|   | (Unaudited)           | (Audited)            |
| (in million pesos)                                    |                       |                      |
| <b>Consolidated Statements of Financial Position:</b> |                       |                      |
| Noncurrent assets                                     | 129,748               | 136,581              |
| Current assets  | 57,538                | 46,755               |
| Equity  | 55,474                | 52,143               |
| Noncurrent liabilities                                | 77,547                | 86,605               |
| Current liabilities                                   | 54,265                | 44,588               |

|   | Nine Months Ended September 30,<br>2010 | 2009    |
|---|---|---------|
|   | (Unaudited)                             |         |
| (in million pesos)                        |   |         |
| <b>Consolidated Statements of Income:</b> |   |         |
| Revenues                                  | 189,887                                 | 143,810 |
| Expenses                                  | 172,187                                 | 130,470 |
| Other expenses                            | 5,618                                   | –       |
| Net income                                | 8,515                                   | 5,713   |

The above information includes the financial information of Meralco as at September 30, 2010 and December 31, 2009 and for the nine months ended September 30, 2010 and 2009 as shown below:

|   | September 30,<br>2010 | December 31,<br>2009 |
|---|-----------------------|----------------------|
|   | (Unaudited)           | (Audited)            |
| (in million pesos)                                    |                       |                      |
| <b>Consolidated Statements of Financial Position:</b> |                       |                      |
| Noncurrent assets                                     | 128,320               | 135,071              |
| Current assets  | 55,530                | 45,342               |
| Equity  | 62,978                | 60,878               |
| Noncurrent liabilities                                | 70,582                | 76,516               |
| Current liabilities                                   | 50,290                | 43,019               |

|   | Nine Months Ended September 30,<br>2010 | 2009    |
|---|---|---------|
|   | (Unaudited)                             |         |
| (in million pesos)                        |   |         |
| <b>Consolidated Statements of Income:</b> |   |         |
| Revenues                                  | 188,904                                 | 143,810 |
| Expenses                                  | 171,582                                 | 130,470 |
| Other expenses                            | 5,646                                   | –       |
| Net income                                | 7,966                                   | 5,713   |

### *Investments in Joint Ventures*

#### *Transfer of PCEV's Equity Interest in Meralco*

On March 1, 2010, PCEV, MPIC and Beacon, entered into an Omnibus Agreement, or OA. Beacon, formerly known as Rightlight Holdings, Inc., was organized with the sole purpose of holding the respective shareholdings in Meralco of PCEV and MPIC. PCEV and MPIC are Philippine affiliates of First Pacific and both held equity shares in Meralco. Under the OA, PCEV and MPIC have agreed to set out their mutual agreement in respect of, among other matters, the capitalization, organization, conduct of business and the extent of their participation in the management of the affairs of Beacon.

### *Investment in Beacon*

Prior to the transactions contemplated under the OA, MPIC beneficially owned the entire outstanding capital stock of Beacon consisting of 25,000 common shares of Beacon, with a total par value of Php25,000.

On April 29, 2010, the Philippine SEC approved Beacon's application to increase its authorized capital stock to Php5 billion consisting of 3 billion common shares with par value of Php1 per share and 2 billion preferred shares with par value of Php1 per share. The preferred shares of Beacon are non-voting, not convertible to common shares or any shares of any class of Beacon, have no pre-emptive rights to subscribe to any share or convertible debt securities or warrants issued or sold by Beacon. The preference shareholder is entitled to liquidation preference and yearly cumulative dividends at the rate of 7% of the issue value subject to: (a) availability of unrestricted retained earnings; and (b) dividend payment restrictions imposed by Beacon's bank creditors.

Under the OA, each of PCEV and MPIC agreed to subscribe to 1,156.5 million common shares of Beacon, for a subscription price of Php20 per share or a total of Php23,130 million. PCEV and MPIC also agreed that their resulting equity after such subscriptions and PCEV's purchase from MPIC of 12,500 Beacon common shares will be 50% each of the outstanding common shares of Beacon.

MPIC additionally agreed to subscribe to 801 million shares of Beacon's preferred stock for a subscription price of Php10 per share or a total of Php8,010 million.

The completion of the subscription of MPIC to 1,156.5 million common shares and 801 million preferred shares of Beacon was subject to the following conditions, all of which have been satisfied: (a) approval of MPIC's Board of Directors, which was obtained on March 1, 2010; (b) approval of the shareholders of First Pacific, which was obtained on March 30, 2010; and (c) full payment of the subscription price, which was made on March 30, 2010. Consequently, on March 30, 2010, MPIC completed its subscription to 1,156.5 million common shares of Beacon and approximately 801 million preferred shares of Beacon in consideration of: (1) the transfer of 163.6 million Meralco shares at a price of Php150 per share, or Php24,540 million in the aggregate; and (2) Php6,600 million in cash, as further described below in "Transfer of Meralco Shares to Beacon".

The completion of the subscription of PCEV to 1,156.5 million common shares of Beacon was subject to the following conditions, all of which have been satisfied: (a) PCEV Board of Directors' approval, which was obtained on March 1, 2010; (b) the approval of the shareholders of First Pacific, which was obtained on March 30, 2010; (c) the approval of the shareholders of PCEV, which was obtained on May 7, 2010; and (d) the full payment of the subscription price, which was made on May 12, 2010.

Although PCEV secured the approval of its shareholders only on May 7, 2010, such approval was deemed to be a formality as Smart owns 99.5% of PCEV's capital stock. Consequently, upon receipt of all other required approvals under the OA on March 30, 2010, including that of the shareholders of First Pacific, PCEV recognized as an asset the deposit for future stock subscription of Php23,130 million for its subscription to 1,156.5 million common shares of Beacon. The deposit for future stock subscription was eventually reclassified to investment account when Beacon's increase in authorized capital stock was approved by the SEC.

The subscription price of PCEV's and MPIC's subscription to Beacon shares was offset in full (in the case of PCEV) and in part (in the case of MPIC) against the consideration for the transfer of Meralco shares held by PCEV and MPIC as described in "Transfer of Meralco Shares to Beacon" section below. In addition, MPIC settled its remaining balance in cash. On May 12, 2010, PCEV also completed the purchase from MPIC of 12,500 shares or 50% of the 25,000 Beacon common shares originally owned by MPIC.



### *Transfer of Meralco Shares to Beacon*

Alongside with the subscription to the Beacon shares described above, Beacon agreed to purchase 154.2 million and 163.6 million Meralco shares, or the Transferred Shares, from PCEV and MPIC, respectively, for a consideration of Php150 per share or a total of Php23,130 million for the PCEV Meralco shares and Php24,540 million for the MPIC Meralco shares.

The completion of the sale of the MPIC Meralco shares to Beacon was subject to the following conditions, all of which have been satisfied: (a) approval of MPIC's Board of Directors, which was obtained on March 1, 2010; (b) approval of the Board of Directors of First Pacific, which was obtained on March 1, 2010; (c) approval of the shareholders of First Pacific, which was obtained on March 30, 2010; and (d) release of the pledge over the MPIC Meralco shares, which was completed on March 30, 2010. Consequently, on March 30, 2010, MPIC transferred 163.6 million Meralco shares to Beacon at a price of Php150 per share for a total consideration of Php24,540 million.

The completion of the sale of the PCEV Meralco shares to Beacon was subject to the following conditions, all of which have been satisfied: (a) PCEV Board of Directors' approval, which was obtained on March 1, 2010; (b) the approval of the Board of Directors of First Pacific, which was obtained on March 1, 2010; (c) the approval of the shareholders of First Pacific, which was obtained on March 30, 2010; and (d) the approval of the shareholders of PCEV, which was obtained on May 7, 2010. Consequently, on May 12, 2010, PCEV transferred 154.2 million Meralco shares to Beacon at a price of Php150 per share for a total consideration of Php23,130 million.

The transfer of legal title to the Meralco shares was implemented through a special block sale/cross sale in the PSE.

Although PCEV secured the approval of its shareholders only on May 7, 2010, such approval was deemed to be a formality as Smart owns 99.5% of PCEV's capital stock. Consequently, upon receipt of all other required approvals under the OA on March 30, 2010, including that of the shareholders of First Pacific, PCEV recognized a Php15,084 million investment (initially recognized as deposit for future stock subscription, see discussion above) in Beacon representing the proportionate carrying cost of the 154.2 million Meralco shares transferred to Beacon under the OA. PCEV recognized a deferred gain of Php8,046 million for the difference between the Php23,130 million transfer price of the Meralco shares to Beacon and the Php15,084 million carrying amount in PCEV's books of the Meralco shares transferred. The deferred gain, presented as a reduction in PCEV's investment in Beacon, will only be realized upon the disposal of the investment to a third party.

Subject to rights over certain property dividends that may be declared or distributed in respect of the approximately 317.8 million Transferred Shares, which will be assigned to FPHC if the Call Option (as discussed below), is exercised, the rights, title and interest transferred to Beacon by MPIC and PCEV in respect of the approximately 317.8 million Transferred Shares includes: (a) all shares issued by Meralco by way of stock dividends on the Transferred Shares from March 1, 2010; (b) all property or cash dividends declared or paid on the Transferred Shares from March 1, 2010; (c) all other rights accruing on the Transferred Shares from March 1, 2010; and (d) the proceeds of all of the foregoing.

PCEV may, at some future time and under such terms and conditions as may be agreed by PCEV and Beacon, transfer to Beacon its remaining 68.8 million Meralco common shares.

### *Call Option*

Under the OA, MPIC assigned its right to acquire the call option, or the Call Option, over 74.7 million common shares of Meralco held by FPHC, or the Option Shares, to Beacon. As a result of this assignment, Beacon and FPHC executed an Option Agreement dated March 1, 2010 pursuant to which FPHC granted the Call Option over the Option Shares to Beacon.

The Call Option is exercisable at the option of Beacon during the period from March 15, 2010 until midnight of May 15, 2010. The exercise price for the Option Shares is Php300 per share or an aggregate exercise price of Php22,410 million. Beacon exercised the Call Option on March 30, 2010 and FPHC transferred the 74.7 million shares of Meralco common stock to Beacon in consideration of the payment by Beacon of Php22,410 million in cash on March 30, 2010.

Subject to rights over certain property dividends that may be declared or payable in respect of the 74.7 million shares of Meralco common stock, which are retained by FPHC following the Call Option exercise, the rights, title and interest transferred to Beacon by FPHC in respect of the Option Shares includes: (a) all shares issued by Meralco by way of stock dividends on the Option Shares from March 1, 2010; (b) all property or cash dividends declared or paid on the Transferred Shares from March 1, 2010; (c) all other rights accruing on the Transferred Shares from March 1, 2010; and (d) the proceeds of any sale or disposition of any of the foregoing.

#### *Property Dividends*

With respect to the approximately 317.8 million Transferred Shares, the remaining 68.8 million Meralco common shares held by PCEV and the 74.7 million Option Shares transferred by FPHC to Beacon pursuant to the Call Option, FPHC has the benefit of being assigned, or retaining in the case of the Option Shares, certain property dividends that may be declared on such shares.

#### *Governance Arrangements*

Beacon, PCEV and MPIC have also agreed on certain corporate governance matters, including Board composition, election of officers, shareholders' action, representation to the Meralco Board, nomination of the Meralco Board Committees, and nomination of Meralco officers. The corporate governance agreements and Beacon equity structure resulted in a jointly-controlled entity.

On March 30, 2010, Beacon also entered into an Php18,000 million ten-year corporate notes facility with First Metro Investment Corporation and PNB Capital and Investment Corporation as joint lead arrangers and various local financial institutions as noteholders. The proceeds of the notes facility partially financed the acquisition of Meralco shares by Beacon pursuant to its exercise of the Call Option. As at September 30, 2010, the amount drawn under this facility amounted to Php16,200 million (Php16,022 million, net of debt issuance cost of Php178 million); the remaining undrawn balance amounted to Php1,800 million.

As at September 30, 2010, Beacon held 393 million Meralco common shares representing approximately 35% equity interest in Meralco with market value of Php88,425 million based on a quoted price of Php225 per share.

#### *Investment of SHI in MPSPL*

In June 2010, SHI and MasterCard Asia/Pacific Pte. Ltd., or MasterCard Asia, entered into a joint venture agreement under which the parties agreed to form MPSPL. The joint venture will develop, provide and market certain mobile payment services among other activities as stipulated in the agreement. MPSPL was incorporated in Singapore on June 4, 2010 and is 40% and 60% owned by SHI and MasterCard Asia, respectively. Based on the agreement, SHI will contribute US\$2.4 million which will be paid within the fourth quarter of 2010 upon finalization of the required documents.

#### *Investment of ePLDT in ePDS*

ePLDT entered into a joint venture agreement on June 27, 2003 with DataPost Pte. Ltd., or DataPost, a subsidiary of Singapore Post, or Spring, and G3 Worldwide ASPAC pursuant to which the parties formed ePDS, a bills printing company that performs laser printing and enveloping services for statements, bills and invoices, and other VAS for companies in the Philippines. ePLDT has a 50% equity interest in ePDS, while DataPost has a 30% equity interest. Spring, the largest international mail services provider, owns the remaining 20% equity interest. ePDS has an initial paid-up capital of Php11 million.

*Investment of PLDT Global in PLDT Italy*

PLDT Global holds 100% nominal interest in PLDT Italy, a company incorporated under the laws of Italy, which is intended to carry the joint venture business between PLDT Global and Hutchison Global Communications Limited, or HGC, a company based in Hong Kong. On March 12, 2008, PLDT Global and HGC entered into a Co-operation Agreement wherein the parties agreed to launch their first commercial venture in Italy by offering mobile telecommunications services through PLDT Italy. Under the terms of the agreement, the aggregate amount of funding to be contributed by PLDT Global and HGC to PLDT Italy, in equal proportions, is capped at Euro 7.0 million. PLDT Global and HGC agreed to share equally the profit and loss from the operations of PLDT Italy. As a condition precedent to the effectiveness of the Co-Operation Agreement, PLDT Global pledged 50% of its shareholding in PLDT Italy to HGC.

On May 17, 2010, the PLDT Italy Board of Directors, during its special meeting, has approved to convert both partner's debts of Euro 370 thousand into equity and to infuse cash of Euro 130 thousand, totaling Euro 500 thousand.

As at September 30, 2010 and December 31, 2009, the aggregate amount of funding contributed by PLDT Global and HGC to PLDT Italy was Euro 6.5 million and Euro 6.0 million, respectively. PLDT Global's share of equity in the joint venture as at September 30, 2010 and December 31, 2009 amounted to Euro 3.25 million, or Php160 million, and Euro 3.0 million, or Php199.7 million, respectively.

***Summarized Financial Information of Joint Ventures***

The following table presents the summarized financial information of our investments in joint ventures.

|   | <b>September 30,<br/>2010</b>                   | December 31,<br>2009 |
|---|---|----------------------|
|   | <b>(Unaudited)</b>                              | (Audited)            |
|   | (in million pesos)                              |                      |
| <b>Consolidated Statements of Financial Position:</b> |   |                      |
| Noncurrent assets                                     | <b>70,777</b>                                   | 103                  |
| Current assets  | <b>1,545</b>                                    | 244                  |
| Equity  | <b>55,323</b>                                   | 57                   |
| Noncurrent liabilities                                | <b>16,031</b>                                   | 88                   |
| Current liabilities                                   | <b>968</b>                                      | 202                  |
|   |   |                      |
|   | <b>Nine Months Ended September 30,<br/>2010</b> | 2009                 |
|   | (Unaudited)                                     |                      |
|   | (in million pesos)                              |                      |
| <b>Consolidated Statements of Income:</b>             |   |                      |
| Revenues  | <b>2,135</b>                                    | 172                  |
| Expenses  | <b>253</b>                                      | 396                  |
| Other expenses  | <b>776</b>                                      | -                    |
| Net income  | <b>1,090</b>                                    | 223                  |

The above information includes the financial information of Beacon as at and for the nine months ended September 30, 2010 as shown below:

|  | (in million pesos) |
|--|--------------------|
| <b>Consolidated Statement of Financial Position:</b> |                    |
| Noncurrent assets                                    | 70,732             |
| Current assets                                       | 1,285              |
| Equity   | 55,131             |
| Noncurrent liabilities                               | 16,022             |
| Current liabilities                                  | 864                |
| <b>Consolidated Statement of Income:</b>             |                    |
| Equity share in net income of Meralco                | 1,951              |
| Expenses   | 66                 |
| Other expenses                                       | 774                |
| Net income   | 1,111              |

As at September 30, 2010, we have no outstanding capital commitments with our joint ventures.

## 11. Investment in Debt Securities

This account consists of:

|   | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|---|--------------------------------------|-----------------------------------|
|   | (in million pesos)                   |                                   |
| Government Securities   | 405                                  | –                                 |
| National Power Corporation, or NAPOCOR, Zero Coupon Bond        | 328                                  | 312                               |
| Rizal Commercial Banking Corporation, or RCBC, Note             | 150                                  | 150                               |
|   | 883                                  | 462                               |
| Less current portion of investment in debt securities (Note 28) | 405                                  | –                                 |
| Noncurrent portion of investment in debt securities (Note 28)   | 478                                  | 462                               |

### *Government Securities*

In August 2010, PCEV invested in Treasury Bills, or T-Bills, which are Philippine peso denominated Government Securities with an average yield to maturity of 4.18% per annum maturing on December 29, 2010. A total face value of Php409 million was purchased at a discount of Php6 million. The discount is amortized using the effective interest rate method. As at September 30, 2010, the carrying value of the T-Bills amounted to Php405 million. Interest income recognized on these T-Bills amounted to Php2 million for the nine months ended September 30, 2010.

### *NAPOCOR Zero Coupon Bonds*

In 2007, Smart purchased, at a discount, a NAPOCOR Zero Coupon Bond, or NAPOCOR Bond, with a face value of Php380 million, maturing on November 29, 2012 at a net yield to maturity of 6.88%. The NAPOCOR Bond, which is classified as a financial asset held-to-maturity, is carried at amortized cost using the effective interest rate method. Interest income recognized on the NAPOCOR Bond amounted to Php16 million and Php15 million for the nine months ended September 30, 2010 and 2009, respectively.

### RCBC Note

In 2008, Smart purchased at par a ten-year RCBC Tier 2 Note, or RCBC Note, with a face value of Php150 million bearing a fixed rate of 7.00% for the first five years and the step-up interest rate from the fifth year up to maturity date. The RCBC Note may be redeemed at the option of the Issuer at par plus accrued and unpaid interest on February 22, 2013. Smart designated the RCBC Note as held-to-maturity financial asset. Interest income recognized on the RCBC Note for the nine months ended September 30, 2010 and 2009 amounted to Php6 million each.

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## 12. Investment Properties

Movements in investment properties are as follows:

|   | September 30,<br>2010 | December 31,<br>2009 |
|---|-----------------------|----------------------|
|   | (Unaudited)           | (Audited)            |
|   | (in million pesos)    |                      |
| Balance at beginning of period                            | 1,210                 | 617                  |
| Disposals   | (55)                  | (21)                 |
| Transfer from (to) property, plant and equipment (Note 9) | (57)                  | 262                  |
| Net gains from fair value adjustments (Note 3)            | -                     | 352                  |
| Balance at end of period (Notes 3 and 28)                 | 1,098                 | 1,210                |

Investment properties are stated at fair values, which have been determined annually based on the year-end appraisal performed by an independent firm of appraisers, 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 seller in an arm's length transaction at the dates of valuation. None of our investment properties are being leased to third parties that earn rental income.

Repairs and maintenance expenses relating to investment properties amounted to Php66 million and Php47 million for the nine months ended September 30, 2010 and 2009, respectively.

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## 13. Business Combinations and Acquisition of Non-Controlling Interests

### 2009 Acquisitions

#### *PLDT's Acquisition of Philcom*

On January 3, 2009, PLDT, PremierGlobal Resources and Philippine Global Communications, Inc., or PGCI, executed a Share Assignment Agreement wherein PGCI sold to PLDT the rights, title and interest in all of the outstanding shares of Philcom's common stock for a cash consideration of Php75 million.

The purchase price consideration has been allocated to the assets and liabilities on the basis of fair values at the date of acquisition as follows:

|                                     | (in million pesos) |
|-------------------------------------|--------------------|
| <b>Assets:</b>                      |                    |
| Property, plant and equipment       | 1,851              |
| Available-for-sale financial assets | 5                  |
| Deferred income tax assets – net    | 3                  |
| Cash and cash equivalents           | 51                 |
| Trade and other receivables         | 204                |
| Inventories and supplies            | 15                 |
| Prepayments                         | 8                  |
|                                     | 2,137              |

|  | (in million pesos) |
|--|--------------------|
| <b>Liabilities:</b>                            |                    |
| Long-term debt                                 | 340                |
| Deferred income tax liabilities – net          | 381                |
| Pension and other employee benefits            | 13                 |
| Accounts payable                               | 1,206              |
| Accrued expenses and other current liabilities | 77                 |
| Dividends payable                              | 2                  |
| Income tax payable                             | 3                  |
|  | 2,022              |
|  | 115                |
| Non-controlling interests                      | 40                 |
| Net assets acquired                            | 75                 |

Non-controlling interests represent the interest not owned by Philcom in its two subsidiaries, which is measured at proportionate share in fair values of identifiable assets and liabilities acquired at the date of acquisition.

The fair value and gross amount of trade and other receivables amounted to Php204 million and Php679 million, respectively. The amount of allowance for impairment for uncollectible trade and other receivables amounted to Php475 million.

Total revenues and net income of Philcom included in our 2009 consolidated income statement from the time of acquisition until December 31, 2009 amounted to Php387 million and Php2 million, respectively.

#### *ePLDT's Acquisition of BayanTrade*

On January 20, 2009 and April 15, 2009, ePLDT acquired additional equity interest of 34.3% and 48.4%, respectively, in BayanTrade for a cash consideration of Php28 million and Php39 million, respectively, thereby increasing its ownership interest to 93.5% as at April 15, 2009. As a result of the transaction, goodwill amounting to Php184 million, representing the difference between the consideration of Php61 million, net of Php5 million accumulated equity share in net losses of BayanTrade, and the book value of the interest acquired, was recognized.

The purchase price consideration has been allocated to the assets and liabilities on the basis of fair values on April 15, 2009 as follows:

|  | (in million pesos) |
|--|--------------------|
| <b>Assets:</b>                                 |                    |
| Property, plant and equipment                  | 21                 |
| Goodwill (Note 14)                             | 184                |
| Deferred income tax assets – net               | 19                 |
| Advances and refundable deposits               | 11                 |
| Cash and cash equivalents                      | 6                  |
| Trade and other receivables                    | 179                |
| Prepayments and other current assets           | 6                  |
|  | 426                |
| <b>Liabilities:</b>                            |                    |
| Long-term debt                                 | 150                |
| Pension and other employee benefits            | 5                  |
| Other noncurrent liabilities                   | 59                 |
| Accounts payable                               | 85                 |
| Accrued expenses and other current liabilities | 75                 |
|  | 374                |
|  | 52                 |
| Non-controlling interests                      | (9)                |
| Net assets acquired                            | 61                 |

Non-controlling interests represent interest not owned by ePLDT, which is measured at proportionate share in fair values of identifiable assets and liabilities acquired at the date of acquisition.

The fair value of trade and other receivables and advances and refundable deposits amounted to Php179 million and Php11 million, respectively. The gross amount of trade and other receivables and advances and refundable deposits amounted to Php195 million and Php11 million, respectively. The amount of allowance for impairment for uncollectible trade and other receivables amounted to Php16 million. None of the advances and refundable deposits has been impaired and it is expected that the full contractual amount can be collected.

The goodwill of Php184 million pertains to the fair value of assembled workforce which offers managed information technology services and has personnel with skills in Systems, Applications and Products, Microsoft and other Enterprise Resource Planning, or ERP. They have the largest pool of ERP practitioners in the South East Asia region.

Our consolidated revenues would have increased by Php61 million while our consolidated net income would have decreased by Php19 million for the year ended December 31, 2009 had the acquisition of BayanTrade actually taken place on January 1, 2009. Total revenues and net losses of BayanTrade included in our 2009 consolidated income statement from April 15, 2009 to December 31, 2009 amounted to Php275 million and Php27 million, respectively.

*Smart's Acquisition of Non-Controlling Interests in PCEV*

Smart's Board of Directors approved on June 19, 2009 a tender offer to acquire at Php8.50 per share, fully payable in cash on August 12, 2009, from PCEV's non-controlling shareholders up to approximately 840 million shares. These shares represented approximately 7.2% of the outstanding common stock of PCEV at that time. Smart filed the Tender Offer Report with the Philippine SEC and the PSE on June 23, 2009 pursuant to Section 19 of the Securities Regulation Code, or SRC. The tender offer commenced on July 1, 2009 and ended on July 29, 2009, with approximately 93.0% of PCEV's non-controlling shares tendered, thereby increasing Smart's ownership to approximately 99.5% of the outstanding common stock of PCEV. The aggregate cost for the tender offer paid by Smart to non-controlling shareholders on August 12, 2009 amounted to Php6,618 million, from which Smart recognized an excess of acquisition cost over the carrying value of non-controlling interests acquired of Php5,479 million presented as part of capital in excess of par value account under "Equity" in our consolidated statement of financial position.

*Smart's Acquisition of Shares in BOW*

In July 2009, Smart (through its subsidiary, SCH) increased its shareholdings in BOW, a Dublin-based company delivering GSM communication capability for the merchant maritime sector to approximately 1.2 million shares representing 51.0% of the total issued and outstanding shares of BOW from 381 thousand shares or 28.3%. Total acquisition cost for Smart's investment in BOW amounted to US\$9 million, or Php439 million, which consists of: (a) US\$4 million, or Php182 million, in cash; (b) US\$2 million, or Php119 million, worth of advances; and (c) fair value of previously held interest amounting to US\$3 million, or Php138 million. Net cash outflow related to the acquisition was US\$12 million, or Php552 million, representing cash payment of US\$17 million, or Php783 million, net of cash acquired from BOW of US\$5 million, or Php231 million.

The purchase price consideration has been allocated to the assets and liabilities on the basis of fair values in July 2009 as follows:

|                                  | In U.S. Dollar | In Php <sup>(1)</sup> |
|----------------------------------|----------------|-----------------------|
|                                  | (in millions)  |                       |
| <b>Assets:</b>                   |                |                       |
| Property, plant and equipment    | 12             | 558                   |
| Goodwill (Note 14)               | 1              | 45                    |
| Intangible assets (Note 14)      | 5              | 221                   |
| Advances and refundable deposits | -              | 7                     |
| Cash and cash equivalents        | 5              | 231                   |
| Trade and other receivables      | -              | 33                    |
| Prepayments                      | -              | 31                    |
|                                  | 23             | 1,126                 |

|  | In U.S. Dollar | In Php <sup>(1)</sup> |
|--|----------------|-----------------------|
|  | (in millions)  |                       |
| <b>Liabilities:</b>                            |                |                       |
| Long-term debt                                 | 4              | 203                   |
| Accrued expenses and other current liabilities | 2              | 106                   |
|  | 6              | 309                   |
|  | 17             | 817                   |
| Non-controlling interests                      | 8              | 378                   |
| Net assets acquired                            | 9              | 439                   |

<sup>(1)</sup> Converted to Philippine Peso using the exchange rate at the time of purchase of Php48.07 to US\$1.00.

