3	5	8	1	5

S.E.C. Registration No.

P	I	L	I	P	I	N	O		T	E	L	E	P	H	O	N	E

C	O	R	P	O	R	A	T	I	O	N

(Company's Full Name)

25th	FLR.	S	M	A	R	T		T	O	W	E	R

6	7	9	9		A	Y	A	L	A		A	V	E	N	U	E

M	A	K	A	T	I		C	I	T	Y		1	2	2	6

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

DEBORAH ANNE N. TAN	+63 2 511-6121
Contact Person	*Company Telephone Number*

					SEC FORM 17-Q	Third Tuesday of May			
1	2		3	1	**(As of March 31, 2006)**	0	5	1	6
Month			Day		FORM TYPE	Month		Day	
Fiscal Year						**Annual Meeting**			

Corporation Finance Department		
Department Requiring this Document		Amended Articles Number/Section

Total Amount of Borrowings

26,197 common stockholders as of March 31, 2006	N.A.	N.A.
Total No. of Stockholders	Domestic	Foreign

To be accomplished by SEC Personnel concerned

File Number

LCU

Document I.D.

Cashier

STAMPS

PILIPINO TELEPHONE CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
For the three months ended March 31, 2006

Some information in this report may contain forward-looking statements. 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 assumed facts and bases almost always vary from actual results, and the differences between assumed facts 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 keep in mind that any forward-looking statements made by us in this report or elsewhere speak only as of the date on which we made it. New risks and uncertainties come up from time to time, and it is impossible for us to predict these events or how they may affect us. We have no duty to, and do not intend to, update or revise the statements in this report after the date hereof. In light of these risks and uncertainties, you should keep in mind that any forward-looking statement made in this report or elsewhere might not occur.

Piltel is the third largest cellular mobile telephone service in the Philippines with 5.4 million subscribers as of March 31, 2006. Piltel also has 46,161 fixed line subscribers under its RTS and E.O. 109 services.

Piltel was incorporated in the Philippines with limited liability on July 18, 1968, and listed on the PSE in July 1995. Until 1991, Piltel's sole business was providing fixed line telecommunications services in eight cities and municipalities in the Philippines. Since 1991, Piltel also operated cellular telephone services using various technologies ranging from the analog AMPS technology to the digital CDMA technology. These services were substantially closed down in 2002. In April 2000, Piltel launched a digital prepaid cellular service, under the *Talk 'N Text* brand, using the GSM platform of Smart, which has since become the main component of its business.

Piltel added 374,022 *Talk 'N Text* subscribers in the first three months of 2006. The increase in the *Talk 'N Text* subscriber base fueled the increase in Piltel's total revenues by 3.0 percent to ₱2,919.3 million for the first three months of 2006 from ₱2,835.1 million for the same period last year. Expenses decreased by 66.5 percent to ₱128.8 million for the three months ended March 31, 2006 from ₱384.7 million for the same period last year as Piltel registered savings from the previous year, notably for cost of sales and selling and promotions. As a result of its improved results, Piltel recorded a net income of ₱2,244.6 million in the first three months of 2006, compared to ₱2,181.3 million for the same period in 2005.

PART I - FINANCIAL INFORMATION

1. Financial Statements

The unaudited consolidated financial statements of Piltel are filed as part of this Report (pages 25-67).

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

Financial Highlights and Key Performance Indicators

(In ₱ millions, except for ratios)			Increase (Decrease)	
	Mar 31, 2006	**Dec 31, 2005**	**Amount**	**%**
Balance Sheets				
Total Assets	27,048.1	25,234.0	1,814.1	7.2
Property, Plant and Equipment – net	3,504.5	3,601.8	(97.3)	(2.7)
Total Liabilities	20,312.4	20,742.9	(430.5)	(2.1)
Stockholders' Equity	6,735.7	4,491.1	2,244.6	50.0
	For the Three Months Ended Mar 31,			
	2006	**2005**		
Income Statements				
Service Revenues[1]	2,694.4	2,578.6	115.8	4.5
Sale of Handsets and SIM Packs	117.2	151.0	(33.8)	(22.4)
Other Income	107.7	105.5	2.2	2.1
Total Revenues and Other Income	2,919.3	2,835.1	84.2	3.0
Expenses	128.8	384.7	(255.9)	(66.5)
Provision for Income Tax	545.9	269.1	276.8	102.9
Net Income	**2,244.6**	**2,181.3**	63.3	2.9
Statements of Cash Flow				
Net cash provided by (used in) operating activities	3,134.7	(19.3)	3,154.0	16,342.0
Net cash used in investing activities	20.7	508.2	(487.5)	(95.9)
Capital expenditures	*65.3*	*506.4*	*(441.1)*	*(87.1)*
Net cash used in financing activities	129.7	144.9	(15.2)	10.5
	Mar 31, 2006	**Mar 31, 2005**		
Operational Data				
Number of cellular subscribers	5,358,447	4,742,203	616,244	13.0
Number of fixed line subscribers	46,161	45,477	684	1.5
Foreign Exchange Rates				
Peso to U.S. dollar	51.1580	54.7470		
Peso to Japanese yen	0.4347	0.5111		