Non-controlling interests represent interest not owned by Smart, which is measured at proportionate share in fair values of identifiable assets and liabilities acquired at the date of acquisition.

The fair value of trade and other receivables and advances and refundable deposits, which is equal to gross amount, amounted to Php33 million and Php7 million, respectively.

The acquisition date fair value of previously held equity interest of 28.3% by Smart immediately before the acquisition date amounted to Php138 million. The amount of loss recognized as a result of remeasuring previously held equity interest to fair value amounted to Php381 million and is included in “Equity share in net earnings of associates and joint ventures” in our consolidated income statement.

The goodwill of Php45 million pertains to the fair value of the expected synergies arising from the acquisition of BOW by SCH. BOW is expected to complement *Smart Link*, Smart’s satellite service catering to the mobile communication requirements of the international maritime market.

Our consolidated revenues would have increased by Php68 million while our consolidated net income would have decreased by Php300 million for the year ended December 31, 2009 had the additional acquisition of BOW actually taken place on January 1, 2009. Total revenues and net losses of BOW included in our 2009 consolidated income statement from July 2009 to December 31, 2009 amounted to Php10 million and Php906 million, respectively.

#### *SPI's Acquisition of Laguna Medical Systems, Inc., or Laguna Medical*

On August 31, 2009, SPi acquired through SPi-America, a wholly-owned U.S. subsidiary of SPi, a 100% equity interest in Laguna Medical for a cash contribution of US\$6.6 million, or Php313 million, plus a contingent consideration in the form of a mandatory put-call option with an aggregate fair value at acquisition date of US\$5.4 million, or Php257 million. As at date of the acquisition, the net cash outflows related on acquisition was US\$5.6 million, or Php287 million, representing cash payments of US\$6.6 million, or Php313 million, net of cash acquired from Laguna Medical of US\$1 million, or Php26 million. Total purchase price consideration including the fair market value of contingent liability at acquisition date amounted to US\$12 million, or Php579 million. Incidental cost related to the acquisition was recognized as expense. See *Note 21 – Deferred Credits and Other Noncurrent Liabilities* and *Note 23 – Accrued Expenses and Other Current Liabilities*.

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

|                                  | In U.S. Dollar | In Php <sup>(1)</sup> |
|----------------------------------|----------------|-----------------------|
|                                  | (in millions)  |                       |
| <b>Assets:</b>                   |                |                       |
| Property, plant and equipment    | –              | 8                     |
| Goodwill (Note 14)               | 10             | 463                   |
| Intangible assets (Note 14)      | 2              | 73                    |
| Deferred income tax assets – net | –              | 3                     |
| Cash and cash equivalents        | 1              | 26                    |
| Trade and other receivables      | 1              | 53                    |
| Other current assets             | –              | 15                    |
|                                  | 14             | 641                   |



|  | In U.S. Dollar | In Php <sup>(1)</sup> |
|--|----------------|-----------------------|
|  | (in millions)  |                       |
| <b>Liabilities:</b>                            |                |                       |
| Accounts payable                               | –              | 4                     |
| Accrued expenses and other current liabilities | 1              | 24                    |
| Deferred income tax liabilities – net          | 1              | 29                    |
| Other current liabilities                      | –              | 5                     |
|  | 2              | 62                    |
| Net assets acquired                            | 12             | 579                   |

<sup>(1)</sup> Converted to Philippine Peso using the exchange rate at the time of purchase of Php47.42 to US\$1.00.

Laguna Medical was accounted for in our consolidated financial statements using the purchase price method of accounting, which resulted in goodwill amounting to Php463 million on August 31, 2009.

The goodwill pertains to the fair value of expanding the healthcare product offering of SPi and other unidentified intangible assets that did not qualify as intangible assets under PAS 38.

The intangible assets pertaining to Laguna Medical's customer relationship and internally developed software were determined at Php50 million and Php23 million, respectively, with estimated useful lives of eight and three years, respectively. Intangible assets were valued by an independent appraiser based on multiple excess earnings approach using weighted average cost of capital of 10.69%.

The fair value of trade and other receivables, which is equal to gross amount, amounted to Php53.4 million. The amount of allowance for impairment for uncollectible trade and other receivables amounted to Php0.4 million.

Our consolidated revenues would have increased by Php237 million while our consolidated net income would have increased by Php8 million for the year ended December 31, 2009 had the acquisition of Laguna Medical actually taken place on January 1, 2009. Total revenues and net income of Laguna Medical included in our 2009 consolidated income statement from August 31, 2009 to December 31, 2009 amounted to Php103 million and Php0.3 million, respectively.

#### *Smart's Acquisition of PDSI*

In May and October 2009, Smart acquired an aggregate of approximately 84 million shares, representing the total issued and outstanding capital stock of PDSI, for a total consideration of Php1,569 million. The acquisition was completed on two dates: (a) the first closing took place on May 14, 2009 and involved the acquisition of approximately 34 million shares representing 40% of the issued and outstanding shares of PDSI for a consideration of Php632 million; and (b) the second closing took place on October 2, 2009 and involved the acquisition of the remaining approximately 50 million shares representing 60% of the issued and outstanding shares of PDSI for a consideration of Php937 million.

The purchase price consideration was allocated based on the result of estimates generated from the excess earnings and relief from royalty methods. A fixed asset appraisal was conducted by an independent appraiser to provide the fair market values of the specific fixed assets owned by PDSI. Identified and measurable tangible and intangible assets were totaled and measured against the purchase price with goodwill assigned to the residual value. The results are summarized in the table below:

|   | (in million pesos) |
|---|--------------------|
| <b>Assets:</b>  |                    |
| Property, plant and equipment                             | 93                 |
| Goodwill (Note 14)  | 1,530              |
| Intangible assets (Note 14)                               | 16                 |
| Prepayments   | 10                 |
| Advances and refundable deposits – net of current portion | 8                  |
| Cash and cash equivalents                                 | 12                 |
| Trade and other receivables                               | 42                 |
| Current portion of advances and refundable deposits       | 6                  |
|   | 1,717              |

|  | (in million pesos) |
|--|--------------------|
| <b>Liabilities:</b>                            |                    |
| Accounts payable                               | 30                 |
| Accrued expenses and other current liabilities | 116                |
| Income tax payable                             | 2                  |
|  | 148                |
| Net assets acquired                            | 1,569              |

The acquisition date fair value of the 40% equity interest in PDSI that had been held by Smart immediately before the acquisition date amounted to Php632 million.

The provisional goodwill in 2009 was reduced by the increase in the property, plant and equipment amounting to Php51 million and the recognition of intangible assets amounting to Php16 million. The December 31, 2009 consolidated statement of financial position were no longer restated to reflect the adjustments as the amounts are not material to our consolidated financial statements.

The goodwill of Php1,530 million pertains to the fair value of the expected synergies arising from the acquisition of PDSI by Smart. PDSI is expected to complement SBI's broadband internet service.

Our consolidated revenues would have increased by Php241 million while our consolidated net income would have decreased by Php9 million for the year ended December 31, 2009 had the acquisition of PDSI actually taken place on January 1, 2009. Total revenues and net losses of PDSI included in our 2009 consolidated net income from October 2, 2009 to December 31, 2009 amounted to Php80 million and Php13 million, respectively.

#### *Smart's Acquisition of Chikka*

On December 18, 2009, Smart acquired 120 thousand common shares, representing 100% of the outstanding share capital of Chikka for a total consideration of US\$13.5 million, or Php629 million, of which US\$12.1 million, or Php564 million, was paid in cash on December 18, 2009 and the balance of US\$1.4 million, or Php65 million, was paid on September 27, 2010 upon completion of the Post Closing provisions. See *Note 23 – Accrued Expenses and Other Current Liabilities*.

The purchase price consideration has been initially allocated to the assets and liabilities on the basis of provisional values on December 18, 2009 as follows:

|   | (in million pesos) |
|---|--------------------|
| <b>Assets:</b>  |                    |
| Property, plant and equipment                             | 8                  |
| Provisional goodwill (Note 14)                            | 561                |
| Intangible assets (Note 14)                               | 27                 |
| Advances and refundable deposits – net of current portion | 1                  |
| Cash and cash equivalents                                 | 89                 |
| Trade and other receivables                               | 51                 |
| Current portion of advances and refundable deposits       | 19                 |
|   | 756                |
| <b>Liabilities:</b>                                       |                    |
| Accounts payable  | 8                  |
| Accrued expenses and other current liabilities            | 105                |
| Accrued retirement benefits                               | 12                 |
| Income tax payable  | 2                  |
|   | 127                |
| Net assets acquired                                       | 629                |

The net assets recognized at the date of acquisition were based on provisional fair values as Smart had sought an independent valuation for the assets owned by Chikka. The results of this valuation had not been finalized as at November 4, 2010.

The fair value of trade and other receivables and advances and refundable deposits amounted to Php51 million and Php20 million, respectively. The gross amount of trade and other receivables and advances and refundable deposits amounted to Php67 million and Php20 million, respectively. The amount of allowance for impairment for uncollectible amount for trade and other receivables amounted to Php16 million. None of the advances and refundable deposits has been impaired and it is expected that the full contractual amount can be collected.

The provisional goodwill of Php561 million pertains to the fair value of the expected synergies arising from the acquisition of Chikka by Smart. As a content provider, Chikka is expected to enhance Smart's revenue stream from VAS.

Our consolidated revenues would have increased by Php189 million while our consolidated net income would have decreased by Php6 million for the year ended December 31, 2009 had the acquisition of Chikka actually taken place on January 1, 2009. The results of operation of Chikka from December 18, 2009 to December 31, 2009 were not included in our 2009 consolidated income statement since it was not material.

#### 14. Goodwill and Intangible Assets

Movements in goodwill and intangible assets are as follows:

|  | Intangible Assets |              |            |                        |           | Total Intangible Assets | Goodwill      | Total Goodwill and Intangible Assets |
|--|-------------------|--------------|------------|------------------------|-----------|-------------------------|---------------|--------------------------------------|
|  | Customer List     | Spectrum     | Licenses   | Technology Application | Trademark |                         |               |                                      |
| (in million pesos)                                   |                   |              |            |                        |           |                         |               |                                      |
| <b>September 30, 2010 (Unaudited)</b>                |                   |              |            |                        |           |                         |               |                                      |
| Costs:   |                   |              |            |                        |           |                         |               |                                      |
| Balance at beginning of period                       | 1,655             | 1,205        | 613        | 967                    | 27        | 4,467                   | 15,201        | 19,668                               |
| Translation and other adjustments (Note 13)          | (39)              | –            | –          | 22                     | –         | (17)                    | (553)         | (570)                                |
| Additions  | –                 | –            | 10         | –                      | 1         | 11                      | –             | 11                                   |
| <b>Balance at end of period</b>                      | <b>1,616</b>      | <b>1,205</b> | <b>623</b> | <b>989</b>             | <b>28</b> | <b>4,461</b>            | <b>14,648</b> | <b>19,109</b>                        |
| Accumulated amortization and impairment:             |                   |              |            |                        |           |                         |               |                                      |
| Balance at beginning of period                       | 995               | 428          | 448        | 964                    | –         | 2,835                   | 3,809         | 6,644                                |
| Amortization during the period                       | 163               | 61           | 26         | 9                      | 9         | 268                     | –             | 268                                  |
| Translation and other adjustments                    | (56)              | –            | –          | 2                      | –         | (54)                    | (151)         | (205)                                |
| <b>Balance at end of period</b>                      | <b>1,102</b>      | <b>489</b>   | <b>474</b> | <b>975</b>             | <b>9</b>  | <b>3,049</b>            | <b>3,658</b>  | <b>6,707</b>                         |
| <b>Net balance at end of period (Notes 3 and 28)</b> | <b>514</b>        | <b>716</b>   | <b>149</b> | <b>14</b>              | <b>19</b> | <b>1,412</b>            | <b>10,990</b> | <b>12,402</b>                        |
| Estimated useful lives (in years)                    | 1 – 8             | 15           | 3 – 18     | 3 – 5                  | 1         | –                       | –             | –                                    |
| Remaining useful lives (in years)                    | 1 – 7             | 9            | 1 – 12     | 2                      | 0.25      | –                       | –             | –                                    |
| <b>December 31, 2009 (Audited)</b>                   |                   |              |            |                        |           |                         |               |                                      |
| Costs:   |                   |              |            |                        |           |                         |               |                                      |
| Balance at beginning of year                         | 1,696             | 1,205        | 370        | 894                    | –         | 4,165                   | 12,289        | 16,454                               |
| Business combinations (Notes 3, 13 and 21)           | –                 | –            | 221        | –                      | 27        | 248                     | 3,013         | 3,261                                |
| Translation and other adjustments (Note 13)          | (41)              | –            | 22         | 73                     | –         | 54                      | (101)         | (47)                                 |
| <b>Balance at end of year</b>                        | <b>1,655</b>      | <b>1,205</b> | <b>613</b> | <b>967</b>             | <b>27</b> | <b>4,467</b>            | <b>15,201</b> | <b>19,668</b>                        |
| Accumulated amortization and impairment:             |                   |              |            |                        |           |                         |               |                                      |
| Balance at beginning of year                         | 794               | 348          | 203        | 860                    | –         | 2,205                   | 3,799         | 6,004                                |
| Impairment during the year                           | –                 | –            | 213        | 73                     | –         | 286                     | 93            | 379                                  |
| Amortization during the year                         | 220               | 80           | 37         | 31                     | –         | 368                     | –             | 368                                  |
| Translation and other adjustments                    | (19)              | –            | (5)        | –                      | –         | (24)                    | (83)          | (107)                                |
| <b>Balance at end of year</b>                        | <b>995</b>        | <b>428</b>   | <b>448</b> | <b>964</b>             | <b>–</b>  | <b>2,835</b>            | <b>3,809</b>  | <b>6,644</b>                         |
| <b>Net balance at end of year (Notes 3 and 28)</b>   | <b>660</b>        | <b>777</b>   | <b>165</b> | <b>3</b>               | <b>27</b> | <b>1,632</b>            | <b>11,392</b> | <b>13,024</b>                        |
| Estimated useful lives (in years)                    | 1 – 7             | 15           | 3 – 18     | 4 – 5                  | 6         | –                       | –             | –                                    |
| Remaining useful lives (in years)                    | 1 – 4             | 10           | 2 – 13     | 1                      | 6         | –                       | –             | –                                    |

### ***Intangible Assets***

In 2009, Smart recognized intangible assets of Php221 million for licenses and fees in BOW for the perpetual and exclusive worldwide maritime licenses granted by Altobridge, Limited to BOW to facilitate the successful communication between GSM and satellite communication networks. Smart recognized an impairment charge of Php213 million, net of amortization of Php8 million, for the year ended December 31, 2009, reducing the amount of intangible assets in BOW to zero as at December 31, 2009. The impairment loss resulted from the annual impairment test done on the Company's assets. See *Note 9 – Property, Plant and Equipment* for the basis of impairment valuation.

Smart also recognized in 2009 intangible assets of Php51 million in Chikka for patents and trademark relating to Chikka's internet-based instant messaging facility. These applications were filed in different countries such as Singapore, United Kingdom and the U.S.

The consolidated future amortization of other intangible assets as at September 30, 2010 is as follows:

| <b>Year</b>                     | <b>(in million pesos)</b> |
|---------------------------------|---------------------------|
| 2010 <sup>(1)</sup>             | 105                       |
| 2011                            | 308                       |
| 2012                            | 250                       |
| 2013                            | 194                       |
| 2014 and onwards                | 555                       |
| <b>Balance at end of period</b> | <b>1,412</b>              |

<sup>(1)</sup> October 1, 2010 through December 31, 2010.

### ***Impairment Testing of Goodwill***

#### *Goodwill from Acquisition of SBI, CURE and Airborne Access*

The organizational structure of Smart and its subsidiaries is designed to monitor financial operations based on fixed line and wireless segmentation. Management provides guidelines and decisions on resource allocation, such as continuing or disposing of asset and operations by evaluating the performance of each segment through review and analysis of available financial information on the fixed and wireless segments. As at September 30, 2010, Smart's goodwill comprised of goodwill resulting from Smart's acquisition of SBI in 2004, CURE in 2008, SBI's acquisition of a 99.4% equity interest in Airborne Access from ePLDT in 2008, Smart's acquisition of PDSI in 2009 and based on provisional value from acquisition of Chikka in 2009. The test for recoverability of Smart's goodwill, excluding provisional goodwill, was applied to the wireless asset group, which represents the lowest level for which identifiable cash flows are largely independent of the cash inflows from other groups of assets and liabilities.

Although revenue streams may be segregated among Smart, CURE and SBI through subscribers availing themselves of their respective cellular (for Smart and CURE) and wireless broadband (for SBI) services, the cost items and cash flows are difficult to carve out due largely to the significant portion of shared and common-used network/platform. In the case of CURE, it provides cellular services to its subscribers using Smart's 3G network. SBI, on the other hand, provides broadband wireless access to its subscribers using Smart's cellular base stations and fiber optic and IP backbone. With the common use of wireless assets of Smart in providing 3G cellular and wireless broadband access, the lowest level of assets of CURE and SBI for which cash flows are clearly identifiable from other groups of assets is Smart's wireless business segment.

The recoverable amount of this segment had been determined on the basis of value in use calculations using cash flow projections based on the financial budgets approved by the Board of Directors, covering a five-year period from 2010 to 2014. The pre-tax discount rate applied to cash flow projections is 8.7% and cash flows beyond the five-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.

With regard to the assessment of value-in-use of the entire operations, management believes that no reasonably possible change in the discount of 1% point would cause the carrying value of the unit to materially exceed its recoverable amount.

There were no impairment indicators identified as at September 30, 2010. Annual impairment testing will be performed at year-end.

*Goodwill from Acquisition of BOW*

In December 2009, SCH recognized full impairment loss of Php45 million on goodwill resulting from its acquisition of BOW. The impairment loss resulted from the annual impairment test done on the assets. See *Note 9 – Property, Plant and Equipment* for the basis of impairment valuation.

*Goodwill from Acquisition of SPi and its Subsidiaries, CyMed, Inc., or CyMed, and Springfield Service Corp., or Springfield*

The goodwill acquired through the SPi, CyMed and Springfield transactions was allocated for impairment testing to each of the cash-generating units of those businesses, namely medical transcription, litigation, content and medical billing. 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 and forecasts approved by the Board of Directors, which management believes are reasonable and are management's best estimate of the ranges of economic conditions that will exist over the remaining useful life of the asset. The pre-tax discount rate applied was 15% which was based on the weighted average cost of capital adjusted for the difference in currency and specific risks associated with the assets or business of a cash-generating unit.

ePLDT recognized an impairment loss of Php1,815 million for the year ended December 31, 2008 pertaining to the medical transcription and litigation businesses of SPi, since the carrying amount of the individual assets of the said business, exceeded the recoverable amount in 2008. In 2009, ePLDT performed an impairment testing in its goodwill from the acquisition of SPi and its Subsidiaries, CyMed and Springfield and no additional impairment charge was recognized.

There were no impairment indicators identified as at September 30, 2010. Annual impairment testing will be performed at year-end.

*Goodwill from Acquisition of Level Up!*

Goodwill acquired from our acquisition in 2006 of a 60% equity interest in Level Up! was tested for impairment in December 2009 where the recoverable amount was determined using the value in use approach. Value in use was based on the cash flow projections of the most recent financial budgets and forecasts approved by the Board of Directors of ePLDT. The pre-tax discount rate of 22% was applied based on the weighted average cost of capital adjusted for specific risks associated with the assets or business. ePLDT recognized an impairment charge of Php203 million for the year ended December 31, 2008 pertaining to the goodwill from acquisition of Level Up!. In 2009, ePLDT performed an impairment testing in its goodwill from the acquisition of Level Up! and no additional impairment charge was recognized.

There were no impairment indicators identified as at September 30, 2010. Annual impairment testing will be performed at year-end.

*Goodwill from Acquisition of Digital Paradise*

Goodwill acquired from the acquisition of Digital Paradise was tested for impairment in December 2009 based on the recoverable amount of the long lived assets where recoverable amount was determined based on the cash flow projections on the most recent financial budgets and forecasts approved by the Board of Directors. The pre-tax discount rate applied was 22% which was based on the weighted average cost of capital. ePLDT recognized full impairment provision of Php85 million as at December 31, 2009.

## 15. Cash and Cash Equivalents

This account consists of:

|                                      | September 30,<br>2010 | December 31,<br>2009 |
|--------------------------------------|-----------------------|----------------------|
|                                      | (Unaudited)           | (Audited)            |
|                                      | (in million pesos)    |                      |
| Cash on hand and in banks (Note 28)  | 2,435                 | 3,300                |
| Temporary cash investments (Note 28) | 24,467                | 35,019               |
|                                      | <b>26,902</b>         | <b>38,319</b>        |

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. See *Note 28 – Financial Assets and Liabilities*.

Interest income earned from cash in banks and temporary cash investments amounted to Php811 million and Php978 million for the nine months ended September 30, 2010 and 2009, respectively.

## 16. Trade and Other Receivables

This account consists of receivables from:

|  | September 30,<br>2010 | December 31,<br>2009 |
|--|-----------------------|----------------------|
|  | (Unaudited)           | (Audited)            |
|  | (in million pesos)    |                      |
| Retail subscribers (Note 28)                 | 8,692                 | 8,026                |
| Corporate subscribers (Notes 24 and 28)      | 8,587                 | 9,106                |
| Foreign administrations (Note 28)            | 4,105                 | 4,353                |
| Domestic carriers (Notes 24 and 28)          | 2,095                 | 1,267                |
| Dealers, agents and others (Notes 24 and 28) | 4,868                 | 3,927                |
|  | <b>28,347</b>         | <b>26,679</b>        |
| Less allowance for doubtful accounts         | <b>13,176</b>         | <b>11,950</b>        |
|  | <b>15,171</b>         | <b>14,729</b>        |

Movements in the allowance for doubtful accounts are as follows:

|  | Total              | Retail<br>Subscribers | Corporate<br>Subscribers | Foreign<br>Administrations | Domestic<br>Carriers | Dealers,<br>Agents and<br>Others |
|--|--------------------|-----------------------|--------------------------|----------------------------|----------------------|----------------------------------|
|  | (in million pesos) |                       |                          |                            |                      |                                  |
| <b>September 30, 2010 (Unaudited)</b>        |                    |                       |                          |                            |                      |                                  |
| Balance at beginning of period               | 11,950             | 4,480                 | 6,677                    | 289                        | 83                   | 421                              |
| Provisions for the period<br>(Notes 3 and 5) | 1,256              | 607                   | 492                      | 17                         | 32                   | 108                              |
| Translation and other adjustments            | (14)               | 585                   | (524)                    | (132)                      | (15)                 | 72                               |
| Write-offs                                   | (16)               | –                     | (10)                     | (3)                        | –                    | (3)                              |
| Balance at end of period                     | <b>13,176</b>      | <b>5,672</b>          | <b>6,635</b>             | <b>171</b>                 | <b>100</b>           | <b>598</b>                       |
| Individual impairment                        | 10,547             | 3,579                 | 6,221                    | 171                        | 100                  | 476                              |
| Collective impairment                        | 2,629              | 2,093                 | 414                      | –                          | –                    | 122                              |
|  | <b>13,176</b>      | <b>5,672</b>          | <b>6,635</b>             | <b>171</b>                 | <b>100</b>           | <b>598</b>                       |

|   | <b>Total</b> | <b>Retail<br/>Subscribers</b> | <b>Corporate<br/>Subscribers</b> | <b>Foreign<br/>Administrations</b> | <b>Domestic<br/>Carriers</b> | <b>Dealers,<br/>Agents and<br/>Others</b> |
|---|--------------|-------------------------------|----------------------------------|------------------------------------|------------------------------|---|
| (in million pesos)  |              |                               |                                  |                                    |                              |   |
| Gross amount of receivables<br>individually impaired, before<br>deducting any impairment<br>allowance | 10,547       | 3,579                         | 6,221                            | 171                                | 100                          | 476                                       |
| <b>December 31, 2009 (Audited)</b>  |              |                               |                                  |                                    |                              |   |
| Balance at beginning of year  | 12,336       | 5,089                         | 6,323                            | 439                                | 174                          | 311                                       |
| Provisions for the year   | 2,335        | 1,512                         | 670                              | 18                                 | 35                           | 100                                       |
| Business combinations (Note 13)   | 513          | 454                           | 36                               | –                                  | –                            | 23  |
| Reversals   | (46)         | (9)                           | (18)                             | (13)                               | (6)                          | –   |
| Write-offs  | (3,212)      | (1,657)                       | (1,178)                          | (216)                              | (157)                        | (4)                                       |
| Translation and other adjustments   | 24           | (909)                         | 844                              | 61                                 | 37                           | (9)                                       |
| Balance at end of year  | 11,950       | 4,480                         | 6,677                            | 289                                | 83                           | 421                                       |
| Individual impairment   | 9,624        | 2,595                         | 6,256                            | 289                                | 83                           | 401                                       |
| Collective impairment   | 2,326        | 1,885                         | 421                              | –                                  | –                            | 20  |
|   | 11,950       | 4,480                         | 6,677                            | 289                                | 83                           | 421                                       |
| Gross amount of receivables<br>individually impaired, before<br>deducting any impairment<br>allowance | 9,624        | 2,595                         | 6,256                            | 289                                | 83                           | 401                                       |

Receivables from foreign administrations and domestic carriers represent receivables arising from interconnection agreements with other telecommunication carriers. The aforementioned amounts of receivables are shown net of related payable to the same telecommunications carriers where a legal right of offset exists and settlement is facilitated on a net basis.

## 17. Inventories and Supplies

This account consists of:

|  | <b>September 30,<br/>2010</b> | December 31,<br>2009 |
|--|-------------------------------|----------------------|
|  | <b>(Unaudited)</b>            | (Audited)            |
| (in million pesos)   |                               |                      |
| Spare parts and supplies:  |                               |                      |
| At net realizable value  | <b>916</b>                    | 982                  |
| At cost  | <b>1,934</b>                  | 1,998                |
| Terminal and cellular phone units:                                       |                               |                      |
| At net realizable value  | <b>794</b>                    | 652                  |
| At cost  | <b>959</b>                    | 981                  |
| Others:  |                               |                      |
| At net realizable value  | <b>520</b>                    | 531                  |
| At cost  | <b>522</b>                    | 534                  |
| Total inventories at the lower of cost or net realizable value (Note 28) | <b>2,230</b>                  | 2,165                |

The cost of inventories and supplies recognized as expense for the period are as follows:

|  | <b>Nine Months Ended September 30,</b> |             |
|--|--|-------------|
|  | <b>2010</b>                            | <b>2009</b> |
| (Unaudited)  |  |             |
| (in million pesos)                                     |  |             |
| Cost of sales  | <b>1,981</b>                           | 2,480       |
| Repairs and maintenance                                | <b>241</b>                             | 324         |
| Write-down of inventories and supplies (Notes 3 and 5) | <b>42</b>                              | 167         |
|  | <b>2,264</b>                           | 2,971       |

## 18. Prepayments

This account consists of:

|   | <b>September 30,</b> | December 31, |
|---|----------------------|--------------|
|   | <b>2010</b>          | 2009         |
| (Unaudited) (Audited)                         |                      |              |
| (in million pesos)                            |                      |              |
| Prepaid taxes                                 | <b>6,976</b>         | 7,768        |
| Prepaid benefit costs (Notes 3 and 25)        | <b>5,309</b>         | 5,414        |
| Prepaid fees and licenses                     | <b>225</b>           | 44           |
| Prepaid rent – net (Notes 3 and 26)           | <b>89</b>            | 208          |
| Prepaid insurance (Note 24)                   | <b>82</b>            | 109          |
| Other prepayments                             | <b>1,079</b>         | 218          |
|   | <b>13,760</b>        | 13,761       |
| Less current portion of prepayments (Note 28) | <b>4,897</b>         | 5,098        |
| Noncurrent portion of prepayments (Note 28)   | <b>8,863</b>         | 8,663        |

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

Prepaid benefit costs represent excess of plan assets over present value of defined benefit obligations recognized in our consolidated statements of financial position. See *Note 25 – Share-based Payments and Employee Benefits*.

### *Option to Purchase Series C Preferred Shares of ProtoStar*

On September 16, 2008, PLDT signed an option to purchase Series C Preferred Shares of ProtoStar pursuant to which PLDT was entitled to subscribe for and purchase 39.7 million Series C Preferred Shares at the exercise price of US\$0.6925 per share during the exercise period. PLDT paid US\$27.5 million to ProtoStar as a deposit to pay the exercise price if PLDT exercised the option or, if not exercised, such payment would be applied as payment of the service fees to ProtoStar under the Space Segment Services Agreement between PLDT and ProtoStar. On May 15, 2009, PLDT formally advised ProtoStar that it will not exercise its option to purchase ProtoStar's Series C Preferred Shares and that it has elected to apply the US\$27.5 million it had paid for such option as Priority Deposit under the Space Segment Services Agreement, which amount was deemed as full prepayment of the space segment services under said agreement.

On July 29, 2009, ProtoStar and its affiliates ProtoStar Satellite Systems, Inc., ProtoStar I Ltd., ProtoStar II Ltd., ProtoStar Development Ltd. and ProtoStar Asia Pte. Ltd. each filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code. The cases before the United States Bankruptcy Court for the District of Delaware are pending but are nearing conclusion. An auction of ProtoStar's ProtoStar I satellite was held in October 2009 and of ProtoStar's ProtoStar II satellite in December 2009, the proceeds of which were to be distributed to ProtoStar's secured lenders and the balance, if any, to its unsecured lenders. During the pendency of the proceedings, however, the unsecured creditors challenged the perfection of the secured lenders' security over the satellites. Thereafter, settlement negotiations were commenced among ProtoStar, the secured lenders and the unsecured creditors. The parties have reached a settlement, the terms of which are embodied in ProtoStar's "Plan of Reorganization." This Plan was confirmed by the bankruptcy court at a hearing held on October 6, 2010 in Delaware. The filing of the bankruptcy case and the eventual sale of the ProtoStar I satellite constitute a breach by ProtoStar of the Space Segment Services Agreement. On this basis, we recognized a full impairment provision of



US\$27.5 million, or Php1,304 million, in 2009 with respect to our prepayments on the Space Segment Services Agreement. On October 22, 2010, PLDT received approximately US\$3.3 million settlement of its claim and recognized such as “Other income” in the consolidated statements of income.

## 19. Equity

The movement of PLDT’s capital account are as follows:

|  | Preferred Stock –<br>Php10 par value per share |           |                             |                 | Common Stock –<br>Php5 par value per share |               |
|--|--|-----------|-----------------------------|-----------------|--|---------------|
|  | Series<br>A to HH                              | IV        | Total<br>Preferred<br>Stock | Amount          | No. of Shares                              | Amount        |
|  |  |           |                             |                 |  |               |
| <b>Authorized</b>                                  |  |           | 823                         | Php8,230        | 234  | Php1,170      |
| <b>Issued</b>                                      |  |           |                             | (in millions)   |  |               |
| Balance as at January 1, 2009                      | 405  | 36        | 441                         | Php4,415        | 189  | Php947        |
| Issuance   | –  | –         | –                           | 2               | –  | –             |
| Conversion   | –  | –         | –                           | (1)             | –  | –             |
| <b>Balance as at December 31, 2009 (Audited)</b>   | <b>405</b>                                     | <b>36</b> | <b>441</b>                  | <b>Php4,416</b> | <b>189</b>                                 | <b>Php947</b> |
| Balance as at January 1, 2010                      | 405  | 36        | 441                         | Php4,416        | 189  | Php947        |
| Issuance   | –  | –         | –                           | 1               | –  | –             |
| <b>Balance as at September 30, 2010 Unaudited)</b> | <b>405</b>                                     | <b>36</b> | <b>441</b>                  | <b>Php4,417</b> | <b>189</b>                                 | <b>Php947</b> |

### *Preferred Stock*

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

The Series A to II 10% Cumulative Convertible Preferred Stock earns 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 ask 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, 2010, 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 outstanding are at anytime 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 of 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 sale price utilized in calculating the conversion price as the Board of Directors, in its sole discretion, shall deem appropriate.

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

On January 26, 2010, the Board of Directors designated 100 thousand shares of preferred stock as Series II 10% Cumulative Convertible Preferred Stock for issuance from January 1, 2010 to December 31, 2012.

The issuance of each of SIP Series FF, GG and HH is an exempt transaction under Section 10.2 of the SRC, as confirmed by the Philippine SEC in a letter sent to us on April 2, 2007. As at September 30, 2010, there were 1,200 and 2,200 aggregate issued and outstanding shares, respectively, for Series FF, GG and HH.

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

The provisions of the resolutions creating preferred stock limit the ability of PLDT to pay cash dividends unless all dividends on such preferred stock for all past dividend payment periods have been paid and or declared and set apart and provision has been made for the currently payable dividends.

### **Common Stock**

In 2008, the Board of Directors approved a share buyback program of up to five million shares of PLDT's common stock, representing approximately 3% of PLDT's total outstanding shares of common stock. The share buyback program reflects PLDT's commitment to capital management as an important element in enhancing shareholder value. This also reinforces initiatives that PLDT has already undertaken such as the declaration of special dividends on common stock in addition to the regular dividend payout equivalent to 70% of our earnings per share, after having determined that PLDT has the capacity to pay additional returns to shareholders. Under the share buyback program, PLDT reacquired shares on an opportunistic basis, directly from the open market through the trading facilities of the PSE and NYSE.

As at September 30, 2010 and December 31, 2009, we had acquired a total of approximately 2.7 million shares of PLDT's common stock at a weighted average price of Php2,387 per share for a total consideration of Php6,405 million in accordance with the share buyback program. See *Note 8 – Earnings Per Common Share* and *Note 28 – Financial Assets and Liabilities*.

### **Dividends Declared For The Nine Months Ended September 30, 2010 (Unaudited)**

| Class  | Date               |                    |                    | Amount    |        |
|--|--------------------|--------------------|--------------------|-----------|--------|
|  | Approved           | Record             | Payable            | Per Share | Total  |
| (in million pesos)   |                    |                    |                    |           |        |
| <b>10% Cumulative Convertible Preferred Stock</b>            |                    |                    |                    |           |        |
| Series CC  | January 26, 2010   | February 25, 2010  | March 31, 2010     | Php1.00   | 17     |
| Series DD  | January 26, 2010   | February 11, 2010  | February 26, 2010  | 1.00      | 3      |
| Series EE  | March 26, 2010     | April 23, 2010     | May 31, 2010       | 1.00      | –      |
| Series A, I, R, W, AA and BB                                 | July 7, 2010       | August 5, 2010     | August 31, 2010    | 1.00      | 128    |
| Series B, F, Q, V and Z                                      | August 3, 2010     | September 2, 2010  | September 30, 2010 | 1.00      | 92     |
| Series E, K, O and U   | August 31, 2010    | September 30, 2010 | October 29, 2010   | 1.00      | 44     |
| Series C, D, J, T and X                                      | September 28, 2010 | October 28, 2010   | November 30, 2010  | 1.00      | 57     |
|  |                    |                    |                    |           | 341    |
| <b>Cumulative Non-Convertible Redeemable Preferred Stock</b> |                    |                    |                    |           |        |
| Series IV*   | January 26, 2010   | February 19, 2010  | March 15, 2010     | Php–      | 12     |
|  | May 13, 2010       | May 27, 2010       | June 15, 2010      | –         | 13     |
|  | August 3, 2010     | August 18, 2010    | September 15, 2010 | –         | 12     |
|  |                    |                    |                    |           | 37     |
| <b>Common Stock</b>  |                    |                    |                    |           |        |
| Regular Dividend   | March 2, 2010      | March 17, 2010     | April 20, 2010     | Php76.00  | 14,197 |
|  | August 3, 2010     | August 19, 2010    | September 21, 2010 | 78.00     | 14,570 |
| Special Dividend   | March 2, 2010      | March 17, 2010     | April 20, 2010     | 65.00     | 12,142 |
|  |                    |                    |                    |           | 40,909 |
| Charged to retained earnings                                 |                    |                    |                    |           | 41,287 |

\* Dividends were declared based on total amount paid up.

## Dividends Declared For The Nine Months Ended September 30, 2009 (Unaudited)

| Class  | Date               |                    |                    | Amount           |        |
|--|--------------------|--------------------|--------------------|------------------|--------|
|  | Approved           | Record             | Payable            | Per Share        | Total  |
| (in million pesos)   |                    |                    |                    |                  |        |
| <b>Preferred Stock Subject to Mandatory Redemption</b>       |                    |                    |                    |                  |        |
| Series V   | March 3, 2009      | March 19, 2009     | April 15, 2009     | Php4.675         | –      |
|  | June 9, 2009       | June 25, 2009      | July 15, 2009      | 4.675            | –      |
|  | *August 4, 2009    | August 22, 2009    | September 10, 2009 | 0.051944 per day | –      |
| Series VI  | March 3, 2009      | March 19, 2009     | April 15, 2009     | US\$0.09925      | –      |
|  | June 9, 2009       | June 25, 2009      | July 15, 2009      | 0.09925          | –      |
|  | August 25, 2009    | September 24, 2009 | October 15, 2009   | 0.09925          | –      |
| Charged to income  |                    |                    |                    |                  | –      |
| <b>10% Cumulative Convertible Preferred Stock</b>            |                    |                    |                    |                  |        |
| Series CC  | January 27, 2009   | February 26, 2009  | March 31, 2009     | Php1.00          | 17     |
| Series DD  | January 27, 2009   | February 13, 2009  | February 27, 2009  | 1.00             | 3      |
| Series EE  | March 31, 2009     | April 30, 2009     | May 29, 2009       | 1.00             | –      |
| Series A, I, R, W, AA and BB                                 | July 7, 2009       | August 6, 2009     | August 28, 2009    | 1.00             | 128    |
| Series B, F, Q, V and Z                                      | August 4, 2009     | September 1, 2009  | September 30, 2009 | 1.00             | 91     |
| Series E, K, O and U   | August 25, 2009    | September 24, 2009 | October 30, 2009   | 1.00             | 44     |
| Series C, D, J, T and X                                      | September 29, 2009 | October 29, 2009   | November 26, 2009  | 1.00             | 57     |
|  |                    |                    |                    |                  | 340    |
| <b>Cumulative Non-Convertible Redeemable Preferred Stock</b> |                    |                    |                    |                  |        |
| Series IV**  | January 27, 2009   | February 20, 2009  | March 15, 2009     | Php–             | 12     |
|  | May 5, 2009        | May 22, 2009       | June 15, 2009      | –                | 13     |
|  | August 4, 2009     | August 19, 2009    | September 15, 2009 | –                | 13     |
|  |                    |                    |                    |                  | 38     |
| <b>Common Stock</b>  |                    |                    |                    |                  |        |
| Regular Dividend   | March 3, 2009      | March 18, 2009     | April 21, 2009     | Php70.00         | 13,124 |
|  | August 4, 2009     | August 20, 2009    | September 22, 2009 | 77.00            | 14,384 |
| Special Dividend   | March 3, 2009      | March 18, 2009     | April 21, 2009     | 60.00            | 11,250 |
|  |                    |                    |                    |                  | 38,758 |
| Charged to retained earnings                                 |                    |                    |                    |                  | 39,136 |

\* Only the holders of Series V Convertible Preferred Stock whose shares were originally issued on August 22, 2002 and mandatorily converted on August 23, 2009 shall be entitled to this final dividends.

\*\* Dividends were declared based on total amount paid up.

## Dividends Declared after September 30, 2010 (Unaudited)

| Class  | Date             |                   |                   | Amount    |       |
|--|------------------|-------------------|-------------------|-----------|-------|
|  | Approved         | Record            | Payable           | Per Share | Total |
| (in million pesos)   |                  |                   |                   |           |       |
| <b>Cumulative Non-Convertible Redeemable Preferred Stock</b> |                  |                   |                   |           |       |
| Series IV*   | November 4, 2010 | November 19, 2010 | December 15, 2010 | Php–      | 12    |
| <b>10% Cumulative Convertible Preferred Stock</b>            |                  |                   |                   |           |       |
| Series G   | November 4, 2010 | December 2, 2010  | December 29, 2010 | Php1.00   | 2     |
| Series N   | November 4, 2010 | December 2, 2010  | December 29, 2010 | 1.00      | 5     |
| Series P   | November 4, 2010 | December 2, 2010  | December 29, 2010 | 1.00      | 10    |
| Series S   | November 4, 2010 | December 2, 2010  | December 29, 2010 | 1.00      | 10    |
|  |                  |                   |                   |           | 27    |
|  |                  |                   |                   |           | 39    |

\* Dividends were declared based on total amount paid up.

## 20. Interest-bearing Financial Liabilities

This account consists of the following:

|   | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|---|--------------------------------------|-----------------------------------|
|   | (in million pesos)                   |                                   |
| <b>Long-term portion of interest-bearing financial liabilities:</b>                 |                                      |                                   |
| Long-term debt (Notes 4, 5, 9, 23, 26 and 28)                                       | 80,773                               | 86,066                            |
| Obligations under finance lease (Notes 3, 4, 5, 23, 26 and 28)                      | 9                                    | 13                                |
|   | <b>80,782</b>                        | <b>86,079</b>                     |
| <b>Current portion of interest-bearing financial liabilities:</b>                   |                                      |                                   |
| Long-term debt maturing within one year (Notes 4, 5, 9, 23, 26 and 28)              | 12,687                               | 10,384                            |
| Obligations under finance lease maturing within one year (Notes 3, 4, 5, 26 and 28) | 33                                   | 51                                |
| Notes payable (Notes 4, 5, 23, 26 and 28)   | –                                    | 2,279                             |
|   | <b>12,720</b>                        | <b>12,714</b>                     |

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

|  | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|--|--------------------------------------|-----------------------------------|
|  | (in million pesos)                   |                                   |
| Long-term debt (Note 28)                   | 3,159                                | 3,858                             |
| Obligation under finance lease             | 2                                    | 3                                 |
| Unamortized debt discount at end of period | <b>3,161</b>                         | <b>3,861</b>                      |

The following table describes all changes to unamortized debt discount.

|  | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|--|--------------------------------------|-----------------------------------|
|  | (in million pesos)                   |                                   |
| Unamortized debt discount at beginning of period   | 3,861                                | 4,577                             |
| Additions during the period  | 116                                  | 182                               |
| Revaluations during the period   | (52)                                 | 22                                |
| Accretion during the period included as part of “Financing costs – net –<br>Accretion on financial liabilities” (Note 5) | (764)                                | (920)                             |
| Unamortized debt discount at end of period   | <b>3,161</b>                         | <b>3,861</b>                      |



## ***U.S. Dollar Debts:***

### **Export Credit Agencies-Supported Loans**

In order to acquire 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.

#### ***Finnvera, Plc, or Finnvera***

On February 11, 2005, Smart signed a refinancing facility with Finnish Export Credit, Plc, as Lender, and ING Bank N.V., as Arranger and Facility Agent under an export credit agency-backed facility in connection with Smart's GSM expansion program. This facility was covered by a guarantee from Finnvera, the Finnish Export Credit Agency, for 100% of the political and commercial risk for the refinancing facility of GSM Phases 5A and 5B. The facility was payable in equal semi-annual payments over five years starting September 1, 2005 and was fully paid on March 1, 2010. The principal benefit of refinancing the Phase 5 loan was the savings from a lower interest margin on the refinancing facility.

On May 14, 2009, Smart signed a US\$50 million five-year term facility to finance the Phase 10 (Extension) GSM equipment and services contract with Finnish Export Credit, Plc guaranteed by Finnvera and awarded to Calyon as the Arranger. The facility was drawn on July 15, 2009. The loan is payable over five years in ten equal semi-annual payments. The amounts of US\$39 million, or Php1,701 million, and US\$48 million, or Php2,240 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

On October 9, 2009, Smart signed a US\$50 million five-year term loan facility to finance GSM equipment and services contracts with Finnish Export Credit, Plc guaranteed by Finnvera, the Finnish Export Credit Agency, for 100% political and commercial risk cover. The facility was awarded to Citicorp as the Arranger. The loan is payable over five years in ten equal semi-annual payments. The amount of US\$48 million, or Php2,103 million, net of unamortized debt discount, remained outstanding as at September 30, 2010. As at December 31, 2009, no amounts have been drawn under the facility.

#### ***Exportkreditnamnden, or EKN***

On November 25, 2008, Smart signed a US\$22 million five-year term loan facility to finance the supply, installation, commissioning and testing of Wireless Code Division Multiple Access, or W-CDMA/High Speed Packet Access project with Nordea Bank AB as Original Lender, Arranger and Facility Agent and subsequently assigned its rights and obligations to the Swedish Export Credit Corporation (AB Svensk Exportkredit) supported by EKN on December 10, 2008. The amounts of US\$8 million, US\$13 million and US\$1 million were drawn on December 15, 2008, August 5, 2009 and September 1, 2009, respectively. This facility is payable semi-annually in ten equal installments commencing six months from December 10, 2008. The outstanding balance under the facility amounted to US\$16 million, or Php718 million, and US\$18 million, or Php860 million, both net of unamortized debt discount, as at September 30, 2010 and December 31, 2009, respectively.

#### ***Kreditanstalt für Wiederaufbau, or KfW***

As at September 30, 2010, we owed an aggregate principal amount of US\$9.6 million, or Php422 million, to KfW, a German state-owned development bank, as follows:

- US\$8.5 million provided in connection with the US\$149 million refinancing facility discussed below; and
- US\$1.1 million provided for credit facilities without guarantee/insurance cover in connection with the US\$149 million refinancing facility discussed in the following paragraph.

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. On various dates from 2002 to 2004, we had drawn a total of US\$140 million under this facility. PLDT waived further disbursements under this refinancing facility effective September 1, 2004 and the undrawn portion of US\$9 million was cancelled.

The outstanding amount of US\$9.6 million, or Php422 million, as at September 30, 2010 was fully paid on October 15, 2010. Principal amortizations on these loans are payable in equal semi-annual installments.

#### Fixed Rate Notes

PLDT has the following non-amortizing fixed rate notes outstanding:

| Principal Amount | Interest Rate | Maturity Date | September 30, 2010 |                  | December 31, 2009 |           |
|------------------|---------------|---------------|--------------------|------------------|-------------------|-----------|
|                  |               |               | (Unaudited)        |                  | (Audited)         |           |
|                  |               |               | (in millions)      |                  |                   |           |
| US\$234,259,000  | 8.350%        | March 6, 2017 | <b>US\$232</b>     | <b>Php10,170</b> | US\$242           | Php11,256 |
| US\$145,789,000  | 11.375%       | May 15, 2012  | <b>143</b>         | <b>6,303</b>     | 143               | 6,620     |
|                  |               |               | <b>US\$375</b>     | <b>Php16,473</b> | US\$385           | Php17,876 |

#### Term Loans

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

On July 2, 2004, Smart acquired from PCEV's creditors approximately US\$289 million, or 69.4%, the aggregate of PCEV'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 unamortized debt discount amounting to Php7,464 million.

The outstanding balance of the Facility amounted to US\$220 million, or Php9,661 million, and US\$209 million, or Php9,725 million, both net of unamortized debt discount, as at September 30, 2010 and December 31, 2009, respectively. The Facility will be payable in full on June 30, 2014.

##### *GSM Network Expansion Facilities*

On August 8, 2005, Smart signed a US\$30 million commercial facility with Nordic Investment Bank to partly finance the related Phase 8 GSM equipment and services contracts. The facility is a five-year term loan payable semi-annually in ten equal installments with final repayment on July 11, 2011. The facility was drawn on July 11, 2006 for the full amount of US\$30 million. The amounts of US\$6 million, or Php263 million, and US\$12 million, or Php556 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

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 Finnish Export Credit, Plc as the Lender. Smart opted to utilize only a total of US\$67 million of which US\$10 million and US\$57 million were drawn on February 15, 2006 and March 13, 2006, respectively. The undrawn balance of US\$3 million was cancelled. The facility is a five-year term loan payable in ten equal semi-annual installments and was fully paid on September 1, 2010.

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 Finnish Export Credit, Plc with ABN AMRO Bank N.V., Standard Chartered Bank, Sumitomo Mitsui Banking Corporation and Mizuho Corporate Bank Ltd. as the Lead Arrangers. The facility is a five-year term loan payable in ten equal semi-annual installments with final repayment on July 15, 2011. The facility was drawn on November 10, 2006 for the full amount of US\$44.2 million. The amounts of US\$9 million, or Php387 million, and US\$18 million, or Php819 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

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 quarterly installments commencing on the third quarter from initial drawdown date with final repayment on October 10, 2012. The facility was drawn on October 10, 2007 for the full amount of US\$50 million. The amounts of US\$25 million, or Php1,098 million, and US\$33 million, or Php1,547 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

On October 10, 2007, Smart signed a US\$50 million five-year term loan facility to finance the related Phase 10 GSM equipment and service contracts. The facility was awarded to Norddeutsche Landesbank Girozentrale Singapore Branch as the Original Lender with Standard Chartered Bank (Hong Kong) Ltd. as the Facility Agent. The full amount of the facility was drawn on March 10, 2008. The loan is payable over five years in ten equal semi-annual payments with final repayment on March 11, 2013. The amounts of US\$25 million, or Php1,093 million, and US\$35 million, or Php1,616 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

On November 27, 2008, Smart signed a US\$50 million five-year term loan facility to finance the Phase 10 GSM equipment and service contracts with Finnish Export Credit, Plc. The facility was awarded to ABN AMRO Bank N.V., Australia and New Zealand Banking Group Limited, Standard Chartered Bank, Mizuho Corporate Bank Ltd. as the Lead Arrangers. The loan is payable over five years in ten equal semi-annual installments with final repayment on January 23, 2014. The facility was drawn on January 23, 2009 and May 5, 2009 in the amounts of US\$5 million and US\$45 million, respectively. The amounts of US\$34 million, or Php1,517 million, and US\$44 million, or Php2,058 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

#### *Other Term Loans*

On January 15, 2008, PLDT signed a US\$100 million term loan facility agreement with Norddeutsche Landesbank Girozentrale Singapore Branch to be used for the capital expenditure requirements of PLDT. Two separate drawings of US\$50 million each was drawn from the facility on March 27, 2008 and April 10, 2008 and this term loan is payable over five years in ten equal semi-annual installments with final repayment on March 27, 2013. The amounts of US\$50 million, or Php2,196 million, and US\$70 million, or Php3,250 million, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

On July 15, 2008, PLDT signed a loan agreement amounting to US\$50 million with the Bank of the Philippine Islands to refinance its loan obligations which were utilized for service improvements and expansion programs. The initial drawdown under this loan was made on July 21, 2008 in the amount of US\$15 million and the balance of US\$35 million was drawn on September 30, 2008. This loan is payable in 17 equal quarterly installments commencing on the fourth quarter from initial drawdown date with final repayment on July 22, 2013. The amounts of US\$36 million, or Php1,550 million, and US\$44 million, or Php2,048 million, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

On September 24, 2008, BOW signed an Islamic finance facility agreement granted by the Bank of London and the Middle East for a total of US\$19 million, which will mature on various dates from June 30, 2013 to September 30, 2014. The amounts of US\$3 million, or Php143 million, and US\$4 million, or Php186 million, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.



## ***Philippine Peso Debts:***

### *Corporate Notes*

#### *Php5,000 Million Fixed Rate Corporate Notes*

On February 15, 2007, Smart issued Php5,000 million fixed rate corporate notes, comprised of Series A five-year notes amounting to Php3,800 million and Series B ten-year notes amounting to Php1,200 million. Proceeds from the issuance of these notes have been used primarily for Smart's capital expenditures for network improvement and expansion. The amounts of Php4,961 million and Php4,968 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

#### *Php5,000 Million Fixed Rate Corporate Notes*

On December 12, 2008, Smart issued a five-year term unsecured fixed rate corporate notes amounting to Php5,000 million. The facility has annual amortizations equivalent to 1% of the principal amount with the balance of 96% payable on December 13, 2013. Funds raised from the issuance of these notes were used primarily to finance Smart's capital expenditures for network upgrade and expansion. The amounts of Php4,914 million and Php4,907 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

#### *Php5,000 Million Fixed Rate Corporate Notes*

On February 20, 2009, PLDT issued Php5,000 million fixed rate corporate notes under a Notes Facility Agreement dated February 18, 2009, comprised of Series A five-year notes amounting to Php2,390 million, Series B seven-year notes amounting to Php100 million, and Series C ten-year notes amounting to Php2,510 million. Proceeds from the facility were used to finance capital expenditures of PLDT. The aggregate amounts of Php4,976 million and Php5,000 million, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

#### *Php3,000 Million Corporate Notes*

On June 29, 2009, Smart signed a Notes Facility Agreement with BDO Private Bank, Inc. amounting to Php3,000 million to finance capital expenditures. The facility is comprised of Php1,000 million Series A1 note payable in full in 1.5 years and Php1,000 million each for Series B1 and B2 notes payable in full in two years. The aggregate amount of Php2,000 million of Series A1 and B1 notes were drawn on July 8, 2009 while the amount of Php1,000 million of Series B2 notes was drawn on September 1, 2009. The aggregate amounts of Php2,995 million and Php2,988 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

#### *Php7,000 Million Fixed Rate Corporate Notes*

On December 10, 2009, PLDT issued Php7,000 million fixed rate corporate notes under a Notes Facility Agreement dated December 8, 2009, comprised of Series A 5.25-year notes amounting to Php5,050 million, Series B seven-year notes amounting to Php850 million, and Series C ten-year notes amounting to Php1,100 million. Proceeds from the facility will be used to finance capital expenditures and/or to refinance its loan obligations which were also used to finance capital expenditures for network expansion and improvement. The aggregate amount of Php7,000 million remained outstanding as at September 30, 2010 and December 31, 2009.