---

[1]Piltel states its service revenues based on actual usage, net of the following: (1) Smart's share in *Talk 'N Text* revenues pursuant to the Omnibus Service Agreement, (2) interconnection expense, (3) discounts given to dealers on the sale of prepaid airtime, (4) preloaded airtime, and (5) content provider costs in relation to Piltel's VAS.

RESULTS OF OPERATION

Piltel derives its revenues from two business segments, cellular and fixed line services. The cellular service consists of the prepaid GSM service *Talk 'N Text,* which runs on Smart's GSM network and a lease line service making use of Piltel's remaining AMPS/CDMA network. The fixed line service consists of the RTS and E.O. 109 exchanges in selected parts of Luzon and Mindanao.

The table below shows the contribution of each business segment to revenues, expenses and net income before income tax for the three months ended March 31, 2006 and 2005:

	For the Three Months Ended Mar 31,		Increase (Decrease)	
(In ₱ millions)	2006	2005	Amount	%
Revenues and Other Income				
Cellular	2,739.3	2,635.4	103.9	3.9
Fixed line	180.0	199.7	(19.7)	(9.9)
Total	**2,919.3**	**2,835.1**	84.2	3.0
Expenses				
Cellular	29.4	310.5	(281.1)	(90.5)
Fixed line	99.4	74.2	25.2	34.0
Total	**128.8**	**384.7**	(255.9)	(66.5)
Net income before income tax				
Cellular	2,709.9	2,324.9	385.0	16.6
Fixed line	80.6	125.5	(44.9)	(35.8)
Total	**2,790.5**	**2,450.4**	340.1	13.9

REVENUES AND OTHER INCOME

Piltel's revenues and other income increased by 3.0 percent to ₱2,919.3 million for the three months ended March 31, 2006 from ₱2,835.1 million for the same period in 2005, with the increase fueled by the growth in the *Talk 'N Text* subscriber base. The table below shows the breakdown of revenues and other income:

	For the Three Months Ended Mar 31,		Increase (Decrease)	
(In ₱ millions)	2006	2005	Amount	%
Cellular service				
GSM				
Service revenues				
Gross revenues	3,555.8	3,563.8	(8.0)	(0.2)
Less: Smart's share	665.2	652.8	12.4	1.9
Interconnection expenses	371.5	473.0	(101.5)	(21.5)
Cost of pre-loaded airtime	1.1	59.8	(58.7)	(98.2)
Net service revenues	2,518.0	2,378.2	139.8	5.9
Non-service revenues				
Sale of handsets and SIM packs	117.2	151.0	(33.8)	(22.4)
Other income	103.2	105.1	(1.9)	(1.8)
Net revenues – GSM	2,738.4	2,634.3	104.1	4.0
AMPS/CDMA				
Service revenues	0.9	1.1	(0.2)	(18.2)
Net revenues – Cellular	**2,739.3**	**2,635.4**	**103.9**	**3.9**
Fixed line service				
Service revenues				
Gross revenues	208.4	224.9	(16.5)	(7.3)
Less: Interconnection expenses	32.9	25.6	7.3	28.5
Net service revenues	175.5	199.3	(23.8)	(11.9)
Other income	4.5	0.4	4.1	1,025.0
Net revenues – Fixed Line	**180.0**	**199.7**	**(19.7)**	**(9.9)**
Revenues and Other Income – Total Piltel	**2,919.3**	**2,835.1**	**84.2**	**3.0**

Cellular

<u>*Prepaid GSM Service*</u>

Piltel offers a prepaid GSM service, *Talk 'N Text*, which operates on the network of Smart under an Omnibus Service Agreement which provides that Piltel's net revenues will be shared by Piltel and Smart at the rate of 80/20, in favor of Piltel (see discussion under "Related Party Transactions"). Under the arrangement with Smart, Piltel pays for marketing the *Talk 'N Text* service, acquiring subscribers, selling handsets and phone cards, and providing customer service, while Smart provides and manages the GSM infrastructure network.

As at March 31, 2006, *Talk 'N Text* subscribers reached 5,358,447, an increase of 616,244 or 13.0 percent over the subscriber base of 4,742,203 as at March 31, 2005.