#### *Php2,500 Million Fixed Rate Corporate Notes*

On July 13, 2010, PLDT issued Php2,500 million five-year fixed rate corporate notes under a Notes Facility Agreement dated July 12, 2010 to mature on July 13, 2015. Proceeds from the facility will be used to finance capital expenditures and/or to refinance its loan obligations which were also used to finance capital expenditures for network expansion and improvement. The amount of Php2,500 million remained outstanding as at September 30, 2010.

### *Php2,500 Million Fixed Rate Corporate Notes*

On July 13, 2010, Smart issued Php2,500 million five-year fixed rate corporate notes under a Notes Facility Agreement dated July 12, 2010 to mature on July 13, 2015. Proceeds from the facility will be used primarily to finance Smart's capital expenditures for network improvement and expansion. The amount of Php2,483 million, net of unamortized debt discount, remained outstanding as at September 30, 2010.

### *Term Loans*

#### *Unsecured Term Loans*

##### *Php2,500 Million Term Loan Facility*

On August 14, 2006, Smart signed a Philippine Peso term loan facility with Metropolitan Bank and Trust Company amounting to Php2,500 million to finance the related Phase 9 GSM facility. The facility is payable over five years in 18 equal quarterly installments commencing on the third quarter from initial drawdown date with final repayment on December 9, 2011. The facility was drawn on December 11, 2006. The amounts of Php693 million and Php1,109 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

##### *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 Fixed Rate Corporate Notes which were repaid on June 12, 2007. Both refinancing loans will mature on June 12, 2014. The amounts of Php400 million and Php20 million both remained outstanding as at September 30, 2010 and December 31, 2009.

##### *Php2,500 Million Term Loan Facility*

On October 21, 2008, Smart signed a Philippine Peso term loan facility with Metropolitan Bank and Trust Company to finance capital expenditures for an amount of Php2,500 million, which was drawn in full on November 13, 2008. The facility is payable over five years in 16 equal consecutive quarterly installments commencing on the fifth quarter from the date of the first drawdown with final repayment on November 13, 2013. The amounts of Php2,026 million and Php2,492 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

##### *Php2,400 Million Term Loan Facility*

On November 21, 2008, PLDT signed a loan agreement with Land Bank of the Philippines amounting to Php2,400 million to finance capital expenditures and/or to refinance its loan obligations which were utilized for service improvements and expansion programs. The initial drawdown under this loan was made on December 12, 2008 in the amount of Php500 million and the balance of Php1,900 million was subsequently drawn on May 20, 2009 and July 31, 2009 in two equal Php500 million tranches and on September 15, 2009 in the amount of Php900 million. The loan is payable over five years in ten equal semi-annual installments with final repayment on December 12, 2013. The amounts of Php1,789 million and Php2,044 million remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

##### *Php3,000 Million Term Loan Facility*

On November 26, 2008, PLDT signed a loan agreement with Union Bank of the Philippines amounting to Php3,000 million to finance capital expenditures and/or to refinance its loan obligations which were utilized for service improvements and expansion programs. The initial drawdown under this loan was made on December 22, 2008 in the amount of Php500 million and the balance of Php2,500 million was subsequently drawn on April 14, 2009. The loan is payable over five years in nine equal semi-annual installments commencing on the second semester from initial drawdown date with final repayment on December 23, 2013. The amounts of Php2,333 million and Php2,667 million remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

#### *Php2,000 Million Term Loan Facility*

On November 28, 2008, PLDT signed a loan agreement with Philippine National Bank amounting to Php2,000 million to be used for its capital expenditure requirements in connection with PLDT's service improvement and expansion programs. The initial drawdown under this loan was made on December 19, 2008 in the amount of Php500 million and the balance of Php1,500 million was subsequently drawn on January 30, 2009, February 27, 2009 and March 13, 2009 in three equal Php500 million tranches. The loan is payable over five years in 17 equal quarterly installments commencing on the fourth quarter from initial drawdown date with final repayment on December 19, 2013. The amounts of Php1,529 million and Php1,882 million remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

#### *Php1,000 Million Term Loan Facility*

On February 20, 2009, Smart signed a Philippine Peso term loan facility with China Trust (Philippines) Commercial Bank Corporation to finance capital expenditures for an amount of Php1,000 million, which was drawn in full on April 27, 2009. The facility is a five-year term loan payable in eight equal semi-annual installments starting on the eighteenth month from initial drawdown date. The first installment will commence on October 27, 2010 with final repayment on April 25, 2014. The amounts of Php997 million and Php996 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

#### *Php2,500 Million Term Loan Facility*

On March 6, 2009, PLDT signed a loan agreement with Banco de Oro Unibank, Inc. amounting to Php2,500 million to finance capital expenditures and/or refinance its loan obligations which were utilized for service improvements and expansion programs. The loan is payable in full upon maturity on April 17, 2014. The amount of Php2,500 million was fully drawn on April 17, 2009 and remained outstanding as at September 30, 2010 and December 31, 2009.

#### *Php1,500 Million Term Loan Facility*

On May 12, 2009, Smart signed a Philippine Peso term loan facility with Banco de Oro Unibank, Inc. amounting to Php1,500 million to finance capital expenditures which was fully drawn on May 20, 2009. The facility is a three-year loan payable in full upon maturity on May 20, 2012. The amounts of Php1,493 million and Php1,491 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

#### *Php1,000 Million Term Loan Facility*

On May 14, 2009, Smart signed a Philippine Peso term loan facility with Asia United Bank amounting to Php1,000 million to finance capital expenditures, which was drawn in full on July 3, 2009. The facility is payable over five years in eight equal semi-annual installments commencing on the eighteenth month from initial drawdown date with final repayment on July 3, 2014. The amounts of Php997 million and Php996 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

#### *Php1,000 Million Term Loan Facility*

On May 15, 2009, Smart signed a Philippine Peso term loan facility with Philippine National Bank amounting to Php1,000 million to finance capital expenditures, which was drawn in full on July 2, 2009. The facility is a seven-year loan, payable in full upon maturity on July 2, 2016. The amounts of Php996 million and Php995 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

*Php2,500 Million Term Loan Facility*

On June 8, 2009, PLDT signed a loan agreement with Rizal Commercial Banking Corporation amounting to Php2,500 million to finance capital expenditures and/or refinance its loan obligations which were utilized for service improvements and expansion programs. The facility is payable over seven years with an annual amortization of 1% on the fifth and sixth year from initial drawdown date and the balance payable upon maturity on September 28, 2016. The amount of Php2,500 million was fully drawn on September 28, 2009 and remained outstanding as at September 30, 2010 and December 31, 2009.

*Php1,500 Million Term Loan Facility*

On June 16, 2009, PLDT signed a loan agreement with Allied Banking Corporation amounting to Php1,500 million to finance capital expenditures and/or refinance its loan obligations which were utilized for service improvements and expansion programs. The facility is payable over five years in 17 equal quarterly installments commencing on September 15, 2010 with final repayment on September 15, 2014. The amount of Php1,500 million was fully drawn on September 15, 2009. The amounts of Php1,412 million and Php1,500 million remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

*Php500 Million Term Loan Facility*

On June 29, 2009, PLDT signed a loan agreement with Insular Life Assurance Company, Ltd. amounting to Php500 million to finance capital expenditures and/or refinance its loan obligations which were utilized for service improvements and expansion programs. The loan will mature on July 1, 2016. The amount of Php500 million was fully drawn on July 1, 2009 and remained outstanding as at September 30, 2010 and December 31, 2009.

*Php1,000 Million Term Loan Facility*

On July 16, 2009, Smart signed a Philippine Peso term loan facility with Metropolitan Bank and Trust Company to finance capital expenditures for an amount of Php1,000 million, which was drawn in full on August 3, 2009. The facility is payable over five years in 16 equal consecutive quarterly installments commencing on the fifth quarter from the date of the first drawdown with final repayment on August 1, 2014. The amounts of Php997 million and Php996 million, both net of unamortized debt discount, remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

*Php2,000 Million Term Loan Facility*

On September 18, 2009, PLDT signed a loan agreement with Bank of the Philippine Islands amounting to Php2,000 million to finance capital expenditures and/or refinance its loan obligations which were utilized for service improvements and expansion programs. The facility is payable over five years in 17 equal quarterly installments with final repayment on October 27, 2014. The initial drawdown under this loan was made on October 26, 2009 in the amount of Php1,000 million and the balance of Php1,000 million was subsequently drawn on December 4, 2009. The outstanding balance of the loan was Php2,000 million as at September 30, 2010 and December 31, 2009.

*Php1,000 Million Term Loan Facility*

On November 23, 2009, PLDT signed a loan agreement with Bank of the Philippine Islands amounting to Php1,000 million to finance capital expenditures and/or refinance its obligations which were utilized for service improvements and expansion programs. The facility is payable over five years in 17 equal quarterly installments with final repayment on December 18, 2014. The amount of Php1,000 million was fully drawn on December 18, 2009 and remained outstanding as at September 30, 2010 and December 31, 2009.

## *Secured Term Loans*

### *Php150 Million Term Loan Facility*

On June 7, 2007, BayanTrade obtained a medium term loan facility with Bank of the Philippine Islands amounting to Php150 million, which was fully availed of in December 2007. Each interest period will cover a 90-day period commencing on the initial drawdown date and the interest rate will be determined at the first day of each interest period and payable at the end of the interest period. The loan facility was obtained to facilitate the purchase of a subsidiary and to support its working capital requirements. The aggregate loan amount is due as follows: (a) 20% within the third year from first drawdown date; (b) 20% within the fourth year from first drawdown date; and (c) 60% within the fifth year from first drawdown date. BayanTrade is given a right to repay the principal and the interest accruing thereon on each interest payment date or interest rate setting date without any prepayment penalty. BayanTrade and the bank has agreed to the following terms: (a) pledge of BayanTrade's shares of stock of the subsidiary purchased at a collateral loan ratio of 2:1; (b) assignment of receivables at a collateral-to-loan of 2:1; and (c) negative pledge on other present and future assets of BayanTrade. The outstanding principal balance of the loan was Php120 million and Php139 million as at September 30, 2010 and December 31, 2009, respectively.

### *Php8 Million Term Loan Facility*

On March 31, 2009, Level Up! secured a three-year loan facility with Asia United Bank amounting to Php8 million maturing on March 30, 2012. Principal is payable in twelve equal successive quarterly installments of Php673 thousand starting June 30, 2009 and every quarter thereafter. This loan has a floating interest rate payable every 30 days starting April 30, 2009. The loan is secured by the equipment where the proceeds of the loan were used. The amounts of Php4 million and Php6 million remained outstanding as at September 30, 2010 and December 31, 2009, respectively.

## **Notes Payable**

On April 23, 2009, PLDT signed the notes facility agreement with BDO Private Bank, Inc. amounting to Php2,000 million to finance capital expenditures and/or refinance its loan obligations which were utilized for service improvements and expansion programs. The facility is comprised of a Php1,000 million Tranche A fixed rate note and a Php1,000 million Tranche B floating rate note, which were fully drawn on April 28, 2009 and were fully paid on April 28, 2010.

## **Debt Covenants**

Our debt instruments contain restrictive covenants, including covenants that require us to comply with specified financial ratios and other financial tests, calculated in conformity with PFRS at relevant measurement dates, principally at the end of each quarterly period. We have complied with all of our maintenance financial ratios as required under our loan covenants and other debt instruments.

The principal factors that can negatively affect our ability to comply with these financial ratios and other financial tests are depreciation of the Philippine peso relative to the U.S. dollar, poor operating performance of PLDT and its consolidated subsidiaries, impairment or similar charges in respect of investments or other long-lived assets that may be recognized by PLDT and its consolidated subsidiaries, and increases in our interest expense. Interest expense may increase as a result of various factors including issuance of new debt, the refinancing of lower cost indebtedness by higher cost indebtedness, depreciation of the Philippine peso, the lowering of PLDT's credit ratings or the credit ratings of the Philippines, increase in reference interest rates, and general market conditions. Since approximately 42% of PLDT's total consolidated debts as at September 30, 2010 was 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 Philippine 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) disposing of all or substantially all of its assets or of assets in excess of specified thresholds of its tangible net worth; (d) creating any lien or security interest; (e) permitting set-off against amounts owed to PLDT; (f) merging or consolidating with any other company; (g) entering into transactions with stockholders and affiliates; and (h) 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 a 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 that will be triggered only if the principal amount of the defaulted indebtedness exceeds a threshold amount specified in these debt instruments; (b) failure by PLDT to meet certain financial ratio covenants referred to above; (c) the occurrence of any material adverse change in circumstances that a lender reasonably believes materially impairs PLDT's ability to perform its obligations under its debt instrument with the lender; (d) the revocation, termination or amendment of any of the permits or franchises of PLDT in any manner unacceptable to the lender; (e) the abandonment, termination or amendment of the project financed by a loan in a manner unacceptable to the lender; (f) the nationalization or sustained discontinuance of all or a substantial portion of PLDT's business; and (g) other typical events of default, including the commencement of bankruptcy, insolvency, liquidation or winding up proceedings by PLDT.

Smart's debt instruments contain certain restrictive covenants that require Smart to comply with specified financial ratios and other financial tests at semi-annual measurement dates. The financial tests under Smart's loan agreements include compliance with a consolidated debt to consolidated equity ratio of not more than 1.5:1.0, a consolidated debt to consolidated EBITDA ratio of not more than 3:1 and a debt service coverage ratio of not less than 1.5:1.0. The agreements also contain customary and other default provisions that permit the lender to accelerate amounts due under the loans or terminate their commitments to extend additional funds under the loans. These default provisions include: (a) cross-defaults and cross-accelerations that permit a lender to declare a default if Smart is in default under another loan agreement. These cross-default provisions are triggered upon a payment or other default permitting the acceleration of Smart debt, whether or not the defaulted debt is accelerated; (b) failure by Smart to comply with certain financial ratio covenants; and (c) the occurrence of any material adverse change in circumstances that the lender reasonably believes materially impairs Smart's ability to perform its obligations or impair guarantors' ability to perform their obligations under its loan agreements.

As at September 30, 2010, we were in compliance with all of our debt covenants.

### **Obligations Under Finance Lease**

The consolidated future minimum payments for finance leases as at September 30, 2010 are as follows:

| <b>Year</b>  | <b>(in million pesos)</b> |
|--|---------------------------|
| 2010 <sup>(1)</sup>  | 28                        |
| 2011   | 7                         |
| 2012   | 5                         |
| 2013 and onwards   | 4                         |
| Total minimum finance lease payments (Note 26)                                 | 44                        |
| Less amount representing interest  | 2                         |
| Present value of net minimum finance lease payments (Notes 3 and 28)           | 42                        |
| Less obligations under finance lease maturing within one year (Notes 9 and 28) | 33                        |
| Long-term portion of obligations under finance lease (Notes 9 and 28)          | 9                         |

<sup>(1)</sup> October 1, 2010 through December 31, 2010.

#### *Municipal Telephone Projects*

PCEV has an existing finance lease agreement for the Palawan Telecommunications System of the Municipal Telephone Project Office, or MTPO, with the DOTC. Presently, the 18 public calling office stations that were put up pursuant to the MTPO Contract are no longer working. The last payment by PCEV to the DOTC was in July 2000 and no payments have been made since then. PCEV made several attempts to pre-terminate the MTPO Contract in letters to the DOTC where PCEV also manifested its willingness to discuss mutually beneficial compromise agreements for the pre-termination.

The DOTC denied PCEV's petition and reiterated a provision in the MTPO Contract that the pre-termination will result in the imposition of sanctions in the form of liquidated damages not exceeding Php23 million.

PCEV maintains that it had pre-terminated the MTPO Contract as early as 2003, and that the issue of PCEV's pre-termination of the MTPO Contract be referred for arbitrations in accordance with the provisions of the MTPO Contract.

On May 8, 2009, PCEV filed with the Philippine Dispute Resolution Center, Inc., or PDRCI, a Request for Arbitration against the DOTC for the PDRCI to commence the formation of the tribunal and such other procedures required under the PDRCI rules. In the Request for Arbitration, PCEV prayed for the following: (1) as interim relief: ordering the DOTC to cease and desist from enforcing collection and charging additional interests and penalties against PCEV pending the resolution of the arbitration proceedings; and (2) as final relief: (a) ordering the suspension of the MTPO Contract; (b) ordering the termination of the MTPO Contract as at March 20, 2003 and holding PCEV free from any liability for non-performance of the obligations thereunder from March 20, 2003; and (c) ordering the DOTC to pay PCEV attorney's fees and the expenses and cost of arbitration.

Last April 13, 2010, the Arbitral Tribunal issued a Final Award for the arbitration case. In the Disposition portion of the Final Award, the Arbitral Tribunal declared valid and justified PCEV's suspension of the MTPO contract as at March 20, 2003 on the basis of Section 9.3 (Force Majeure) of the MTPO contract, thereby holding PCEV free from liquidated damages for non-performance of the obligations thereunder. PCEV, however, was ordered to pay the DOTC the unpaid annual lease rentals after September 2000 to January 14, 2003 in the amount of Php5.2 million as well as interest and penalties of Php2 million for non-payment of such rentals. Further, PCEV was declared as entitled to the automatic transfer of the ownership of the facilities as provided in Section 7.8 of the MTPO contract. Accordingly, PCEV shall pay DOTC 50% of the Net Present Value of the unpaid lease up to 30 years in the amount of Php21.3 million for the facilities.

The total amount to be paid by PCEV to DOTC is Php28.5 million. As at September 30, 2010, PCEV already advanced Php1 million to DOTC for arbitration expenses and site inspection costs. The remaining balance of Php27.5 million will be paid in two parts: (1) Php26.1 million shall be released directly to DOTC; and (2) Php1.4 million shall be remitted to the Bureau of Treasury to be recorded under Fund Code 152, Special Account of the General Fund for the Office of the Solicitor General.

On April 30, 2010, PCEV filed a Petition for Confirmation of the Final Award with the Regional Trial Court of Mandaluyong City. In a Manifestation and Motion filed by the DOTC in the same court, the DOTC joined PCEV in the latter's Petition for Confirmation of the Final Award. In a July 5, 2010 Decision, Branch 212 of the Regional Trial Court of Mandaluyong City, finding the Final Award to be contrary to law, morals, good customers and public policy, confirmed the Final Award. PCEV is now in the process of discussing with DOTC the finalization of an agreement for the transfer of the facilities to PCEV and the payment of the amounts due, as stated in the Final Award.

#### *Other Long-term Finance Lease Obligations*

The PLDT Group has various long-term lease contracts for a period of three years covering various office equipment. In particular, PLDT, Smart and ePLDT have finance lease obligations in the aggregate amount of Php18 million and Php24 million as at September 30, 2010 and December 31, 2009, respectively, in respect of office equipment. See *Note 9 – Property, Plant and 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.

## 21. Deferred Credits and Other Noncurrent Liabilities

This account consists of:

|  | September 30,<br>2010 | December 31,<br>2009 |
|--|-----------------------|----------------------|
|  | (Unaudited)           | (Audited)            |
|  | (in million pesos)    |                      |
| Accrual of capital expenditures under long-term financing  | 11,960                | 11,966               |
| Provision for asset retirement obligations (Notes 3 and 9)   | 1,311                 | 1,204                |
| Unearned revenues (Note 23)  | 107                   | 66                   |
| Contingent consideration for business acquisitions – net of current portion<br>(Notes 13, 14 and 23) | –                     | 1,193                |
| Others   | 69                    | 9                    |
|  | <b>13,447</b>         | <b>14,438</b>        |

Accrual of capital expenditures under long-term financing represent expenditures related to the expansion and upgrade of our network facilities which are not due to be settled within one year. Such accruals are settled through refinancing from long-term loans obtained from the banks.

The following table summarizes all changes to the liabilities on asset retirement:

|  | September 30,<br>2010 | December 31,<br>2009 |
|--|-----------------------|----------------------|
|  | (Unaudited)           | (Audited)            |
|  | (in million pesos)    |                      |
| Provision for asset retirement obligations at beginning of period    | 1,204                 | 1,100                |
| Accretion expenses for the period                                    | 72                    | 94                   |
| Additional liability recognized during the period                    | 40                    | 17                   |
| Settlement of obligations  | (5)                   | (7)                  |
| Provision for asset retirement obligations at end of period (Note 3) | 1,311                 | 1,204                |

## 22. Accounts Payable

This account consists of:

|   | September 30,<br>2010 | December 31,<br>2009 |
|---|-----------------------|----------------------|
|   | (Unaudited)           | (Audited)            |
|   | (in million pesos)    |                      |
| Suppliers and contractors (Notes 26 and 28) | 15,296                | 14,975               |
| Taxes (Notes 27 and 28)                     | 1,974                 | 1,894                |
| Carriers (Notes 26 and 28)                  | 1,913                 | 1,937                |
| Related parties (Notes 24, 26 and 28)       | 254                   | 233                  |
| Others                                      | 189                   | 562                  |
|   | <b>19,626</b>         | <b>19,601</b>        |



### 23. Accrued Expenses and Other Current Liabilities

This account consists of:

|   | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|---|--------------------------------------|-----------------------------------|
|   | (in million pesos)                   |                                   |
| Accrued utilities and related expenses (Notes 24, 26 and 28)                            | 19,028                               | 17,549                            |
| Accrued employee benefits (Notes 3, 25, 26 and 28)                                      | 4,809                                | 8,074                             |
| Unearned revenues (Note 21)   | 4,358                                | 4,588                             |
| Accrued taxes and related expenses (Notes 26 and 27)                                    | 2,163                                | 1,941                             |
| Current portion of contingent consideration for business acquisitions (Notes 13 and 14) | 1,248                                | 14                                |
| Accrued interests and other related costs (Notes 20, 26 and 28)                         | 1,087                                | 1,167                             |
| Liability arising from purchase of investment (Notes 10, 13 and 28)                     | 114                                  | 65                                |
| Others (Note 10)  | 2,354                                | 2,048                             |
|   | <b>35,161</b>                        | <b>35,446</b>                     |

Unearned revenues represent advance payments for leased lines, installation fees, monthly service fees and unused and/or unexpired portion of prepaid loads.

#### *Contingent Consideration for Business Acquisitions*

Contingent consideration for business acquisitions were recognized in relation to SPi's acquisition cost of Springfield and Laguna Medical on April 12, 2007 and August 31, 2009, respectively. See *Note 2 – Summary of Significant Accounting Policies, Note 13 – Business Combinations and Acquisition of Non-Controlling Interests and Note 14 – Goodwill and Intangible Assets.*

SPi acquired 100% of Springfield plus contingent consideration with fair value at acquisition date of US\$18 million, or Php894 million. As at September 30, 2010 and December 31, 2009, the adjusted fair value of contingent consideration, as revised after effecting adjustments on forecasted earn-out and accretion, amounted to US\$22.7 million, or Php997 million, and US\$20.5 million, or Php951 million, respectively.

SPi acquired 80% of Laguna Medical with a mandatory Put-Call option in respect of the remaining 20% of the outstanding common stock of Laguna Medical. The estimated fair value of the contingent consideration from the mandatory Put-Call option at the acquisition date amounted to US\$5.4 million, or Php257 million. As at September 30, 2010 and December 31, 2009, the adjusted fair value of contingent consideration after the accretion amounted to US\$5.7 million, or Php251 million, and US\$5.5 million, or Php256 million, respectively.

Movements in contingent consideration for business acquisitions are as follows:

|   | September 30, 2010<br>(Unaudited) |        | December 31, 2009<br>(Audited) |        |
|---|-----------------------------------|--------|--------------------------------|--------|
|   | In U.S. Dollar                    | In Php | In U.S. Dollar                 | In Php |
|   | (in millions)                     |        |                                |        |
| Balance at beginning of period  | 26                                | 1,207  | 15                             | 720    |
| Accretion for the period  | 2                                 | 121    | 3                              | 142    |
| Translation   | –                                 | (80)   | –                              | (31)   |
| Business combinations (Note 13)   | –                                 | –      | 8                              | 389    |
| Payments  | –                                 | –      | –                              | (13)   |
| Balance at end of period  | 28                                | 1,248  | 26                             | 1,207  |
| Less current portion of contingent consideration for business acquisitions            | 28                                | 1,248  | –                              | 14     |
| Contingent consideration for business acquisitions – net of current portion (Note 21) | –                                 | –      | 26                             | 1,193  |

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## 24. Related Party Transactions

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

Under the Founder NSP Air Time Purchase Agreement, or ATPA, entered into with AIL in March 1997, which was amended in December 1998 (as amended, the “Original ATPA”), PLDT was granted the exclusive right to sell AIL services, through ACeS Philippines, 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 expected 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”).

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 term sheet negotiated with the relevant banks (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 thousand 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.

Total fees under the Amended ATPA amounted to Php93 million and Php120 million for the nine months ended September 30, 2010 and 2009, respectively. As at September 30, 2010 and December 31, 2009, outstanding obligations of PLDT under the Amended ATPA amounted to Php131 million and Php114 million, respectively. See *Note 5 – Income and Expenses*.

### b. *Agreements between PLDT and certain subsidiaries with Meralco*

In the ordinary course of business, Meralco provides electricity to PLDT and certain subsidiaries’ offices within its franchise area. The rates charged by Meralco are the same as those with unrelated parties. Total electricity costs amounted to Php1,513 million and Php462 million for the nine months ended September 30, 2010 and for the period from July 14, 2009 to September 30, 2009, respectively (PCEV acquired a 20% equity interest in Meralco on July 14, 2009). As at September 30, 2010 and December 31, 2009, outstanding utilities payable amounted to Php110 million and Php188 million, respectively.

In 2009, PLDT and Smart renewed their respective Pole Attachment Contracts with Meralco, wherein Meralco leases its pole spaces to accommodate PLDT’s and Smart’s cable network facilities. Total fees under these contracts amounted to Php148 million and Php41 million for the nine months ended September 30, 2010 and for the period from July 14, 2009 to September 30, 2009, respectively. As at September 30, 2010 and December 31, 2009, outstanding obligations under these contracts amounted to Php111 million and Php135 million, respectively.

See also *Note 10 – Investments in Associates and Joint Ventures* for additional transactions involving Meralco.

### c. *Transactions with Major Stockholders, Directors and Officers*

Material transactions to which PLDT or any of its subsidiaries is a party, in which a director, key officer or owner of more than 10% of the outstanding common stock of PLDT, or any member of the immediate family of a director, key officer or owner of more than 10% of the outstanding common stock of PLDT had a direct or indirect material interest, as at September 30, 2010 (unaudited) and December 31, 2009 (audited) and for the nine months ended September 30, 2010 and 2009 (unaudited) are as follows:

1. *Cooperation Agreement with First Pacific and certain affiliates, or the FP Parties, NTT Communications and NTT DoCoMo*

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

- certain contractual veto rights over a number of major decisions or transactions; and
- rights relating to the representation on the Board of Directors of PLDT and Smart, respectively, and any committees thereof.

Moreover, key provisions of the Cooperation Agreement pertain to, among other things:

- *Restriction on Ownership of Shares of PLDT by NTT Communications and NTT DoCoMo.* Each of NTT Communications and NTT DoCoMo has agreed not to beneficially own, directly or indirectly, in the aggregate with their respective subsidiaries and affiliates, more than 21% of the 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 the issued and outstanding shares of PLDT's common stock, have the right to terminate their respective rights and obligations under the Cooperation Agreement, the Shareholders Agreement and the Stock Purchase and Strategic Investment Agreement.
- *Limitation on Competition.* NTT Communications, NTT DoCoMo and their respective subsidiaries are prohibited from investing in excess of certain thresholds in businesses competing with PLDT in respect of customers principally located in the Philippines and from using their assets in the Philippines in such businesses. Moreover, if PLDT, Smart or any of Smart's subsidiaries intend to enter into any contractual arrangement relating to certain competing businesses, PLDT is required to provide, or to use reasonable efforts to procure that Smart or any of Smart's subsidiaries provide, NTT Communications and NTT DoCoMo with the same opportunity to enter into such agreement with PLDT or Smart or any of Smart's subsidiaries, as the case may be.
- *Business Cooperation.* PLDT and NTT DoCoMo agreed in principle to collaborate with each other on the business development, roll-out and use of a W-CDMA mobile communication network. In addition, PLDT agreed, to the extent of the power conferred by its direct or indirect shareholding in Smart, to procure that Smart will: (i) become a member of a strategic alliance group for international roaming and corporate sales and services; and (ii) enter into a business relationship concerning preferred roaming and inter-operator tariff discounts with NTT DoCoMo.
- *Additional Rights of NTT DoCoMo.* Pursuant to amendments effected by the Cooperation Agreement to the Stock Purchase and Strategic Investment Agreement and the Shareholders Agreement, upon NTT Communications and NTT DoCoMo and their respective subsidiaries owning in the aggregate 20% or more of PLDT's shares of common stock and for as long as they continue to own in the aggregate at least 17.5% of PLDT's shares of common stock then outstanding, NTT DoCoMo has additional rights under the Stock Purchase and Strategic Investment Agreement and Shareholders Agreement, including that:
  1. NTT DoCoMo is entitled to nominate one additional NTT DoCoMo nominee to the Board of Directors of each PLDT and Smart;
  2. PLDT must consult NTT DoCoMo no later than 30 days prior to the first submission to the board of PLDT or certain of its committees of any proposal of investment in an entity that would primarily engage in a business that would be in direct competition or substantially the same business opportunities, customer base, products or services with business carried on by NTT DoCoMo, or which NTT DoCoMo has announced publicly an intention to carry on;

3. PLDT must procure that Smart does not cease to carry on its business, dispose of all of its assets, issue common shares, merge or consolidate, or effect winding up or liquidation without PLDT first consulting with NTT DoCoMo no later than 30 days prior to the first submission to the board of PLDT or Smart, or certain of its committees; and
4. PLDT must first consult with NTT DoCoMo no later than 30 days prior to the first submission to the board of PLDT or certain of its committees for the approval of any transfer by any member of the PLDT Group of Smart common capital stock to any person who is not a member of the PLDT Group.

As at September 30, 2010, NTT Communications and NTT DoCoMo together beneficially owned approximately 21% of PLDT's outstanding common stock.

- *Change in Control.* Each of NTT Communications, NTT DoCoMo and the FP Parties agreed that to the extent permissible under applicable laws and regulations of the Philippines and other jurisdictions, subject to certain conditions, to cast its vote as a shareholder in support of any resolution proposed by the Board of Directors of PLDT for the purpose of safeguarding PLDT from any Hostile Transferee. A "Hostile Transferee" is defined under the Cooperation Agreement to mean any person (other than NTT Communications, NTT DoCoMo, First Pacific or any of their respective affiliates) determined to be so by the PLDT Board of Directors and includes, without limitation, a person who announces an intention to acquire, seeking to acquire or acquires 30% or more of PLDT common shares then issued and outstanding from time to time or having (by itself or together with itself) acquired 30% or more of the PLDT common shares who 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 be reasonably satisfied; (c) without making an offer for all PLDT common shares not held by it and/or its affiliates and/or persons who, pursuant to an agreement or understanding (whether formal or informal), actively cooperate to obtain or consolidate control over PLDT; (d) whose offer for the PLDT common shares is unlikely to succeed; or (e) whose intention is otherwise not *bona fide*; provided that, no person will be deemed a Hostile Transferee unless prior to making such determination, the Board of Directors of PLDT has used reasonable efforts to discuss with NTT Communications and NTT DoCoMo in good faith whether such person should be considered a Hostile Transferee.
- *Termination.* If NTT Communications, NTT DoCoMo or their respective subsidiaries cease to own, in the aggregate, full legal and beneficial title to at least 10% of the shares of PLDT's common stock then issued and outstanding, their respective rights and obligations under the Cooperation Agreement and the Shareholders Agreement will terminate and the Strategic Arrangements (as defined in the Stock Purchase and Strategic Investment Agreement) will terminate. If the FP Parties and their respective subsidiaries cease to have, directly or indirectly, effective voting power in respect of shares of PLDT's common stock representing at least 18.5% of the shares of PLDT's common stock then issued and outstanding, their respective rights and obligations under the Cooperation Agreement, the Stock Purchase and Strategic Investment Agreement, and the Shareholders Agreement will terminate.

## 2. *Integrated i-mode Services Package Agreement between NTT DoCoMo and Smart*

An Integrated i-mode Services Package Agreement was entered into by Smart and NTT DoCoMo on February 15, 2006, under which NTT DoCoMo agreed to grant Smart, on an exclusive basis within the territory of the Philippines for a period of five years, an integrated i-mode services package including a non-transferable license to use the licensed materials and the i-mode brand, as well as implementation support and assistance and post-commercial launch support from NTT DoCoMo. Pursuant to this agreement, Smart is required to pay an initial license fee and running royalty fees based on the revenue arising from i-mode subscription fees and data traffic. There was no royalty fees for the nine months ended September 30, 2010 and 2009. Smart has no outstanding obligation under this agreement as at September 30, 2010 and December 31, 2009.

3. *Advisory Service Agreement between NTT DoCoMo and PLDT*

An Advisory Services Agreement was entered into by NTT DoCoMo and PLDT on June 5, 2006, in accordance with the Cooperation Agreement dated January 31, 2006. Pursuant to the Advisory Services Agreement, NTT DoCoMo will provide the services of certain key personnel in connection with certain aspects of the business of PLDT and Smart. Also, this 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 Php63 million for the nine months ended September 30, 2010 and 2009, respectively. As at September 30, 2010 and December 31, 2009, outstanding obligations of PLDT under this agreement amounted to Php6 million each.

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, and manages 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 trade name "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;
- *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; and
- *Service Agreement.* On February 1, 2008, PLDT entered into an agreement with NTT World Engineering Marine Corporation wherein the latter provides offshore submarine cable repair and other allied services for the maintenance of PLDT's domestic fiber optic network submerged plant.

Total fees under these agreements amounted to Php83 million and Php87 million for the nine months ended September 30, 2010 and 2009, respectively. As at September 30, 2010 and December 31, 2009, outstanding obligations of PLDT under these agreements amounted to Php37 million and Php39 million, respectively.

5. *Agreements between Smart and Asia Link B.V., or ALBV*

Smart has an existing Technical Assistance Agreement with ALBV, a subsidiary of the First Pacific Group. ALBV provides technical support services and assistance in the operations and maintenance of Smart's cellular business. The agreement, which upon its expiration on February 23, 2008 was renewed until February 23, 2012 and is subject to further renewal upon mutual agreement of the parties, provides for payment of technical service fees equivalent to 1% of the consolidated net revenues of Smart. Total service fees charged to operations under this agreement amounted to Php461 million and Php471 million for the nine months ended September 30, 2010 and 2009, respectively. As at September 30, 2010 and December 31, 2009, outstanding obligations of Smart under this agreement amounted to Php46 million and Php188 million, respectively.

## 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 Php264 million and Php290 million for the nine months ended September 30, 2010 and 2009, respectively. Two directors of PLDT have direct/indirect interests in or serve as a director/officer of Gotuaco and Malayan.

## *Compensation of Key Officers of the PLDT Group*

The compensation of key officers of the PLDT Group by benefit type for the period is as follows:

|  | <b>Nine Months Ended September 30,</b> |             |
|--|--|-------------|
|  | <b>2010</b>                            | <b>2009</b> |
|  | <i>(Unaudited)</i>                     |             |
|  | <i>(in million pesos)</i>              |             |
| Short-term employee benefits   | <b>424</b>                             | 411         |
| Share-based payments and other long-term employee benefits (Note 25) | <b>206</b>                             | 268         |
| Post-employment benefits (Note 25)                                   | <b>12</b>                              | 25          |
| <b>Total compensation paid to key officers of the PLDT Group</b>     | <b>642</b>                             | 704         |

In 2008, 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 thousand for each meeting of the board attended. Each of the members or advisors of the audit, executive compensation, governance and nomination and technology strategy committees is entitled to a fee in the amount of Php50 thousand for each committee meeting attended.

On January 27, 2009, the Board of Directors of PLDT approved the increase in director's fee to Php200 thousand for board meeting attendance and to Php75 thousand for Board Committee meeting attendance. The director's fee was last adjusted in July 1998.

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.

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## **25. Share-based Payments and Employee Benefits**

### ***LTIP***

On August 28, 2006, the 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, 2007 to 2009 LTIP, upon endorsement of the ECC, was approved by the Board of Directors to cover the period from January 1, 2007 to December 31, 2009, or the 2007 to 2009 Performance Cycle. The payment under the 2007 to 2009 LTIP was intended to be made at the end of the 2007 to 2009 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 2007 to 2009 Performance Cycle and a cumulative consolidated net income target for the 2007 to 2009 Performance Cycle.

The value of the reward and accrued as at December 31, 2009, was computed in accordance with the formula prescribed in 2007 to 2009 LTIP, subject to the minimum and maximum award level to be granted, following the terms and formula as described therein. The fair value of the 2007 to 2009 LTIP were estimated using an option pricing model, which considered annual stock volatility, risk-free interest rates, dividends yield, the remaining life of options and share price. Cost per share for the 2007 to 2009 LTIP as at September 30, 2009 amounted to Php1,011, which was based on the computed minimum award level. The fair value of the 2007 to 2009 LTIP recognized as expense for the nine months ended September 30, 2009 amounted to Php1,320 million. As at December 31, 2009, outstanding 2007 to 2009 LTIP liability amounted to Php4,582 million, which was paid in April 2010. See Note 3 – Management’s Use of Judgments, Estimates and Assumptions, Note 5 – Income and Expenses, Note 23 – Accrued Expenses and Other Current Liabilities and Note 26 – Contractual Obligations and Commercial Commitments.

**Pension**

*Defined Benefit Pension Plans*

We have defined benefit pension plans, covering substantially all of our permanent and regular employees, excluding those employees of Smart and its subsidiary, I-Contacts, which require contributions to be made to a separate administrative fund.

Our actuarial valuation is performed every year-end. Based on the latest actuarial valuation, the actual present value of accrued (prepaid) benefit costs, net periodic benefit costs and average assumptions used in developing the valuation are as follows:

|  | (in million pesos) |
|--|--------------------|
| Present value of defined benefit obligations as at December 31, 2009 (Audited) | 17,399             |
| Fair value of plan assets as at December 31, 2009 (Audited)                    | 19,980             |
| Surplus status – net   | (2,581)            |
| Unrecognized net actuarial losses (Note 3)                                     | (2,474)            |
|  | (5,055)            |
| Actuarial pension costs during the period                                      | 175                |
| Contributions  | (39)               |
|  | (4,919)            |
| Accrued benefit costs as at September 30, 2010 (Unaudited) (Note 3)            | (390)              |
| Prepaid benefit costs as at September 30, 2010 (Unaudited) (Notes 3 and 18)    | 5,309              |

Net periodic benefit costs were computed as follows:

|   | Nine Months Ended September 30, |       |
|---|---------------------------------|-------|
|   | 2010                            | 2009  |
|   | (Unaudited)                     |       |
|   | (in million pesos)              |       |
| Components of net periodic benefit costs:               |                                 |       |
| Interest costs  | <b>1,169</b>                    | 894   |
| Current service costs                                   | <b>743</b>                      | 482   |
| Amortizations of unrecognized net actuarial loss (gain) | <b>17</b>                       | (2)   |
| Expected return on plan assets                          | <b>(1,754)</b>                  | (505) |
| Net periodic benefit costs (Notes 3 and 5)              | <b>175</b>                      | 869   |

Actual return on plan assets amounted to gain of Php4,036 million for the year ended December 31, 2009.

The weighted average assumptions used to determine pension benefits as at September 30, 2010 (unaudited) and December 31, 2009 (audited) are as follows:

|   |     |
|---|-----|
| Average remaining working years of covered employee | 18  |
| Expected rate of return on plan assets              | 12% |
| Discount rate                                       | 9%  |
| Rate of increase in compensation                    | 9%  |

We have adopted mortality rates in accordance with the 1994 Group Annuity Mortality Table developed by the U.S. Society of Actuaries, which provides separate rates for males and females.

As at September 30, 2010 and December 31, 2009, the assets of the beneficial trust fund established for PLDT's pension plan include investments in shares of stocks of PLDT with a fair value amounting to Php429 million and Php430 million, respectively, which represent about 2% each of such beneficial trust fund's 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 various equity securities, debt and fixed income 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:

|  | <b>September 30,<br/>2010</b> | December 31,<br>2009 |
|--|-------------------------------|----------------------|
|  | <b>(Unaudited)</b>            | (Audited)            |
| Investments in listed and unlisted equity securities | <b>53%</b>                    | 78%                  |
| Investments in temporary placements                  | <b>30%</b>                    | 7%                   |
| Investments in debt and fixed income securities      | <b>11%</b>                    | 9%                   |
| Investments in real estate                           | <b>5%</b>                     | 5%                   |
| Investments in mutual funds                          | <b>1%</b>                     | 1%                   |
|  | <b>100%</b>                   | 100%                 |

Total contribution of PLDT to the pension plan for the year ended December 31, 2009 amounted to Php8,848 million, which was used to invest in various listed and unlisted equity securities. As a result of the contributions in 2009, PLDT expects substantial reduction in net periodic benefit costs moving forward. In addition, PLDT does not expect to make contributions to the beneficial trust fund in the next few years.

#### *Defined Contribution Plan*

Smart and I-Contacts contributions to the plan are made based on the employee's years of tenure and range from 5% to 10% of the employee's monthly salary. Additionally, an employee has an option to make a personal contribution to the fund, at an amount not exceeding 10% of his monthly salary. The employer then provides an additional contribution to the fund ranging from 10% to 50% of the employee's contribution based on the employee's years of tenure. Although the plan has a defined contribution format, Smart and I-Contacts regularly monitor compliance with R.A. 7641, otherwise known as "The Retirement Pay Law". As at September 30, 2010 and 2009, Smart and I-Contacts were in compliance with the requirements of R.A. 7641.

The plan's investment portfolio seeks to achieve regular income and long-term capital growth and consistent performance over its own portfolio benchmark. In order to attain this objective, the trustee's mandate is to invest in a diversified portfolio of bonds and equities, both domestic and international. The portfolio mix is kept at 60% to 90% for debt and fixed income securities while 10% to 40% is allotted to equity securities.

The allocation of the fair value of the beneficial trust fund's assets for Smart and I-Contacts pension plan is as follows:

|  | <b>September 30,<br/>2010</b> | December 31,<br>2009 |
|--|-------------------------------|----------------------|
|  | <b>(Unaudited)</b>            | (Audited)            |
| Investments in debt and fixed income securities      | <b>62%</b>                    | 61%                  |
| Investments in listed and unlisted equity securities | <b>38%</b>                    | 34%                  |
| Others   | -                             | 5%                   |
|  | <b>100%</b>                   | 100%                 |

Smart and I-Contacts currently expect to make approximately Php190 million of cash contributions to their pension plans in 2010.



### Pension Benefit Costs

Total consolidated pension benefit costs for the period is as follows:

|  | <b>Nine Months Ended September 30,</b> |             |
|--|--|-------------|
|  | <b>2010</b>                            | <b>2009</b> |
|  | (Unaudited)                            |             |
|  | (in million pesos)                     |             |
| Expense recognized for defined benefit plans   | <b>175</b>                             | 869         |
| Expense recognized for defined contribution plans                                      | <b>22</b>                              | 132         |
| <b>Total expense recognized for consolidated pension benefit costs (Notes 3 and 5)</b> | <b>197</b>                             | 1,001       |

### Other Long-Term Employee Benefits

The new LTIP, or 2010 to 2012 LTIP, has been presented to and approved by the Executive Compensation Committee, or ECC, and Board of Directors, and is based on profit targets with the Performance Cycle. The cost of 2010 to 2012 LTIP is determined using the projected unit credit method based on assumed discount rates and profit targets. Total outstanding liability and fair value of 2010 to 2012 LTIP cost for the nine month ended September 30, 2010 amounted to Php1,061 million. See *Note 3 – Management’s Use of Judgments, Estimates and Assumptions*.

Net periodic benefit costs were computed as follows:

|   | <b>Nine Months Ended</b>  |
|---|---------------------------|
|   | <b>September 30, 2010</b> |
|   | (Unaudited)               |
|   | (in million pesos)        |
| Components of net periodic benefit costs:         |                           |
| Current service costs                             | 1,029                     |
| Interest costs                                    | 17                        |
| Net actuarial loss                                | 15                        |
| <b>Net periodic benefit costs (Notes 3 and 5)</b> | <b>1,061</b>              |

## 26. Contractual Obligations and Commercial Commitments

### Contractual Obligations

The following table discloses our consolidated contractual undiscounted obligations outstanding:

|   | <b>Payments Due by Period</b> |                             |                  |                  |                              |
|---|-------------------------------|-----------------------------|------------------|------------------|------------------------------|
|   | <b>Total</b>                  | <b>Less than<br/>1 year</b> | <b>1-3 years</b> | <b>3-5 years</b> | <b>More than<br/>5 years</b> |
|   | (in million pesos)            |                             |                  |                  |                              |
| <b>September 30, 2010 (Unaudited)</b>                   |                               |                             |                  |                  |                              |
| <i>Debt<sup>(1)</sup>:</i>                              | <i>120,299</i>                | <i>4,525</i>                | <i>50,845</i>    | <i>42,078</i>    | <i>22,851</i>                |
| Principal   | 96,619                        | 4,074                       | 36,013           | 36,712           | 19,820                       |
| Interest  | 23,680                        | 451                         | 14,832           | 5,366            | 3,031                        |
| <i>Lease obligations:</i>                               | <i>8,341</i>                  | <i>4,838</i>                | <i>1,708</i>     | <i>917</i>       | <i>878</i>                   |
| Operating lease   | 8,297                         | 4,809                       | 1,694            | 916              | 878                          |
| Finance lease   | 44                            | 29                          | 14               | 1                | –                            |
| <i>Unconditional purchase obligations<sup>(2)</sup></i> | <i>790</i>                    | <i>229</i>                  | <i>264</i>       | <i>264</i>       | <i>33</i>                    |
| <i>Other obligations:</i>                               | <i>62,473</i>                 | <i>43,772</i>               | <i>14,134</i>    | <i>696</i>       | <i>3,871</i>                 |
| Derivative financial liabilities <sup>(3)</sup> :       | 4,404                         | –                           | 1,920            | 675              | 1,809                        |
| Long-term currency swaps                                | 4,404                         | –                           | 1,920            | 675              | 1,809                        |
| Various trade and other obligations:                    | 58,069                        | 43,772                      | 12,214           | 21               | 2,062                        |
| Suppliers and contractors                               | 27,256                        | 15,296                      | 11,960           | –                | –                            |
| Utilities and related expenses                          | 15,585                        | 15,469                      | 71               | 16               | 29                           |
| Employee benefits                                       | 4,798                         | 4,798                       | –                | –                | –                            |
| Customers’ deposits                                     | 2,221                         | –                           | 183              | 5                | 2,033                        |

|  | Payments Due by Period |                     |               |               |                      |
|--|------------------------|---------------------|---------------|---------------|----------------------|
|  | Total                  | Less than<br>1 year | 1-3 years     | 3-5 years     | More than<br>5 years |
|  | (in million pesos)     |                     |               |               |                      |
| Dividends  | 2,139                  | 2,139               | –             | –             | –                    |
| Carriers   | 1,913                  | 1,913               | –             | –             | –                    |
| Others   | 4,157                  | 4,157               | –             | –             | –                    |
| <b>Total contractual obligations</b>                     | <b>191,903</b>         | <b>53,364</b>       | <b>66,951</b> | <b>43,955</b> | <b>27,633</b>        |
| <b>December 31, 2009 (Audited)</b>                       |                        |                     |               |               |                      |
| <i>Debt</i> <sup>(1)</sup> :                             | 130,075                | 5,241               | 56,398        | 38,073        | 30,363               |
| Principal  | 102,587                | 4,876               | 40,226        | 31,953        | 25,532               |
| Interest   | 27,488                 | 365                 | 16,172        | 6,120         | 4,831                |
| <i>Lease obligations</i> :                               | 7,564                  | 3,778               | 1,956         | 994           | 836                  |
| Operating lease  | 7,497                  | 3,730               | 1,940         | 991           | 836                  |
| Finance lease  | 67                     | 48                  | 16            | 3             | –                    |
| <i>Unconditional purchase obligations</i> <sup>(2)</sup> | 834                    | 137                 | 279           | 279           | 139                  |
| <i>Other obligations</i> :                               | 64,456                 | 44,322              | 15,528        | 826           | 3,780                |
| Derivative financial liabilities <sup>(3)</sup> :        | 4,759                  | –                   | 2,153         | 789           | 1,817                |
| Long-term currency swaps                                 | 4,759                  | –                   | 2,153         | 789           | 1,817                |
| Various trade and other obligations:                     | 59,697                 | 44,322              | 13,375        | 37            | 1,963                |
| Suppliers and contractors                                | 26,941                 | 14,975              | 11,966        | –             | –                    |
| Utilities and related expenses                           | 14,737                 | 14,687              | 18            | 5             | 27                   |
| Employee benefits  | 8,082                  | 8,082               | –             | –             | –                    |
| Customers' deposits                                      | 2,166                  | –                   | 198           | 32            | 1,936                |
| Carriers   | 1,937                  | 1,937               | –             | –             | –                    |
| Dividends  | 1,749                  | 1,749               | –             | –             | –                    |
| Others   | 4,085                  | 2,892               | 1,193         | –             | –                    |
| <b>Total contractual obligations</b>                     | <b>202,929</b>         | <b>53,478</b>       | <b>74,161</b> | <b>40,172</b> | <b>35,118</b>        |

<sup>(1)</sup> Consist of notes payable and long-term debt, including current portion; gross of unamortized debt discount and debt issuance costs.

<sup>(2)</sup> Based on the Amended ATPA with AIL. See Note 24 – Related Party Transactions.

<sup>(3)</sup> Gross liabilities before any offsetting application.

### *Debt*

See Note 20 – Interest-bearing Financial Liabilities for a detailed discussion of our debt.

### *Operating Lease Obligations*

The PLDT Group has various lease contracts for periods ranging from one to ten years covering certain offices, warehouses, cell sites telecommunications equipment locations and various office equipment amounting to Php8,297 million and Php7,497 million as at September 30, 2010 and December 31, 2009, respectively.

### *Finance Lease Obligations*

See Note 20 – Interest-bearing Financial Liabilities for the detailed discussion of our long-term finance lease obligations.

### *Unconditional Purchase Obligations*

See Note 24 – Related Party Transactions for a detailed discussion of PLDT's obligation under the Original ATPA and the Amended ATPA.

As at September 30, 2010 and December 31, 2009, PLDT's aggregate remaining minimum obligation under the Amended ATPA is approximately Php790 million and Php834 million, respectively.

### *Other Obligations*

#### *Derivative Financial Liabilities*

See Note 28 – Financial Assets and Liabilities for the detailed discussion of our derivative financial liabilities.

### *Various Trade and Other Obligations*

PLDT Group has various obligations to suppliers for the acquisition of phone and network equipment, contractors for services rendered on various projects, foreign administrations and domestic carriers for the access charges, shareholders for unpaid dividends distributions, employees for benefits related obligations, and various business and operational related agreements. As at September 30, 2010 and December 31, 2009, total obligations under these various agreements amounted to approximately Php58,069 million and Php59,697 million, respectively. See *Note 22 – Accounts Payable* and *Note 23 – Accrued Expenses and Other Current Liabilities*.

### ***Commercial Commitments***

As at September 30, 2010 and December 31, 2009, our outstanding consolidated commercial commitments, in the form of letters of credit, amounted to Php229 million and Php1,317 million, respectively. These commitments will expire within one year.

See *Note 28 – Financial Assets and Liabilities* for discussion of Liquidity Risk Management.

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## **27. Provisions and Contingencies**

### *NTC Supervision and Regulation Fees, or SRF*

Since 1994, following the rejection of PLDT's formal protest against the assessments by the NTC of SRF, PLDT and the NTC had been involved in legal proceedings before the Court of Appeals and the Supreme Court. The principal issue in these proceedings was the basis for the computation of the SRF. PLDT's opinion, which was upheld by the Court of Appeals, but, as set forth below, rejected by the Supreme Court, was that the SRF should be computed based only on the par value of the subscribed or paid up capital of PLDT, excluding stock dividends, premium or capital in excess of par. The Supreme Court, in its decision dated July 28, 1999, ordered the NTC to make a recomputation of the SRF based on PLDT's capital stock subscribed and paid. Subsequently, in February 2000, the NTC issued an assessment letter for the balance of the SRF, but in calculating said fees, the NTC used as a basis not only capital stock subscribed or paid but also the stock dividends. PLDT questioned the inclusion of the stock dividends in the calculation of the SRF and sought to restrain the NTC from enforcing/implementing its assessment until the resolution of the said issue. Prior to the resolution of the issue mentioned above, PLDT paid the SRF due in 2000 together with the balance due from the recalculation of the SRF and had been paying the SRF due in September of each year thereafter, excluding the portion that was based on stock dividends.

The Supreme Court, in a resolution promulgated on December 4, 2007, held that the computation of the SRF should be based on the outstanding capital stock of PLDT, including stock dividends. In a letter to PLDT on February 29, 2008, the NTC assessed PLDT the total amount of Php2,870 million as SRF, which included penalties and interest. On April 3, 2008, PLDT paid NTC the outstanding principal amount relating to SRF on stock dividends in the amount of Php455 million, but did not pay the penalties and interest assessed by the NTC. PLDT believes that it is not liable for penalties and interest, and therefore protested and disputed NTC's assessments of the same. In letters dated April 14, 2008 and June 18, 2008, the NTC demanded payment of the balance of its assessment. On July 9, 2008, PLDT filed a Petition for Certiorari and Prohibition with the Court of Appeals (the "Petition") praying that the NTC be restrained from enforcing or implementing its assessment letter of February 29, 2008, and demand letters dated April 14, 2008 and June 18, 2008, all demanding payment of SRF including penalties and interests. The Petition further prayed that after notice and hearing, the NTC be ordered to forever cease and desist from implementing and/or enforcing, and annulling and reversing and setting aside, the said assessment letter and demand letters. The Court of Appeals, in its Decision dated May 25, 2010, granted PLDT's Petition and set aside/annulled the NTC's letters-assessments dated February 29, 2008, April 14, 2008 and June 18, 2008. The NTC did not file a Motion for Reconsideration of the decision of the Court of Appeals. Instead, the NTC, through the Solicitor General, filed a petition for review directly with the Supreme Court. PLDT received a copy of the petition on July 16, 2010. PLDT is still awaiting for the order of the Supreme Court to file its comment.

### *PLDT's Local Business and Franchise Tax Assessments*

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 that the Public Telecommunications Policy Act, or R.A. 7925, which took effect on March 16, 1995, and the grant of local franchise and business taxes exemption privileges to other franchise holders subsequent to the effectivity of R.A. 7160, implicitly restored its local franchise and business taxes exemption privilege under Section 12 of R.A. 7082, or the PLDT Franchise pursuant to Section 23 thereof or the equality of treatment clause. To confirm this position, PLDT sought and obtained on June 2, 1998 a ruling from the Bureau of Local Government Finance, or BLGF, of the Philippine Department of Finance, which ruled that PLDT is exempt from the payment of local franchise and business taxes imposable by LGUs under R.A. 7160. However, on March 25, 2003, in a ruling relating to a tax assessment by the City of Davao, the Supreme Court decided that PLDT was not exempt from the local franchise tax.

Although PLDT believes that it is not liable to pay local franchise and business taxes, PLDT has entered into compromise settlements with several LGUs, including the City of Makati, in order to maintain and preserve its good standing and relationship with these LGUs. Under these compromise settlements, which have mostly been approved by the relevant courts, PLDT has paid as at September 30, 2010 a total amount of Php925 million for local franchise tax covering prior periods up to September 30, 2010.

As at September 30, 2010, PLDT has no contested assessments of LGUs for franchise taxes based on gross receipts received or collected for services within their respective territorial jurisdiction.

However, PLDT contested the imposition of local business taxes in addition to local franchise tax by the City of Tuguegarao in the amount of Php1.9 million for the years 1998 to 2003. The Regional Trial Court, or RTC, rendered a decision stating that the City of Tuguegarao cannot impose local business tax on PLDT, there being no ordinance enacted for that purpose. The City of Tuguegarao has filed a Motion for Reconsideration which was denied by the court in its Order dated March 2, 2009. The City of Tuguegarao has filed a Notice of Appeal before the Court of Appeals. PLDT filed a motion to dismiss the said appeal on the ground of lack of jurisdiction as the appeal should have been filed before the Court of Tax Appeals, or CTA. The City of Tuguegarao filed its Comment to PLDT's Motion to Dismiss. PLDT will file its Reply on the said Comment of the City of Tuguegarao.

Moreover, PLDT also contested the imposition of franchise tax by the Province of Cagayan based on gross receipts derived from outside its territorial jurisdiction specifically that of the City of Tuguegarao, in the amount of Php3 million for the years 1999 to 2006. The RTC in its decision dated February 25, 2009, ruled in favor of PLDT, stating that the Province of Cagayan can no longer tax PLDT for transactions taking place in the City of Tuguegarao. The Province of Cagayan filed a Motion for Reconsideration which was denied by the RTC in its Order dated October 7, 2009. The Province of Cagayan filed a Petition for Review before the CTA. The CTA ordered PLDT to file its Comment on the Petition which PLDT timely filed on February 25, 2010. In a resolution dated April 30, 2010, the court ordered both parties to submit their respective memoranda which PLDT timely complied by filing its memorandum on June 4, 2010. Last September 20, 2010 PLDT received the Decision of the CTA which Affirmed with Modifications the Decision of the RTC. Though said Decision affirmed that the Province of Cagayan cannot impose franchise tax on gross receipts realized in the City of Tuguegarao, the CTA ruled that PLDT is subject to surcharge and interest for the years 1999 to 2004 thereby reducing the amount refundable to PLDT from Php2.8 million to Php1 million. PLDT filed a partial motion for reconsideration of the said decision.

### *Smart's Local Business and Franchise Tax Assessments*

In *Smart Communications, Inc. vs. City of Makati* (Civil Cases No. 02-249 and 02-725, August 3, 2004), the deficiency local franchise tax assessment issued against Smart by the City of Makati totaling approximately Php312 million, inclusive of surcharges and interests, covering the years 1995 and 1998 to 2001 had been ordered cancelled by the RTC of City of Makati. This was upheld by the Court of Appeals in its Resolution dated June 9, 2005 (CA G.R. SP No. 88681, June 9, 2005). The Court's Decision declaring Smart as exempt from paying local franchise tax had become final and executory.

In a letter dated March 24, 2008, the Miscellaneous, Taxes, Fees and Charges Division of the City of Makati requested payment for alleged deficiency local franchise tax covering the years 1995 and 1997 to 2003. Smart replied and reiterated its exemption from local franchise tax based on its legislative franchise and the *Smart vs. City of Makati* case, which covered the years 1995 and 1998 to 2001. On March 9, 2009, Smart received another letter from the City of Makati on alleged outstanding franchise tax obligations covering the period from 1995 to 2009. In November 2009, Smart received a Billing Statement from the City of Makati for alleged franchise tax liability covering the period from 1995 and 1997 to 2003. On December 16, 2009 and January 29, 2010, Smart filed its reply letters and refuted the alleged franchise tax liability based on the *Smart vs. City of Makati* case and its BOI registration dated May 3, 2001.

In August 2009, the Business Tax Division of the City of Makati issued a Letter of Authority for the examination of Smart's local tax liabilities covering the years 2006, 2007 and 2008. The City of Makati issued a Notice of Assessment dated October 23, 2009 against Smart for alleged deficiency local business taxes, fees and charges, including interest and penalties, covering the years 2006 to 2008. Smart protested the assessment on December 16, 2009. On February 8, 2010, Smart received the City of Makati's Revised Notice of Assessment, which showed deficiency local franchise and business taxes, including interest and penalties, for the years 2006 to 2008. Smart contested the revised deficiency local tax assessment on February 15, 2010. In a letter dated February 19, 2010, the City of Makati demanded the immediate settlement of the alleged tax liability. On March 3, 2010, Smart requested the City of Makati for a reinvestigation and for it to further evaluate its arguments and supporting documents. Afterwhich, Smart had several meetings with the officials of the City of Makati to discuss its request for reinvestigation. During that period, the City of Makati officials advised Smart that they still need to study and internally discuss the arguments of Smart.

On August 3, 2010, Smart received the City of Makati's Notice of Distraint and Levy dated July 23, 2010. Smart sent a letter to the City of Makati on August 10, 2010 inquiring on the status of Smart's request for reinvestigation and requested for a meeting. On August 19, 2010, Smart's representatives met with the City of Makati officials and they then informed Smart's representatives that its decision on the matter is final.

On September 1, 2010, Smart filed an Appeal with application for the issuance of a Temporary Restraining Order and Writ of Preliminary Injunction before the Regional Trial Court of the City of Makati (Branch 133) docketed as SCA No. 10-852. On September 6, 2010, the Regional Trial Court of the City of Makati (Branch 133) promulgated an Order granting the issuance of a temporary restraining order for 20 days directing the City of Makati and the City Treasurer to maintain the status quo until a hearing can be had to determine the propriety of injunctive relief conditioned upon posting of a Php200 million bond by Smart. In an Order dated September 23, 2010, the Regional Trial Court of the City of Makati (Branch 133) issued a Writ of Preliminary Injunction conditioned upon posting of Php500 million bond by Smart. Smart submitted the bond with the Regional Trial Court of the City of Makati (Branch 133) on October 4, 2010.

Meanwhile, Smart also received similar local franchise tax assessments issued by the City of Iloilo amounting to approximately Php0.7 million, inclusive of surcharge and penalties. The RTC of Iloilo likewise ruled in favor of Smart in its Decision dated January 19, 2005 (Civil Case No. 02-27144) declaring Smart as exempt from payment of local franchise tax. The City of Iloilo appealed the Decision and the Supreme Court, on February 27, 2009, (G.R. No. 167260) ruled that Smart is liable to pay the local franchise tax to the City of Iloilo. On April 2, 2009, Smart filed its Motion for Reconsideration. On July 1, 2009, the Supreme Court's Special Second Division issued a Resolution denying Smart's Motion for Reconsideration. In accordance with this Decision, Smart paid the City of Iloilo.

In 2002, Smart filed a special civil action for declaratory relief for the ascertainment of its rights and obligations under the Tax Code of the City of Davao. The relevant section of Smart's franchise provided that the grantee shall pay a franchise tax equivalent to 3% of all gross receipts of the business transacted under the franchise by the grantee and the said percentage shall be in lieu of all taxes on the franchise or earnings thereof. On September 16, 2008, the Supreme Court's Third Division ruled that Smart is liable for local franchise tax since the phrase "*in lieu of all taxes*" merely covers national taxes and was rendered inoperative when the VAT law took effect. On October 21, 2008, Smart filed its Motion for Reconsideration. Smart argued that the operative word in the "*in lieu of all taxes*" clause in Smart's franchise is the word "*all*". The word "*all*" before "*taxes*" in the clause "*in lieu of all taxes*" covers all kinds of taxes, national and local, except only those mentioned in the franchise. Smart also argued that the BIR already clarified in its Revenue Memorandum Circular No. 5-96 dated March 31, 1997 that the

VAT merely replaced the franchise tax. On July 21, 2009, the Supreme Court's Third Division promulgated its Resolution denying Smart's Motion for Reconsideration and affirming that Smart is liable to pay local franchise tax to the City of Davao. On June 3, 2010, Smart received a local franchise tax assessment from the City of Davao covering the years from 1997 to 2010. Smart filed on June 21, 2010 its letter of protest against the local franchise tax assessment citing its local tax exemption by virtue of its BOI registration. On July 6, 2010, Smart received a letter from the City of Davao requesting for the submission of additional documents. Smart submitted several documents on August 3, 2010.

With the finality of the Iloilo and Davao cases, several cities and provinces have began discussions with Smart on the settlement of alleged local franchise tax within their respective jurisdictions. To limit the years covered by Smart's tax liability, Smart is invoking the prospective application of the Iloilo and Davao decisions and the recognition of its local tax exemption by virtue of its BOI registration issued on May 3, 2001.

#### *PCEV's Local Franchise Tax Assessment*

In 2004, PCEV secured a favorable decision from a Trial Court involving the local franchise tax in the City of Makati. In the case entitled "*Pilipino Telephone Corporation vs. City of Makati and Andrea Pacita S. Guinto*" (*Piltel vs. City of Makati*) (Civil Case No. 01-1760), the Makati Regional Trial Court rendered its Decision dated December 10, 2002 declaring PCEV exempt from the payment of local franchise and business taxes. The Trial Court ruled that the legislative franchise of PCEV, R.A. 7293, granting the corporation exemption from local franchise and business taxes took effect after R.A. 7160 or the Local Government Code which removed all prior tax exemptions granted by law or other special law. The Trial Court's decision was affirmed by the Court of Appeals in its Decision dated July 12, 2004 and then subsequently, the Supreme Court denied the appeal of the City of Makati in its Entry of Judgment dated October 13, 2004. The Supreme Court ruled that the City of Makati, failed to sufficiently show that the Court of Appeals committed any reversible error in the questioned judgment to warrant the exercise of the Supreme Court's discretionary appellate jurisdiction.

On March 9, 2009, PCEV received a letter from the City of Makati on alleged outstanding franchise tax obligations covering the period from 1995 to 2009. In November 2009, PCEV received a Billing Statement from the City of Makati for alleged franchise tax liability covering the period from 1999 to 2003. On December 16, 2009, PCEV filed its reply and refuted the alleged franchise tax liability based on the *Piltel vs. City of Makati* case.

#### *Real Property Tax Assessment*

In *Smart Communications, Inc. vs. Central Board of Assessment Appeals, or CBAA, Local Board of Assessment Appeals of Surigao City, and City Assessor of Surigao City*, Smart filed a Petition for Review with the Court of Appeals assailing the prior decision of the CBAA which declared Smart as being liable to pay real property taxes to the City of Surigao. The Court of Appeals on November 26, 2008 decided that Smart is exempt from the payment of real property taxes for its properties which are actually, directly and exclusively used in the operation of its franchise.

On August 16, 2010, the Court of Appeals issued an Entry of Judgment confirming that the November 26, 2008 Resolution had become final and executory on December 22, 2008, and it was recorded in the book of Entries of Judgments.

#### *Arbitration with Eastern Telecommunications Philippines, Inc., or ETPI*

Since 1990 (up to present), PLDT and ETPI have been engaged in legal proceedings involving a number of issues in connection with their business relationship. While they have entered into Compromise Agreements in the past (one in February 1990, and another one in March 1999), these agreements have not put to rest their issues against each other. Accordingly, to avoid further protracted litigation and simply improve their business relationship, both PLDT and ETPI have agreed in April 2008 to submit their differences and issues to voluntary arbitration. For this arbitration (after collating various claims of one party against the other) ETPI, on one hand, initially submitted its claims of about Php2.9 billion against PLDT; while PLDT, on the other hand, submitted its claims of about Php2.8 billion against ETPI. Currently, PLDT and ETPI have agreed to suspend the arbitration proceedings between them.

### *Matters Relating to a Third Party Aggregator*

In late 2009, PLDT informally received a communication which provided a complaint, or the Draft, setting forth a securities class action lawsuit in the United States District Court for the Southern District of New York against PLDT and certain PLDT officers and indicated that such Draft may be filed against PLDT. The Draft alleges that some PLDT officers and employees caused PLDT's subsidiary, Smart to enter into contracts with a third-party entity in order to divert long distance telephone traffic and profits to such third-party entity. The Draft further alleges that these officers and employees personally created and controlled the third-party entity and were personally enriched as a result. The Draft alleges that this alleged scheme was accomplished by causing Smart to offer a lower rate for long distance telephone traffic to that third-party entity so that long distance traffic which otherwise would have been handled by PLDT at a higher rate was redirected to equipment owned by the third-party entity. The Draft alleges that PLDT failed to disclose material facts regarding the alleged scheme and that, as a result, PLDT misstated its true financial condition in its annual reports from 2002 through 2008.

In light of the nature of the allegations and out of an abundance of caution, PLDT's Board of Directors referred the Draft for review by the Audit Committee. The Audit Committee appointed an independent Investigation Committee to oversee an investigation into the allegations contained in the Draft. The Audit Committee retained independent counsel to lead in the investigation. To preserve the confidential nature of the inquiry, the investigation was limited to internal sources at PLDT, including current PLDT and Smart employees, internal records and discrete inquiries and public records searches.

The independent counsel, under the oversight of the Investigation Committee, has concluded on the basis of the evidence within the control of PLDT or otherwise reasonably available, that: (i) while the investigation cannot definitively exclude the possibility, the investigation has found no evidence to establish that PLDT's officers and employees were personally involved in the creation of the third-party entity referred to in the Draft and has found no evidence of any improper personal financial benefit or gain by these officers and employees, directly or indirectly from such third party entity; and (ii) while Smart had substantial business relationships with various third-party aggregators of long-distance telephone traffic during the relevant period, including the third-party entity referred to in the Draft (with which Smart ceased doing business in 2008), there is no evidence that the relationship with such third-party entity in fact resulted in a material adverse impact on PLDT's revenues during the relevant period and may have in fact benefited PLDT overall through an increase in overall call volume.

On May 7, 2010, the Audit Committee of PLDT approved the recommendation and conclusion of the independent counsel, as endorsed by the Investigation Committee.

Other disclosures required by *PAS 37, Provisions, Contingent Liabilities and Contingent Assets*, were not provided as it may prejudice our position in on-going claims, litigations and assessments.

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## **28. Financial Assets and Liabilities**

We have various financial assets such as trade and non-trade receivables and cash and short-term deposits, which arise directly from our operations. Our principal financial liabilities, other than derivatives, comprise of bank loans and overdrafts, finance leases, trade and non-trade payables. The main purpose of these financial liabilities is to finance our operations. We also enter into derivative transactions, primarily principal only currency swap agreements, currency options, interest rate swaps and forward foreign exchange contracts to manage the currency and interest rate risks arising from our operations and sources of financing. Our accounting policies in relation to derivatives are set out in *Note 2 – Summary of Significant Accounting Policies*.

The following table sets forth our financial assets and financial liabilities:

|   | Loans<br>and<br>receivables | Held-to-<br>maturity<br>investments | Held-for-<br>trading | Available-for-<br>sale financial<br>assets | Liabilities<br>carried at<br>amortized cost | Total<br>financial<br>assets and<br>liabilities | Non-financial<br>assets and<br>liabilities | Total          |
|---|-----------------------------|-------------------------------------|----------------------|--|---|---|--|----------------|
| (in million pesos)  |                             |                                     |                      |  |   |   |  |                |
| <b>Assets as at September 30, 2010 (Unaudited)</b>              |                             |                                     |                      |  |   |   |  |                |
| <i>Noncurrent:</i>  |                             |                                     |                      |  |   |   |  |                |
| Property, plant and equipment – net                             | –                           | –                                   | –                    | –  | –   | –   | 158,033                                    | 158,033        |
| Investments in associates and joint ventures                    | –                           | –                                   | –                    | –  | –   | –   | 23,303                                     | 23,303         |
| Available-for-sale financial assets                             | –                           | –                                   | –                    | 140  | –   | 140   | –  | 140            |
| Investment in debt securities – net of current portion          | –                           | 478                                 | –                    | –  | –   | 478   | –  | 478            |
| Investment properties   | –                           | –                                   | –                    | –  | –   | –   | 1,098                                      | 1,098          |
| Goodwill and intangible assets                                  | –                           | –                                   | –                    | –  | –   | –   | 12,402                                     | 12,402         |
| Deferred income tax assets – net                                | –                           | –                                   | –                    | –  | –   | –   | 6,401                                      | 6,401          |
| Prepayments – net of current portion                            | –                           | –                                   | –                    | –  | –   | –   | 8,863                                      | 8,863          |
| Advances and refundable deposits – net of current portion       | 973                         | –                                   | –                    | –  | –   | 973   | 233  | 1,206          |
| <i>Current:</i>   |                             |                                     |                      |  |   |   |  |                |
| Cash and cash equivalents                                       | 26,902                      | –                                   | –                    | –  | –   | 26,902  | –  | 26,902         |
| Short-term investments  | 2,850                       | –                                   | 516                  | –  | –   | 3,366   | –  | 3,366          |
| Current portion of investment in debt securities                | –                           | 405                                 | –                    | –  | –   | 405   | –  | 405            |
| Trade and other receivables – net                               | 15,171                      | –                                   | –                    | –  | –   | 15,171  | –  | 15,171         |
| Inventories and supplies  | –                           | –                                   | –                    | –  | –   | –   | 2,230                                      | 2,230          |
| Derivative financial assets                                     | –                           | –                                   | 9                    | –  | –   | 9   | –  | 9              |
| Current portion of prepayments                                  | –                           | –                                   | –                    | –  | –   | –   | 4,897                                      | 4,897          |
| Current portion of advances and refundable deposits             | 16                          | –                                   | –                    | –  | –   | 16  | 176  | 192            |
| <b>Total assets</b>   | <b>45,912</b>               | <b>883</b>                          | <b>525</b>           | <b>140</b>                                 | <b>–</b>                                    | <b>47,460</b>                                   | <b>217,636</b>                             | <b>265,096</b> |
| <b>Liabilities as at September 30, 2010 (Unaudited)</b>         |                             |                                     |                      |  |   |   |  |                |
| <i>Noncurrent:</i>  |                             |                                     |                      |  |   |   |  |                |
| Interest-bearing financial liabilities – net of current portion | –                           | –                                   | –                    | –  | 80,782                                      | 80,782  | –  | 80,782         |
| Deferred income tax liabilities – net                           | –                           | –                                   | –                    | –  | –   | –   | 1,604                                      | 1,604          |
| Derivative financial liabilities                                | –                           | –                                   | 2,366                | –  | –   | 2,366   | –  | 2,366          |
| Pension and other employee benefits                             | –                           | –                                   | –                    | –  | –   | –   | 1,468                                      | 1,468          |
| Customers' deposits   | –                           | –                                   | –                    | –  | 2,221                                       | 2,221   | –  | 2,221          |
| Deferred credits and other noncurrent liabilities               | –                           | –                                   | –                    | –  | 11,960                                      | 11,960  | 1,487                                      | 13,447         |
| <i>Current:</i>   |                             |                                     |                      |  |   |   |  |                |
| Accounts payable  | –                           | –                                   | –                    | –  | 17,636                                      | 17,636  | 1,990                                      | 19,626         |
| Accrued expenses and other current liabilities                  | –                           | –                                   | –                    | –  | 28,371                                      | 28,371  | 6,790                                      | 35,161         |
| Provision for assessments                                       | –                           | –                                   | –                    | –  | –   | –   | 1,555                                      | 1,555          |
| Current portion of interest-bearing financial liabilities       | –                           | –                                   | –                    | –  | 12,720                                      | 12,720  | –  | 12,720         |
| Dividends payable   | –                           | –                                   | –                    | –  | 2,139                                       | 2,139   | –  | 2,139          |
| Income tax payable  | –                           | –                                   | –                    | –  | –   | –   | 2,912                                      | 2,912          |
| <b>Total liabilities</b>  | <b>–</b>                    | <b>–</b>                            | <b>2,366</b>         | <b>–</b>                                   | <b>155,829</b>                              | <b>158,195</b>                                  | <b>17,806</b>                              | <b>176,001</b> |
| <b>Net assets (liabilities)</b>                                 | <b>45,912</b>               | <b>883</b>                          | <b>(1,841)</b>       | <b>140</b>                                 | <b>(155,829)</b>                            | <b>(110,735)</b>                                | <b>199,830</b>                             | <b>89,095</b>  |
| <b>Assets as at December 31, 2009 (Audited)</b>                 |                             |                                     |                      |  |   |   |  |                |
| <i>Noncurrent:</i>  |                             |                                     |                      |  |   |   |  |                |
| Property, plant and equipment                                   | –                           | –                                   | –                    | –  | –   | –   | 161,256                                    | 161,256        |
| Investments in associates and joint ventures                    | –                           | –                                   | –                    | –  | –   | –   | 22,233                                     | 22,233         |
| Available-for-sale financial assets                             | –                           | –                                   | –                    | 134  | –   | 134   | –  | 134            |
| Investment in debt securities                                   | –                           | 462                                 | –                    | –  | –   | 462   | –  | 462            |
| Investment properties   | –                           | –                                   | –                    | –  | –   | –   | 1,210                                      | 1,210          |
| Goodwill and intangible assets                                  | –                           | –                                   | –                    | –  | –   | –   | 13,024                                     | 13,024         |
| Deferred income tax assets – net                                | –                           | –                                   | –                    | –  | –   | –   | 7,721                                      | 7,721          |
| Prepayments – net of current portion                            | –                           | –                                   | –                    | –  | –   | –   | 8,663                                      | 8,663          |
| Advances and refundable deposits – net of current portion       | 842                         | –                                   | –                    | –  | –   | 842   | 260  | 1,102          |
| <i>Current:</i>   |                             |                                     |                      |  |   |   |  |                |
| Cash and cash equivalents                                       | 38,319                      | –                                   | –                    | –  | –   | 38,319  | –  | 38,319         |
| Short-term investments  | 3,338                       | –                                   | 486                  | –  | –   | 3,824   | –  | 3,824          |
| Trade and other receivables – net                               | 14,729                      | –                                   | –                    | –  | –   | 14,729  | –  | 14,729         |
| Inventories and supplies  | –                           | –                                   | –                    | –  | –   | –   | 2,165                                      | 2,165          |
| Derivative financial assets                                     | –                           | –                                   | 6                    | –  | –   | 6   | –  | 6              |
| Current portion of prepayments                                  | –                           | –                                   | –                    | –  | –   | –   | 5,098                                      | 5,098          |
| Current portion of advances and refundable deposits             | 7                           | –                                   | –                    | –  | –   | 7   | 195  | 202            |
| <b>Total assets</b>   | <b>57,235</b>               | <b>462</b>                          | <b>492</b>           | <b>134</b>                                 | <b>–</b>                                    | <b>58,323</b>                                   | <b>221,825</b>                             | <b>280,148</b> |
| <b>Liabilities as at December 31, 2009 (Audited)</b>            |                             |                                     |                      |  |   |   |  |                |
| <i>Noncurrent:</i>  |                             |                                     |                      |  |   |   |  |                |
| Interest-bearing financial liabilities – net of current portion | –                           | –                                   | –                    | –  | 86,079                                      | 86,079  | –  | 86,079         |
| Deferred income tax liabilities – net                           | –                           | –                                   | –                    | –  | –   | –   | 1,321                                      | 1,321          |
| Derivative financial liabilities                                | –                           | –                                   | 2,751                | –  | –   | 2,751   | –  | 2,751          |
| Pension and other employee benefits                             | –                           | –                                   | –                    | –  | –   | –   | 374  | 374            |
| Customers' deposits   | –                           | –                                   | –                    | –  | 2,166                                       | 2,166   | –  | 2,166          |
| Deferred credits and other noncurrent liabilities               | –                           | –                                   | –                    | –  | 13,159                                      | 13,159  | 1,279                                      | 14,438         |
| <i>Current:</i>   |                             |                                     |                      |  |   |   |  |                |
| Accounts payable  | –                           | –                                   | –                    | –  | 17,698                                      | 17,698  | 1,903                                      | 19,601         |
| Accrued expenses and other current liabilities                  | –                           | –                                   | –                    | –  | 28,752                                      | 28,752  | 6,694                                      | 35,446         |
| Provision for assessments                                       | –                           | –                                   | –                    | –  | –   | –   | 1,555                                      | 1,555          |
| Current portion of interest-bearing financial liabilities       | –                           | –                                   | –                    | –  | 12,714                                      | 12,714  | –  | 12,714         |
| Dividends payable   | –                           | –                                   | –                    | –  | 1,749                                       | 1,749   | –  | 1,749          |
| Income tax payable  | –                           | –                                   | –                    | –  | –   | –   | 2,829                                      | 2,829          |
| <b>Total liabilities</b>  | <b>–</b>                    | <b>–</b>                            | <b>2,751</b>         | <b>–</b>                                   | <b>162,317</b>                              | <b>165,068</b>                                  | <b>15,955</b>                              | <b>181,023</b> |
| <b>Net assets (liabilities)</b>                                 | <b>57,235</b>               | <b>462</b>                          | <b>(2,259)</b>       | <b>134</b>                                 | <b>(162,317)</b>                            | <b>(106,745)</b>                                | <b>205,870</b>                             | <b>99,125</b>  |



The following table sets forth the consolidated carrying values and estimated fair values of our financial assets and liabilities:

|  | Carrying Value                       |                                   | Fair Value                           |                                   |
|--|--------------------------------------|-----------------------------------|--------------------------------------|-----------------------------------|
|  | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
| (in million pesos)   |                                      |                                   |                                      |                                   |
| <b>Noncurrent Financial Assets</b>                           |                                      |                                   |                                      |                                   |
| Available-for-sale financial assets:                         |                                      |                                   |                                      |                                   |
| Listed equity securities                                     | 76                                   | 68                                | 76                                   | 68                                |
| Unlisted equity securities                                   | 64                                   | 66                                | 64                                   | 66                                |
| Investment in debt securities – net of current portion       | 478                                  | 462                               | 493                                  | 474                               |
| Advances and refundable deposits –<br>net of current portion | 973                                  | 842                               | 873                                  | 732                               |
| Total noncurrent financial assets                            | 1,591                                | 1,438                             | 1,506                                | 1,340                             |
| <b>Current Financial Assets</b>                              |                                      |                                   |                                      |                                   |
| Cash and cash equivalents:                                   |                                      |                                   |                                      |                                   |
| Cash on hand and in banks                                    | 2,435                                | 3,300                             | 2,435                                | 3,300                             |
| Temporary cash investments                                   | 24,467                               | 35,019                            | 24,467                               | 35,019                            |
| Short-term investments                                       | 3,366                                | 3,824                             | 3,366                                | 3,824                             |
| Current portion of investment in debt securities             | 405                                  | –                                 | 405                                  | –                                 |
| Trade and other receivables – net:                           |                                      |                                   |                                      |                                   |
| Foreign administrations                                      | 3,934                                | 4,064                             | 3,934                                | 4,064                             |
| Retail subscribers   | 3,020                                | 3,546                             | 3,020                                | 3,546                             |
| Domestic carriers  | 1,995                                | 1,184                             | 1,995                                | 1,184                             |
| Corporate subscribers  | 1,952                                | 2,429                             | 1,952                                | 2,429                             |
| Dealers, agents and others                                   | 4,270                                | 3,506                             | 4,270                                | 3,506                             |
| Derivative financial assets:                                 |                                      |                                   |                                      |                                   |
| Bifurcated embedded derivatives                              | 9                                    | 6                                 | 9                                    | 6                                 |
| Current portion of advances and refundable deposits          | 16                                   | 7                                 | 16                                   | 7                                 |
| Total current financial assets                               | 45,869                               | 56,885                            | 45,869                               | 56,885                            |
| <b>Total Financial Assets</b>                                | 47,460                               | 58,323                            | 47,375                               | 58,225                            |
| <b>Noncurrent Financial Liabilities</b>                      |                                      |                                   |                                      |                                   |
| Interest-bearing financial liabilities:                      |                                      |                                   |                                      |                                   |
| Long-term debt – net of current portion                      | 80,773                               | 86,066                            | 86,137                               | 88,383                            |
| Obligations under finance lease                              | 9                                    | 13                                | 8                                    | 12                                |
| Derivative financial liabilities:                            |                                      |                                   |                                      |                                   |
| Long-term currency swap                                      | 2,366                                | 2,751                             | 2,366                                | 2,751                             |
| Customers' deposits  | 2,221                                | 2,166                             | 1,576                                | 1,375                             |
| Deferred credits and other noncurrent liabilities            | 11,960                               | 13,159                            | 10,705                               | 11,629                            |
| Total noncurrent financial liabilities                       | 97,329                               | 104,155                           | 100,792                              | 104,150                           |
| <b>Current Financial Liabilities</b>                         |                                      |                                   |                                      |                                   |
| Accounts payable:  |                                      |                                   |                                      |                                   |
| Suppliers and contractors                                    | 15,296                               | 14,975                            | 15,296                               | 14,975                            |
| Carriers   | 1,913                                | 1,937                             | 1,913                                | 1,937                             |
| Related parties  | 254                                  | 233                               | 254                                  | 233                               |
| Others   | 173                                  | 553                               | 173                                  | 553                               |
| Accrued expenses and other current liabilities:              |                                      |                                   |                                      |                                   |
| Utilities and related expenses                               | 18,776                               | 17,388                            | 18,776                               | 17,388                            |
| Employee benefits  | 4,793                                | 8,071                             | 4,793                                | 8,071                             |
| Interests and other related costs                            | 1,087                                | 1,167                             | 1,087                                | 1,167                             |
| Liability arising from purchase of investment                | 114                                  | 65                                | 114                                  | 65                                |
| Others   | 3,601                                | 2,061                             | 3,601                                | 2,061                             |
| Interest-bearing financial liabilities:                      |                                      |                                   |                                      |                                   |
| Current portion of long-term debt                            | 12,687                               | 10,384                            | 12,687                               | 10,384                            |
| Obligations under finance lease                              | 33                                   | 51                                | 33                                   | 51                                |
| Notes payable  | –                                    | 2,279                             | –                                    | 2,279                             |
| Dividends payable  | 2,139                                | 1,749                             | 2,139                                | 1,749                             |
| Total current financial liabilities                          | 60,866                               | 60,913                            | 60,866                               | 60,913                            |
| <b>Total Financial Liabilities</b>                           | 158,195                              | 165,068                           | 161,658                              | 165,063                           |

Below are the list of financial assets and liabilities carried at fair value that are classified using a fair value hierarchy:

|                                       | September 30, 2010     |                        |              | December 31, 2009      |                        |              |
|---------------------------------------|------------------------|------------------------|--------------|------------------------|------------------------|--------------|
|                                       | (Unaudited)            |                        |              | (Audited)              |                        |              |
|                                       | Level 1 <sup>(1)</sup> | Level 2 <sup>(2)</sup> | Total        | Level 1 <sup>(1)</sup> | Level 2 <sup>(2)</sup> | Total        |
|                                       | (in million pesos)     |                        |              |                        |                        |              |
| <b>Noncurrent Financial Asset</b>     |                        |                        |              |                        |                        |              |
| Available-for-sale financial assets – |                        |                        |              |                        |                        |              |
| Listed equity securities              | 76                     | –                      | 76           | 68                     | –                      | 68           |
| <b>Current Financial Assets</b>       |                        |                        |              |                        |                        |              |
| Short-term investments                | 516                    | –                      | 516          | 486                    | –                      | 486          |
| Derivative financial assets           | –                      | 9                      | 9            | –                      | 6                      | 6            |
| <b>Total</b>                          | <b>592</b>             | <b>9</b>               | <b>601</b>   | <b>554</b>             | <b>6</b>               | <b>560</b>   |
| <b>Noncurrent Financial Liability</b> |                        |                        |              |                        |                        |              |
| Derivative financial liabilities      | –                      | 2,366                  | 2,366        | –                      | 2,751                  | 2,751        |
| <b>Total</b>                          | <b>–</b>               | <b>2,366</b>           | <b>2,366</b> | <b>–</b>               | <b>2,751</b>           | <b>2,751</b> |

<sup>(1)</sup> Fair values determined using observable market inputs that reflect quoted prices in active markets for identical assets or liabilities.

<sup>(2)</sup> Fair values determined using inputs other than quoted prices that are either directly or indirectly observable for the assets or liabilities.

As at September 30, 2010 and December 31, 2009, we do not have financial instruments whose fair values are determined using inputs that are not based on observable market data (Level 3).

For period ended September 30, 2010 and year ended December 31, 2009, there were no transfers between Level 1 and Level 2 fair value measurements.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

*Long-term financial assets and liabilities:* Fair value is based on the following:

| Type  | Fair Value Assumptions   |
|---|--|
| Noncurrent portion of advances and refundable deposits                        | Estimated fair value is based on the discounted values of future cash flows using the applicable zero coupon rates plus credit spread.   |
| Fixed rate loans:<br>U.S. dollar notes<br>Other loans in all other currencies | Quoted market price.<br>Estimated fair value is based on the discounted value of future cash flows using the applicable Commercial Interest Reference Rate and Philippine Dealing System Treasury Fixing rates for similar types of loans. |
| Variable rate loans   | The carrying value approximates fair value because of recent and regular repricing based on market conditions.   |
| Customers' deposits and deferred credits and other noncurrent liabilities     | Estimated fair value is based on the discounted values of future cash flows using the applicable zero coupon rates plus credit spread.   |

*Derivative Financial Instruments:*

*Foreign currency options:* The fair values were computed using an option pricing model using market volatility rates of the U.S. dollar and Philippine peso exchange rate as at valuation date.

*Forward foreign exchange contracts, bifurcated foreign currency forwards and foreign currency swaps:* The fair values were computed as the present value of estimated future cash flows using market U.S. dollar and Philippine peso interest rates as at valuation date.

*Available-for-sale financial assets:* Fair values of available-for-sale financial assets, which consist of proprietary listed shares, were determined using quoted prices. Investments in unlisted securities are carried at cost less any accumulated impairment losses.

*Investment in debt securities:* Fair values were determined using quoted prices. For non-quoted securities, fair values were determined using discounted cash flow based on market observable rates.

Due to the short-term nature of the transactions, the fair value of cash and cash equivalents, short-term investments, current investment in debt securities, trade and other receivables, current portion of advances and refundable deposits, accounts payable, accrued expenses and other current liabilities, current portion of interest-bearing financial liabilities, and dividends payable approximate their carrying values as at the end of the reporting period.

#### *Derivative Financial Instruments*

Our derivative financial instruments are accounted for as either cash flow hedges or transactions not designated as hedges. Cash flow hedges refer to those transactions that hedge our exposure to variability in cash flows attributable to a particular risk associated with a recognized financial asset or liability and exposures arising from forecast transactions. Changes in the fair value of these instruments representing effective hedges are recognized directly in other comprehensive income until the hedged item is recognized in our consolidated income statement. 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. As at September 30, 2010 and December 31, 2009, we have no outstanding financial instruments designated as hedges.

The table below sets out the information about our derivative financial instruments not designated as hedges.

|                                 | Maturity | September 30, 2010<br>(Unaudited) |                                  | December 31, 2009<br>(Audited) |                                  |
|---------------------------------|----------|-----------------------------------|----------------------------------|--------------------------------|----------------------------------|
|                                 |          | Notional                          | Mark-to-market Gains<br>(Losses) | Notional                       | Mark-to-market Gains<br>(Losses) |
| (in millions)                   |          |                                   |                                  |                                |                                  |
| <b>PLDT</b>                     |          |                                   |                                  |                                |                                  |
| Currency swaps                  | 2017     | US\$222                           | (Php1,676)                       | US\$245                        | (Php1,803)                       |
|                                 | 2012     | 100                               | (690)                            | 146                            | (948)                            |
|                                 |          | 322                               | (2,366)                          | 391                            | (2,751)                          |
| <b>ePLDT</b>                    |          |                                   |                                  |                                |                                  |
| Bifurcated embedded derivatives | 2012     | 1                                 | 9                                | 1                              | 4                                |
| <b>Smart</b>                    |          |                                   |                                  |                                |                                  |
| Bifurcated embedded derivatives | 2010     | -                                 | -                                | -                              | 2                                |
| Net liabilities                 |          |                                   | (Php2,357)                       |                                | (Php2,745)                       |

|                        | September 30,<br>2010<br>(Unaudited) | December 31,<br>2009<br>(Audited) |
|------------------------|--------------------------------------|-----------------------------------|
| (in million pesos)     |                                      |                                   |
| Presented as:          |                                      |                                   |
| Current assets         | 9                                    | 6                                 |
| Noncurrent liabilities | (2,366)                              | (2,751)                           |
| Net liabilities        | (2,357)                              | (2,745)                           |

Analyses of losses on derivative financial instruments are as follows:

|   | Nine Months Ended September 30,<br>2010<br>(Unaudited) |         |
|---|--|---------|
|   | 2010   | 2009    |
| (in million pesos)                                      |  |         |
| Net mark-to-market losses at end of period              | (2,357)  | (2,607) |
| Net mark-to-market losses at beginning of period        | (2,745)  | (1,792) |
| Net change  | 388  | (815)   |
| Hedge cost  | (358)  | (472)   |
| Settlements, accretion and conversion                   | (525)  | 753     |
| Net losses on derivative financial instruments (Note 4) | (495)  | (534)   |

## **PLDT**

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.

### *Currency Swaps*

PLDT entered into long-term principal only currency swap agreements with various foreign counterparties to hedge the currency risk on its fixed rate notes maturing in 2012 and 2017. As at September 30, 2010 and December 31, 2009, these long-term currency swaps have an aggregate notional amount of US\$322 million and US\$391 million, respectively, with total mark-to-market losses of Php2,366 million and Php2,751 million, respectively. 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, 2010 and December 31, 2009, the outstanding swap contracts have an agreed average swap exchange rates of Php50.45 and Php50.60, respectively. The semi-annual fixed or floating swap cost payments that PLDT is required to make to its counterparties averaged about 2.93% and 2.83% per annum as at September 30, 2010 and December 31, 2009, respectively.

On various dates in 2009, the long-term principal only currency swap agreements maturing in 2012 and 2017 were partially terminated, with a total aggregate settlement amount of Php112 million and Php485 million, respectively. As a result of these unwinding transactions, the outstanding notional amount as at December 31, 2009 was reduced to US\$146 million and US\$245 million for the swaps maturing in 2012 and 2017, respectively.

On various dates from January to September 2010, the long-term principal only currency swap agreements maturing in 2012 and 2017 were partially terminated, with a total aggregate settlement amount of Php372 million and Php168 million, respectively. As a result of these unwinding transactions, the outstanding notional amount as at September 30, 2010 was reduced to US\$100 million and US\$222 million for the swaps maturing in 2012 and 2017, respectively.

In October 2010, PLDT entered into several overlay principal only swap agreements with an aggregate amount of US\$50 million to effectively unwind a portion of the outstanding long-term principal only swap agreement maturing in 2012. The overlay swaps are offsetting swaps which carry the direct opposite terms and cashflows of our existing swap agreement. In addition, PLDT will settle the unwind cost on a semi-annual basis over the life of the offsetting swaps. As a result of these unwinding transactions, the outstanding notional amount of our 2012 hedge was effectively reduced to US\$50 million.

## **ePLDT**

Level Up! embedded derivatives were bifurcated from various license contracts and other service agreements denominated in U.S. dollar. The aggregate notional amount of these bifurcated embedded currency forwards amounted to US\$1 million each as at September 30, 2010 and December 31, 2009. The total mark-to-market gains of these bifurcated embedded currency forwards as at September 30, 2010 and December 31, 2009 amounted to Php9 million and Php4 million, respectively.

## **Smart**

Smart's embedded derivatives were bifurcated from service and purchase contracts. As at September 30, 2010 and December 31, 2009, outstanding contracts amounted to US\$140 thousand and US\$209 thousand, respectively, including service contracts 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. The total mark-to-market gains of these bifurcated embedded currency forwards as at September 30, 2010 and December 31, 2009 amounted to Php230 thousand and Php2 million, respectively.

## **Financial Risk Management Objectives and Policies**

The main risks arising from our financial instruments are liquidity risk, foreign currency exchange risk, interest rate risk and credit risk. The importance of managing those risks has significantly increased in light of the considerable change and volatility in both the Philippine and international financial markets. Our Board of Directors reviews and approves policies for managing each of these risks. Our policies for managing these risks are summarized below. We also monitor the market price risk arising from all financial instruments.

### ***Liquidity Risk***

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

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

Any excess funds are primarily invested in short-dated and principal-protected bank products that provide flexibility of withdrawing the funds anytime. We also allocate a portion of our cash in longer tenor investments such as fixed income securities issued or guaranteed by the Republic of the Philippines, and Philippine banks and corporates, managed funds and other structured products linked to the Republic of the Philippines. We regularly evaluate available financial products and monitor market conditions for opportunities to enhance yields at acceptable risk levels. Our investments are also subject to certain restrictions contained in our debt covenants. Our funding arrangements are designed to keep an appropriate balance between equity and debt and to provide financing flexibility while enhancing our businesses.

We have letters of credit amounting to Php229 million as at September 30, 2010 and certain financial instruments that are allocated to meet our short-term liquidity needs. These financial instruments are cash and cash equivalents, and short-term investments amounting to Php26,902 million and Php3,366 million, respectively, as at September 30, 2010. See *Note 15 – Cash and Cash Equivalents*. Details on our letters of credit and summary of the maturity profile of our financial liabilities as at September 30, 2010 and December 31, 2009 based on contractual undiscounted payments is set out in *Note 26 – Contractual Obligations and Commercial Commitments*.

### ***Foreign Currency Exchange Risk***

The revaluation of our foreign currency-denominated financial assets and liabilities as a result of the appreciation or depreciation of the Philippine peso is recognized as foreign exchange gains or losses as at the end of the reporting period. The extent of foreign exchange gains or losses is largely dependent on the amount of foreign currency debt. 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 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 and to stabilize our cash flows in order to improve investment and cash flow planning, we enter into forward foreign exchange contracts, currency swap contracts, currency option contracts and other hedging products aimed at reducing and/or managing the adverse impact of changes in foreign exchange rates on our operating results and cash flows. We use forward foreign exchange purchase contracts, currency swap contracts and foreign currency option contracts to manage the foreign currency risks associated with our foreign currency-denominated loans. We also enter into forward foreign exchange sale contracts to manage foreign currency risks associated with our U.S. dollar-linked and U.S. dollar-denominated revenues. In order to manage the 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 contracts. We accounted for these instruments as either cash flow hedges, wherein changes in the fair value are recognized as cumulative translation adjustments in other comprehensive income until the hedged transaction affects our consolidated income statement 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.

The following table shows our consolidated foreign currency-denominated monetary financial assets and liabilities and their Philippine peso equivalents.

|   | September 30, 2010 |                    | December 31, 2009 |                    |
|---|--------------------|--------------------|-------------------|--------------------|
|   | (Unaudited)        |                    | (Audited)         |                    |
|   | U.S. Dollar        | Php <sup>(1)</sup> | U.S. Dollar       | Php <sup>(2)</sup> |
|   | (in millions)      |                    |                   |                    |
| <b>Noncurrent Financial Assets</b>                              |                    |                    |                   |                    |
| Note receivable   | 2                  | 82                 | 2                 | 81                 |
| Advances and refundable deposits                                | –                  | 35                 | –                 | 7                  |
| Total noncurrent financial assets                               | 2                  | 117                | 2                 | 88                 |
| <b>Current Financial Assets</b>                                 |                    |                    |                   |                    |
| Cash and cash equivalents                                       | 132                | 5,819              | 140               | 6,496              |
| Short-term investments  | 17                 | 723                | 47                | 2,164              |
| Trade and other receivables – net                               | 203                | 8,914              | 206               | 9,573              |
| Derivative financial assets                                     | –                  | 9                  | –                 | 6                  |
| Total current financial assets                                  | 352                | 15,465             | 393               | 18,239             |
| <b>Total Financial Assets</b>                                   | <b>354</b>         | <b>15,582</b>      | <b>395</b>        | <b>18,327</b>      |
| <b>Noncurrent Financial Liabilities</b>                         |                    |                    |                   |                    |
| Interest-bearing financial liabilities – net of current portion | 792                | 34,779             | 837               | 38,871             |
| Derivative financial liabilities                                | 54                 | 2,366              | 59                | 2,751              |
| Total noncurrent financial liabilities                          | 846                | 37,145             | 896               | 41,622             |
| <b>Current Financial Liabilities</b>                            |                    |                    |                   |                    |
| Accounts payable  | 133                | 5,829              | 155               | 7,180              |
| Accrued expenses and other current liabilities                  | 134                | 5,893              | 95                | 4,409              |
| Current portion of interest-bearing financial liabilities       | 113                | 4,963              | 155               | 7,220              |
| Total current financial liabilities                             | 380                | 16,685             | 405               | 18,809             |
| <b>Total Financial Liabilities</b>                              | <b>1,226</b>       | <b>53,830</b>      | <b>1,301</b>      | <b>60,431</b>      |

<sup>(1)</sup> The exchange rate used to translate the U.S. dollar amounts into Philippine peso was Php43.92 to US\$1.00, the peso-dollar exchange rate as quoted through the Philippine Dealing System as at September 30, 2010.

<sup>(2)</sup> The exchange rate used to translate the U.S. dollar amounts into Philippine peso was Php46.43 to US\$1.00, the peso-dollar exchange rate as quoted through the Philippine Dealing System as at December 31, 2009.

As at November 3, 2010, the peso-dollar exchange rate was Php42.58 to US\$1.00. Using this exchange rate, our consolidated net foreign currency-denominated financial liabilities as at September 30, 2010 would have decreased in peso terms by Php1,168 million.

As at September 30, 2010 and December 31, 2009, approximately 42% and 46%, respectively, of our total consolidated debts (net of consolidated debt discount) was denominated in U.S. dollars. Consolidated foreign currency-denominated debt decreased to Php39,325 million as at September 30, 2010 from Php45,633 million as at December 31, 2009. See Note 20 – Interest-bearing Financial Liabilities. PLDT's outstanding long-term principal only currency swap contracts amounted to US\$322 million and US\$391 million as at September 30, 2010 and December 31, 2009, respectively. Consequently, the unhedged portion of our consolidated debt amounts was approximately 27% (or 20%, net of our consolidated U.S. dollar cash balances) and 28% (or 19%, net of our consolidated U.S. dollar cash balances) as at September 30, 2010 and December 31, 2009, respectively.

For the nine months ended September 30, 2010 and 2009, approximately 32% and 34%, respectively, of our consolidated service revenues were denominated in U.S. dollars and/or were linked to U.S. dollars. In this respect, the appreciation of the weighted average exchange rate of the Philippine peso against the U.S. dollar decreased our revenues, and consequently, our cash flow from operations in Philippine peso terms.

The Philippine peso had appreciated by 5.39% against the U.S. dollar to Php43.92 to US\$1.00 as at September 30, 2010 from Php46.43 to US\$1.00 as at December 31, 2009. As at September 30, 2009, the Philippine peso had appreciated by 0.47% against the U.S. dollar to Php47.42 to US\$1.00 from Php47.65 to US\$1.00 as at December 31, 2008. As a result of our consolidated foreign exchange movements as well as the amount of our consolidated outstanding net foreign currency financial assets and liabilities, we recognized net consolidated foreign exchange gains of Php1,667 million and Php232 million for the nine months ended September 30, 2010 and 2009, respectively. See *Note 4 – Operating Segment Information*.

Management conducted a survey among our banks to determine the outlook of the peso-dollar exchange rate until our next reporting date of December 31, 2010. Our outlook is that the peso-dollar exchange rate may weaken/strengthen by 2.21% as compared to the exchange rate of Php43.92 to US\$1.00 as at September 30, 2010. If the peso-dollar exchange rate had weakened/strengthened by 2.21% as at September 30, 2010, with all other variables held constant, profit after tax for the nine months ended September 30, 2010 would have been approximately Php401 million higher/lower and our consolidated stockholders' equity as at September 30, 2010 would have been approximately Php394 million higher/lower, mainly as a result of consolidated foreign exchange gains and losses on translation of U.S. dollar-denominated net assets/liabilities and mark-to-market valuation of derivative financial instruments.

### **Interest Rate Risk**

Our exposure to the risk of changes in market interest rates relates primarily to our long-term debt obligations and short-term borrowings with floating interest rates.

Our policy is to manage interest cost through a mix of fixed and variable rate debts. We evaluate the fixed to floating ratio of our loans in line with movements of relevant interest rates in the financial markets. Based on our assessment, new financing will be priced either on a fixed or floating rate basis. On a limited basis, we enter into interest rate swap agreements in order to manage our exposure to interest rate fluctuations. We make use of hedging instruments and structures solely for reducing or managing financial risk associated with our liabilities and not for trading purposes.

The following tables set out the carrying amounts, by maturity, of our financial instruments that are expected to have exposure on interest rate risk. Financial instruments that are not subject to interest rate risk were not included in the table.

### **As at September 30, 2010 (Unaudited)**

|                                   | In U.S. Dollar        |           |           |           |              |       | In Php | Discount/<br>Debt<br>Issuance<br>Cost<br>In Php | Carrying<br>Value<br>In Php | Fair Value        |        |
|-----------------------------------|-----------------------|-----------|-----------|-----------|--------------|-------|--------|---|-----------------------------|-------------------|--------|
|                                   | Below 1 year          | 1-2 years | 2-3 years | 3-5 years | Over 5 years | Total |        |   |                             | In U.S.<br>Dollar | In Php |
| (in millions)                     |                       |           |           |           |              |       |        |   |                             |                   |        |
| <b>Assets:</b>                    |                       |           |           |           |              |       |        |   |                             |                   |        |
| <i>Cash in Bank</i>               |                       |           |           |           |              |       |        |   |                             |                   |        |
| U.S. Dollar                       | 10                    | –         | –         | –         | –            | 10    | 453    | –   | 453                         | 10                | 453    |
| Interest rate                     | 0.0010% to<br>0.7840% | –         | –         | –         | –            | –     | –      | –   | –                           | –                 | –      |
| Philippine Peso                   | 24                    | –         | –         | –         | –            | 24    | 1,064  | –   | 1,064                       | 24                | 1,064  |
| Interest rate                     | 0.0625% to<br>3.0000% | –         | –         | –         | –            | –     | –      | –   | –                           | –                 | –      |
| Other Currencies                  | 6                     | –         | –         | –         | –            | 6     | 260    | –   | 260                         | 6                 | 260    |
| Interest rate                     | 0.0100% to<br>2.300%  | –         | –         | –         | –            | –     | –      | –   | –                           | –                 | –      |
| <i>Temporary Cash Investments</i> |                       |           |           |           |              |       |        |   |                             |                   |        |
| U.S. Dollar                       | 107                   | –         | –         | –         | –            | 107   | 4,709  | –   | 4,709                       | 107               | 4,709  |
| Interest rate                     | 0.1000% to<br>1.7900% | –         | –         | –         | –            | –     | –      | –   | –                           | –                 | –      |
| Philippine Peso                   | 450                   | –         | –         | –         | –            | 450   | 19,758 | –   | 19,758                      | 450               | 19,758 |
| Interest rate                     | 1.2500% to<br>4.8100% | –         | –         | –         | –            | –     | –      | –   | –                           | –                 | –      |

|                                      | In U.S. Dollar                        |   |                                   |                                   |                       |              | In Php        | Discount/<br>Debt<br>Issuance<br>Cost<br>In Php | Carrying<br>Value<br>In Php | Fair Value        |               |
|--------------------------------------|---------------------------------------|---|-----------------------------------|-----------------------------------|-----------------------|--------------|---------------|---|-----------------------------|-------------------|---------------|
|                                      | Below 1 year                          | 1-2 years   | 2-3 years                         | 3-5 years                         | Over 5 years          | Total        |               |   |                             | In U.S.<br>Dollar | In Php        |
| (in millions)                        |                                       |   |                                   |                                   |                       |              |               |   |                             |                   |               |
| <i>Short-term Investments</i>        |                                       |   |                                   |                                   |                       |              |               |   |                             |                   |               |
| U.S. Dollar                          | 17                                    | -   | -                                 | -                                 | -                     | 17           | 723           | -   | 723                         | 17                | 723           |
| Interest rate                        | 4.25% to<br>9.2600%                   | -   | -                                 | -                                 | -                     | -            | -             | -   | -                           | -                 | -             |
| Philippine Peso                      | 60                                    | -   | -                                 | -                                 | -                     | 60           | 2,643         | -   | 2,643                       | 60                | 2,643         |
| Interest rate                        | 4.1600%                               | -   | -                                 | -                                 | -                     | -            | -             | -   | -                           | -                 | -             |
| <i>Investment in Debt Securities</i> |                                       |   |                                   |                                   |                       |              |               |   |                             |                   |               |
| Philippine Peso                      | 9                                     | -   | 8                                 | 3                                 | -                     | 20           | 883           | -   | 883                         | 20                | 898           |
| Interest rate                        | 4.1800%                               | -   | 6.8700%                           | 7.0000%                           | -                     | -            | -             | -   | -                           | -                 | -             |
|                                      | <b>683</b>                            | <b>-</b>  | <b>8</b>                          | <b>3</b>                          | <b>-</b>              | <b>694</b>   | <b>30,493</b> | <b>-</b>  | <b>30,493</b>               | <b>694</b>        | <b>30,508</b> |
| <b>Liabilities:</b>                  |                                       |   |                                   |                                   |                       |              |               |   |                             |                   |               |
| <i>Long-term Debt</i>                |                                       |   |                                   |                                   |                       |              |               |   |                             |                   |               |
| <i>Fixed Rate</i>                    |                                       |   |                                   |                                   |                       |              |               |   |                             |                   |               |
| U.S. Dollar Notes                    | -                                     | 146   | -                                 | -                                 | 234                   | 380          | 16,692        | 218   | 16,474                      | 443               | 19,445        |
| Interest rate                        | -                                     | 11.3750%  | -                                 | -                                 | 8.3500%               | -            | -             | -   | -                           | -                 | -             |
| U.S. Dollar Fixed Loans              | 9                                     | 29  | 15                                | 303                               | -                     | 356          | 15,627        | 2,759   | 12,868                      | 284               | 12,485        |
| Interest rate                        | 4.7000%                               | 2.9900% to<br>3.7900%                                     | 2.9900% to<br>3.7900%             | 2.2500% to<br>3.7900%             | -                     | -            | -             | -   | -                           | -                 | -             |
| Philippine Peso                      | 45                                    | 146   | 13                                | 461                               | 217                   | 882          | 38,734        | 82  | 38,652                      | 943               | 41,427        |
| Interest rate                        | 6.0323% to<br>6.5396%                 | 5.6250% to<br>8.4346%                                     | 6.5000% to<br>8.4346%             | 6.1250% to<br>9.1038%             | 6.5000% to<br>9.1038% | -            | -             | -   | -                           | -                 | -             |
| <i>Variable Rate</i>                 |                                       |   |                                   |                                   |                       |              |               |   |                             |                   |               |
| U.S. Dollar                          | 16                                    | 148   | 50                                | 15                                | -                     | 229          | 10,065        | 82  | 9,983                       | 227               | 9,984         |
| Interest rate                        | US\$ LIBOR +<br>0.6500% to<br>2.5000% | Swap rate +<br>2.7900%                                    | Swap rate +<br>2.7900%            | Swap rate +<br>2.7900%            | -                     | -            | -             | -   | -                           | -                 | -             |
| Philippine Peso                      | 23                                    | 188   | 85                                | 57                                | -                     | 353          | 15,501        | 18  | 15,483                      | 353               | 15,483        |
| Interest rate                        | PDST-F +<br>1.2500%                   | PDST-F +<br>0.7500% to<br>1.5000%;<br>AUB's prime<br>rate | PDST-F +<br>1.0000% to<br>1.5000% | PDST-F +<br>1.0000% to<br>1.5000% | -                     | -            | -             | -   | -                           | -                 | -             |
|                                      | <b>93</b>                             | <b>657</b>  | <b>163</b>                        | <b>836</b>                        | <b>451</b>            | <b>2,200</b> | <b>96,619</b> | <b>3,159</b>                                    | <b>93,460</b>               | <b>2,250</b>      | <b>98,824</b> |

### As at December 31, 2009 (Audited)

|                                      | In U.S. Dollar      |           |           |           |              |            | In Php        | Discount/<br>Debt<br>Issuance<br>Cost<br>In Php | Carrying<br>Value<br>In Php | Fair Value        |               |
|--------------------------------------|---------------------|-----------|-----------|-----------|--------------|------------|---------------|---|-----------------------------|-------------------|---------------|
|                                      | Below 1 year        | 1-2 years | 2-3 years | 3-5 years | Over 5 years | Total      |               |   |                             | In U.S.<br>Dollar | In Php        |
| (in millions)                        |                     |           |           |           |              |            |               |   |                             |                   |               |
| <b>Assets:</b>                       |                     |           |           |           |              |            |               |   |                             |                   |               |
| <i>Cash in Bank</i>                  |                     |           |           |           |              |            |               |   |                             |                   |               |
| U.S. Dollar                          | 11                  | -         | -         | -         | -            | 11         | 540           | -   | 540                         | 11                | 540           |
| Interest rate                        | 0.0025% to<br>0.88% | -         | -         | -         | -            | -          | -             | -   | -                           | -                 | -             |
| Philippine Peso                      | 36                  | -         | -         | -         | -            | 36         | 1,673         | -   | 1,673                       | 36                | 1,673         |
| Interest rate                        | 0.625% to<br>2.90%  | -         | -         | -         | -            | -          | -             | -   | -                           | -                 | -             |
| Other Currencies                     | 1                   | -         | -         | -         | -            | 1          | 31            | -   | 31                          | 1                 | 31            |
| Interest rate                        | 0.0014 to<br>2.40%  | -         | -         | -         | -            | -          | -             | -   | -                           | -                 | -             |
| <i>Temporary Cash Investments</i>    |                     |           |           |           |              |            |               |   |                             |                   |               |
| U.S. Dollar                          | 384                 | -         | -         | -         | -            | 384        | 17,870        | -   | 17,870                      | 384               | 17,870        |
| Interest rate                        | 0.50% to<br>1.75%   | -         | -         | -         | -            | -          | -             | -   | -                           | -                 | -             |
| Philippine Peso                      | 369                 | -         | -         | -         | -            | 369        | 17,149        | -   | 17,149                      | 369               | 17,149        |
| Interest rate                        | 1.25% to<br>5.50%   | -         | -         | -         | -            | -          | -             | -   | -                           | -                 | -             |
| <i>Short-term Investments</i>        |                     |           |           |           |              |            |               |   |                             |                   |               |
| U.S. Dollar                          | 46                  | -         | -         | -         | -            | 46         | 2,132         | -   | 2,132                       | 46                | 2,132         |
| Interest rate                        | 4.25% to<br>7.006%  | -         | -         | -         | -            | -          | -             | -   | -                           | -                 | -             |
| Philippine Peso                      | 36                  | -         | -         | -         | -            | 36         | 1,692         | -   | 1,692                       | 36                | 1,692         |
| Interest rate                        | 4.40%               | -         | -         | -         | -            | -          | -             | -   | -                           | -                 | -             |
| <i>Investment in Debt Securities</i> |                     |           |           |           |              |            |               |   |                             |                   |               |
| Philippine Peso                      | -                   | -         | -         | 10        | -            | 10         | 462           | -   | 462                         | 10                | 474           |
| Interest rate                        | -                   | -         | -         | 6.92%     | -            | -          | -             | -   | -                           | -                 | -             |
|                                      | <b>883</b>          | <b>-</b>  | <b>-</b>  | <b>10</b> | <b>-</b>     | <b>893</b> | <b>41,549</b> | <b>-</b>  | <b>41,549</b>               | <b>893</b>        | <b>41,561</b> |



|                         | In U.S. Dollar                |  |  |  |                     |              | In Php         | Discount/<br>Debt<br>Issuance<br>Cost<br>In Php | Carrying<br>Value<br>In Php | Fair Value        |                |
|-------------------------|-------------------------------|--|--|--|---------------------|--------------|----------------|---|-----------------------------|-------------------|----------------|
|                         | Below 1 year                  | 1-2 years  | 2-3 years  | 3-5 years  | Over 5 years        | Total        |                |   |                             | In U.S.<br>Dollar | In Php         |
|                         |                               |  |  |  |                     |              |                |   |                             |                   |                |
| (in millions)           |                               |  |  |  |                     |              |                |   |                             |                   |                |
| <b>Liabilities:</b>     |                               |  |  |  |                     |              |                |   |                             |                   |                |
| <i>Long-term Debt</i>   |                               |  |  |  |                     |              |                |   |                             |                   |                |
| <i>Fixed Rate</i>       |                               |  |  |  |                     |              |                |   |                             |                   |                |
| U.S. Dollar Notes       | -                             | -  | 146  | -  | 245                 | 391          | 18,161         | 285   | 17,876                      | 449               | 20,837         |
| Interest rate           | -                             | -  | 11.375%  | -  | 8.350%              | -            | -              | -   | -                           | -                 | -              |
| U.S. Dollar Fixed Loans | 14                            | 27   | 5  | 285  | -                   | 331          | 15,397         | 3,338   | 12,059                      | 229               | 10,654         |
| Interest rate           | 4.515%                        | 3.79% to<br>4.70%  | 3.79%  | 2.25% to<br>3.79%  | -                   | -            | -              | -   | -                           | -                 | -              |
| Philippine Peso         | -                             | 63   | 126  | 236  | 305                 | 730          | 33,858         | 84  | 33,774                      | 744               | 34,535         |
| Interest rate           | -                             | 6.0323% to<br>8.4346%                                      | 5.625% to<br>8.4346%                                       | 6.125% to<br>9.1038%                                       | 6.50% to<br>9.1038% | -            | -              | -   | -                           | -                 | -              |
| <i>Variable Rate</i>    |                               |  |  |  |                     |              |                |   |                             |                   |                |
| U.S. Dollar             | 41                            | 160  | 74   | 60   | -                   | 335          | 15,543         | 124   | 15,419                      | 332               | 15,419         |
| Interest rate           | US\$ LIBOR +<br>0.05% to 2.5% | US\$ LIBOR +<br>0.42% to<br>1.85%;<br>swap rate +<br>2.79% | US\$ LIBOR +<br>0.42% to<br>1.85%;<br>swap rate +<br>2.79% | US\$ LIBOR +<br>0.42% to<br>1.85%;<br>swap rate +<br>2.79% | -                   | -            | -              | -   | -                           | -                 | -              |
| Philippine Peso         | -                             | 185  | 81   | 107  | -                   | 373          | 17,349         | 27  | 17,322                      | 373               | 17,322         |
| Interest rate           | -                             | PDST-F +<br>0.75% to<br>1.5%; AUB's<br>prime rate          | PDST-F +<br>1.0% to<br>1.50%;<br>AUB's<br>prime rate       | PDST-F +<br>1.0% to 1.50%                                  | -                   | -            | -              | -   | -                           | -                 | -              |
| <i>Short-term Debt</i>  |                               |  |  |  |                     |              |                |   |                             |                   |                |
| <i>Notes Payable</i>    |                               |  |  |  |                     |              |                |   |                             |                   |                |
| U.S. Dollar             | 6                             | -  | -  | -  | -                   | 6            | 279            | -   | 279                         | 6                 | 279            |
| Interest rate           | 3.25%                         | -  | -  | -  | -                   | -            | -              | -   | -                           | -                 | -              |
| Philippine Peso         | 43                            | -  | -  | -  | -                   | 43           | 2,000          | -   | 2,000                       | 43                | 2,000          |
| Interest rate           | PDST-F +<br>1.5%;<br>6.0896%  | -  | -  | -  | -                   | -            | -              | -   | -                           | -                 | -              |
|                         | <b>104</b>                    | <b>435</b>   | <b>432</b>   | <b>688</b>   | <b>550</b>          | <b>2,209</b> | <b>102,587</b> | <b>3,858</b>                                    | <b>98,729</b>               | <b>2,176</b>      | <b>101,046</b> |

Fixed rate financial instruments are subject to fair value interest rate risk while floating rate financial instruments are subject to cash flow interest rate risk.

Repricing of floating rate financial instruments is mostly done on intervals of three months or six months. Interest on fixed rate financial instruments is fixed until maturity of the particular instrument.

Management conducted a survey among our banks to determine the outlook of the U.S. dollar and Philippine peso interest rates until our next reporting date of December 31, 2010. Our outlook is that the U.S. dollar and Philippine peso interest rates may move 40 basis points and 25 basis points higher/lower, respectively, as compared to levels as at September 30, 2010. If U.S. dollar interest rates had been 40 basis points higher/lower as compared to market levels as at September 30, 2010, with all other variables held constant, profit after tax for the nine months ended September 30, 2010 and our consolidated stockholders' equity as at September 30, 2010 would have been approximately Php173 million lower/higher, mainly as a result of higher/lower interest expense on floating rate borrowings and loss/gain on derivative transactions. If Philippine peso interest rates had been 25 basis points higher/lower as compared to market levels as at September 30, 2010, with all other variables held constant, profit after tax for the nine months ended September 30, 2010 and our consolidated stockholders' equity as at September 30, 2010 would have been approximately Php103 million lower/higher, mainly as a result of higher/lower interest expense on floating rate borrowings and loss/gain on derivative transactions.

### **Credit Risk**

Credit risk is the risk that we will incur a loss arising from our customers, clients or counterparties that fail to discharge their contracted obligations. We manage and control credit risk by setting limits on the amount of risk we are willing to accept for individual counterparties and by monitoring exposures in relation to such limits.

We trade only with recognized and creditworthy third parties. It is our policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an on-going basis to reduce our exposure to bad debts.

We established a credit quality review process to provide regular identification of changes in the creditworthiness of counterparties. Counterparty limits are established and reviewed periodically based on latest available financial data on our counterparties' credit ratings, capitalization, asset quality and liquidity. Our credit quality review process allows us to assess the potential loss as a result of the risks to which we are exposed and allow us to take corrective actions.

The table below shows the maximum exposure to credit risk for the components of our consolidated statement of financial position, including derivative financial instruments.

|                                     | Gross Maximum Exposure <sup>(1)</sup> |                   | Net Maximum Exposure <sup>(2)</sup> |                   |
|-------------------------------------|---------------------------------------|-------------------|-------------------------------------|-------------------|
|                                     | September 30, 2010                    | December 31, 2009 | September 30, 2010                  | December 31, 2009 |
|                                     | (Unaudited)                           | (Audited)         | (Unaudited)                         | (Audited)         |
|                                     | (in million pesos)                    |                   |                                     |                   |
| Loans and receivables:              |                                       |                   |                                     |                   |
| Advances and refundable deposits    | 989                                   | 849               | 989                                 | 848               |
| Cash and cash equivalents           | 26,902                                | 38,319            | 26,704                              | 38,101            |
| Short-term investments              | 2,850                                 | 3,338             | 2,850                               | 3,338             |
| Foreign administrations             | 3,934                                 | 4,064             | 3,898                               | 4,011             |
| Retail subscribers                  | 3,020                                 | 3,546             | 2,953                               | 3,505             |
| Domestic carriers                   | 1,995                                 | 1,184             | 1,995                               | 1,184             |
| Corporate subscribers               | 1,952                                 | 2,429             | 1,849                               | 2,328             |
| Dealers, agents and others          | 4,270                                 | 3,506             | 4,269                               | 3,506             |
| Held-to-maturity investments:       |                                       |                   |                                     |                   |
| Investment in debt securities       | 883                                   | 462               | 883                                 | 462               |
| Available-for-sale financial assets | 140                                   | 134               | 140                                 | 134               |
| Held-for-trading:                   |                                       |                   |                                     |                   |
| Short-term investments              | 516                                   | 486               | 516                                 | 486               |
| Bifurcated embedded derivatives     | 9                                     | 6                 | 9                                   | 6                 |
| <b>Total</b>                        | <b>47,460</b>                         | <b>58,323</b>     | <b>47,055</b>                       | <b>57,909</b>     |

<sup>(1)</sup> Gross financial assets before taking into account any collateral held or other credit enhancements or offsetting arrangements.

<sup>(2)</sup> Gross financial assets after taking into account any collateral or other credit enhancements or offsetting arrangements or deposit insurance.

The table below provides information regarding the credit quality by class of our financial assets according to our credit ratings of counterparties.

|                                       | Total              | Neither past due nor impaired |                        | Past due but not impaired | Impaired      |
|---------------------------------------|--------------------|-------------------------------|------------------------|---------------------------|---------------|
|                                       |                    | Class A <sup>(1)</sup>        | Class B <sup>(2)</sup> |                           |               |
|                                       | (in million pesos) |                               |                        |                           |               |
| <b>September 30, 2010 (Unaudited)</b> |                    |                               |                        |                           |               |
| Loans and receivables:                |                    |                               |                        |                           |               |
| Advances and refundable deposits      | 989                | 940                           | 49                     | –                         | –             |
| Cash and cash equivalents             | 26,902             | 25,780                        | 1,122                  | –                         | –             |
| Short-term investments                | 2,850              | 2,850                         | –                      | –                         | –             |
| Retail subscribers                    | 8,692              | 832                           | 779                    | 1,409                     | 5,672         |
| Corporate subscribers                 | 8,587              | 363                           | 718                    | 871                       | 6,635         |
| Foreign administrations               | 4,105              | 1,626                         | 708                    | 1,600                     | 171           |
| Domestic carriers                     | 2,095              | 165                           | 11                     | 1,819                     | 100           |
| Dealers, agents and others            | 4,868              | 2,320                         | 1,776                  | 174                       | 598           |
| Held-to-maturity investments:         |                    |                               |                        |                           |               |
| Investment in debt securities         | 883                | 883                           | –                      | –                         | –             |
| Available-for-sale financial assets   | 140                | 105                           | 35                     | –                         | –             |
| Held-for-trading <sup>(3)</sup> :     |                    |                               |                        |                           |               |
| Short-term investments                | 516                | 516                           | –                      | –                         | –             |
| Bifurcated embedded derivatives       | 9                  | 9                             | –                      | –                         | –             |
| <b>Total</b>                          | <b>60,636</b>      | <b>36,389</b>                 | <b>5,198</b>           | <b>5,873</b>              | <b>13,176</b> |
| <b>December 31, 2009 (Audited)</b>    |                    |                               |                        |                           |               |
| Loans and receivables:                |                    |                               |                        |                           |               |
| Advances and refundable deposits      | 849                | 790                           | 59                     | –                         | –             |
| Cash and cash equivalents             | 38,319             | 37,767                        | 552                    | –                         | –             |
| Short-term investments                | 3,338              | 2,971                         | 367                    | –                         | –             |
| Corporate subscribers                 | 9,106              | 1,078                         | 283                    | 1,068                     | 6,677         |
| Retail subscribers                    | 8,026              | 1,236                         | 518                    | 1,792                     | 4,480         |
| Foreign administrations               | 4,353              | 1,261                         | 451                    | 2,352                     | 289           |
| Domestic carriers                     | 1,267              | 157                           | 8                      | 1,019                     | 83            |
| Dealers, agents and others            | 3,927              | 2,068                         | 1,022                  | 416                       | 421           |

|                                     | Total         | Neither past due nor impaired |                        | Past due but not impaired | Impaired      |
|-------------------------------------|---------------|-------------------------------|------------------------|---------------------------|---------------|
|                                     |               | Class A <sup>(1)</sup>        | Class B <sup>(2)</sup> |                           |               |
| (in million pesos)                  |               |                               |                        |                           |               |
| Held-to-maturity investments:       |               |                               |                        |                           |               |
| Investment in debt securities       | 462           | 462                           | –                      | –                         | –             |
| Available-for-sale financial assets | 134           | 103                           | 31                     | –                         | –             |
| Held-for-trading <sup>(3)</sup> :   |               |                               |                        |                           |               |
| Short-term investments              | 486           | 486                           | –                      | –                         | –             |
| Bifurcated embedded derivatives     | 6             | 6                             | –                      | –                         | –             |
| <b>Total</b>                        | <b>70,273</b> | <b>48,385</b>                 | <b>3,291</b>           | <b>6,647</b>              | <b>11,950</b> |

<sup>(1)</sup> This includes low risk and good paying customer accounts with no history of account treatment for a defined period and no overdue accounts as at report date; and deposits or placements to counterparties with good credit rating or bank standing financial review.

<sup>(2)</sup> This includes medium risk and average paying customer accounts with no overdue accounts as at report date, and new customer accounts for which sufficient credit history has not been established; and deposits or placements to counterparties not classified as Class A.

<sup>(3)</sup> Gross receivables from counterparties, before any offsetting arrangements.

The aging analysis of past due but not impaired class of financial assets is as follows:

|                                       | Total         | Neither past due nor impaired | Past due but not impaired |              |              | Impaired      |
|---------------------------------------|---------------|-------------------------------|---------------------------|--------------|--------------|---------------|
|                                       |               |                               | 1-60 days                 | 61-90 days   | Over 91 days |               |
| (in million pesos)                    |               |                               |                           |              |              |               |
| <b>September 30, 2010 (Unaudited)</b> |               |                               |                           |              |              |               |
| Loans and receivables:                |               |                               |                           |              |              |               |
| Advances and refundable deposits      | 989           | 989                           | –                         | –            | –            | –             |
| Cash and cash equivalents             | 26,902        | 26,902                        | –                         | –            | –            | –             |
| Short-term investments                | 2,850         | 2,850                         | –                         | –            | –            | –             |
| Retail subscribers                    | 8,692         | 1,611                         | 1,042                     | 133          | 234          | 5,672         |
| Corporate subscribers                 | 8,587         | 1,081                         | 570                       | 152          | 149          | 6,635         |
| Foreign administrations               | 4,105         | 2,334                         | 892                       | 214          | 494          | 171           |
| Domestic carriers                     | 2,095         | 176                           | 168                       | 157          | 1,494        | 100           |
| Dealers, agents and others            | 4,868         | 4,096                         | 45                        | 18           | 111          | 598           |
| Held-to-maturity investments:         |               |                               |                           |              |              |               |
| Investment in debt securities         | 883           | 883                           | –                         | –            | –            | –             |
| Available-for-sale financial assets   | 140           | 140                           | –                         | –            | –            | –             |
| Held-for-trading:                     |               |                               |                           |              |              |               |
| Short-term investments                | 516           | 516                           | –                         | –            | –            | –             |
| Bifurcated embedded derivatives       | 9             | 9                             | –                         | –            | –            | –             |
| <b>Total</b>                          | <b>60,636</b> | <b>41,587</b>                 | <b>2,717</b>              | <b>674</b>   | <b>2,482</b> | <b>13,176</b> |
| <b>December 31, 2009 (Audited)</b>    |               |                               |                           |              |              |               |
| Loans and receivables:                |               |                               |                           |              |              |               |
| Advances and refundable deposits      | 849           | 849                           | –                         | –            | –            | –             |
| Cash and cash equivalents             | 38,319        | 38,319                        | –                         | –            | –            | –             |
| Short-term investments                | 3,338         | 3,338                         | –                         | –            | –            | –             |
| Corporate subscribers                 | 9,106         | 1,361                         | 433                       | 198          | 437          | 6,677         |
| Retail subscribers                    | 8,026         | 1,754                         | 1,362                     | 184          | 246          | 4,480         |
| Foreign administrations               | 4,353         | 1,712                         | 1,320                     | 405          | 627          | 289           |
| Domestic carriers                     | 1,267         | 165                           | 283                       | 293          | 443          | 83            |
| Dealers, agents and others            | 3,927         | 3,090                         | 332                       | 21           | 63           | 421           |
| Held-to-maturity investments:         |               |                               |                           |              |              |               |
| Investment in debt securities         | 462           | 462                           | –                         | –            | –            | –             |
| Available-for-sale financial assets   | 134           | 134                           | –                         | –            | –            | –             |
| Held-for-trading:                     |               |                               |                           |              |              |               |
| Short-term investments                | 486           | 486                           | –                         | –            | –            | –             |
| Bifurcated embedded derivatives       | 6             | 6                             | –                         | –            | –            | –             |
| <b>Total</b>                          | <b>70,273</b> | <b>51,676</b>                 | <b>3,730</b>              | <b>1,101</b> | <b>1,816</b> | <b>11,950</b> |

### **Impairment Assessments**

The main consideration for the impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or whether there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. Our impairment assessments are classified into two areas: individually assessed allowance and collectively assessed allowances.

### *Individually assessed allowance*

We determine the allowance appropriate for each individually significant loan or advance on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support, the realizable value of collateral, if any, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

### *Collectively assessed allowances*

Allowances are assessed collectively for losses on loans and advances that are not individually significant and for individually significant loans and advances where there is no objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration the following information: historical losses on the portfolio, current economic conditions, the approximate delay between the time a loss is likely to have been incurred and the time it is identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. The impairment allowance is then reviewed by credit management to ensure alignment with our policy.

### ***Capital Management***

We aim to achieve an optimal capital structure in pursuit of our business objectives which include maintaining healthy capital ratios and strong credit ratings, and maximizing shareholder value.

In recent years, our cash flow from operations has allowed us to substantially reduce debts and, in 2005, resume payment of dividends on common shares. Since then, our strong cash flows have enabled us to make investments in new areas and pay higher dividends.

Our approach to capital management focuses on balancing the allocation of cash and the incurrence of debt as we seek new investment opportunities for new businesses and growth areas. Our current dividend policy is to pay out 70% of our core earnings per common share. Further, in the event no investment opportunities arise, we may consider the option of returning additional cash to our shareholders in the form of special dividends or share buybacks. Philippine corporate regulations prescribe, however, that we can only pay out dividends or make capital distribution up to the amount of our unrestricted retained earnings.

As part of our goal to maximize returns to our shareholders, we obtained in 2008 an approval from the Board of Directors to conduct a share buyback program for up to five million PLDT common shares. As at September 30, 2010 and December 31, 2009, we had acquired a total of approximately 2.7 million shares of PLDT's common stock at a weighted average price of Php2,387 per share for a total consideration of Php6,405 million. See *Note 8 – Earnings Per Common Share* and *Note 19 – Equity*.

Some of our debt instruments contain covenants that impose maximum leverage ratios. In addition, our credit ratings from the international credit ratings agencies are based on our ability to remain within certain leverage ratios.

We monitor capital using several financial leverage measurements calculated in conformity with PFRS, such as net consolidated debt to equity ratio. Net consolidated debt is derived by deducting cash and cash equivalents and short-term investments from total debt (long-term debt and notes payable). Our objective is to maintain our net consolidated debt to equity ratio below 100%.

The table below provides information regarding our consolidated debt to equity ratio:

|   | <b>September 30,<br/>2010</b> | December 31,<br>2009 |
|---|-------------------------------|----------------------|
|   | <b>(Unaudited)</b>            | (Audited)            |
|   | (in million pesos)            |                      |
| Long-term debt, including current portion (Note 20) | <b>93,460</b>                 | 96,450               |
| Notes payable (Note 20)                             | –                             | 2,279                |
| Total consolidated debt                             | <b>93,460</b>                 | 98,729               |
| Cash and cash equivalents (Note 15)                 | <b>(26,902)</b>               | (38,319)             |
| Short-term investments                              | <b>(3,366)</b>                | (3,824)              |
| Net consolidated debt                               | <b>63,192</b>                 | 56,586               |
| Equity attributable to equity holders of PLDT       | <b>88,690</b>                 | 98,575               |
| Net consolidated debt to equity ratio               | <b>71%</b>                    | 57%                  |

## 29. Cash Flow Information

|  | <b>September 30, 2010</b> |
|--|---------------------------|
|  | (Unaudited)               |
|  | (in million pesos)        |
| Non-cash investing activities:                 |                           |
| Transfer of Meralco shares to Beacon (Note 10) | 15,084                    |