From its launch in April 2000, *Talk 'N Text* quickly captured market share by offering subscribers handsets at affordable prices.

The following products of Smart are also available to *Talk 'N Text* subscribers:

- *Smart 25^8 Unlimited Call* and *Text* promotion. Beginning March 11, 2005, Smart launched a series of promotions to test the apparent market demand for fixed rate or "bucket plans" for voice and text services. Under a service branded as *Smart 25^8*, Smart and *Talk 'N Text* subscribers had the option to register for unlimited on-network (Smart/*Talk 'N Text* to Smart/*Talk 'N Text*) voice calls or unlimited on-network (Smart/*Talk 'N Text* to Smart/*Talk 'N Text*) text messaging service. Since launch, the promotion has taken on several variations involving changes in load denominations, the periods of network availability (peak/off-peak) as well as a "double text" variation.

  The current *Smart 25^8* promotion, which has been extended until June 2, 2006, has the following features:

  - Unlimited Text - ₱15, ₱30 and ₱60 denominations with expiry periods of one, two and four days, respectively, with unlimited on-network text all day service; and
  - Text and Call Combo - ₱20 load denomination with unlimited text on-network for one day and a call with a maximum duration of five minutes and valid within 24 hours.

- *Flat Rate* promotion. On August 23, 2005, Smart also operated a *Flat Rate* promotion which allows Smart and *Talk 'N Text* prepaid subscribers to make a call to another Smart or *Talk 'N Text* subscriber of up to three minutes for ₱10, or extend up to five minutes for a flat rate of ₱15. The *Flat Rate* promotion was relaunched on February 11, 2006 and is valid until May 13, 2006.

- *All Text* promotion. On February 12, 2006, Smart introduced a new variety of top-ups – *Smart Load "All Text"*, which allows 10 and 20 messages without expiration for a suggested retail price of ₱12 and ₱23, respectively. On May 1, 2006, the number of messages allocated for the 10-message load was increased to 15. This promotion offering the additional five messages is effective until May 28, 2006.

Cellular service revenues from *Talk 'N Text* consist of:

a. revenues derived from actual usage of the network of Smart by *Talk 'N Text* subscribers and any unused peso value of expired prepaid cards or electronic airtime loads, net of value-added tax, discounts given to dealers, the cost of pre-loaded airtime and content provider costs in relation to VAS; and

b. revenues from incoming calls and messages to *Talk 'N Text* subscribers, net of interconnection expenses;

both net of Smart's share of revenues after interconnection expenses. Proceeds from sale of the handsets and SIM packs to subscribers are recognized as non-service revenues.

Talk 'N Text accounts for cellular revenues amounting to ₱2,738.4 million (or 93.8 percent of total revenues) and ₱2,634.3 million (or 92.9 percent of total revenues) for the three months ended March 31, 2006 and 2005, respectively. The remaining cellular revenues of ₱0.9 million and ₱1.1 million for the three months ended March 31, 2006 and 2005, respectively, pertained to the AMPS/CDMA service.

Net service revenues generated from the prepaid GSM service amounted to ₱2,518.0 million for the three months ended March 31, 2006 versus ₱2,378.2 million for the same period in 2005, a 5.9 percent increase due to a growing subscriber base.

Revenues from the sale of prepaid GSM handsets and SIM packs decreased by 22.4 percent to ₱117.2 million for the three months ended March 31, 2006 from ₱151.0 million for the same period in 2005. The decline was due to the shift in sales mix to SIM sales in 2006 from phonekit sales in 2005. (Phonekits accounted for 2.8 percent of total sales volume in 2006 versus 5.4 percent in 2005.) However, this translated to a lower cost of handsets and SIM packs sold, which is included under expenses.

The following table summarizes key measures of *Talk 'N Text*'s performance for the three months ended March 31, 2006 and 2005:

	For the Three Months Ended Mar 31,		Increase (Decrease)	
	2006	2005	Amount	%
GSM Service Revenues (in ₱ millions)				
By Component				
Data[2]	1,562.9	1,153.3	409.6	35.5
Voice	955.1	1,224.9	(269.8)	(22.0)
Total	2,518.0	2,378.2	139.8	5.9
Data Revenues as a % of GSM Revenues	62.1%	48.5%		
Subscribers	5,358,447	4,742,203	616,244	13.0
Average Monthly ARPU[3] – Gross[4] (in ₱)	245	269	(24)	(8.9)
Average Monthly ARPU[3] – Net[5] (in ₱)	207	220	(13)	(5.9)

Data

Revenues from data services, which include all SMS (or "text messaging") or text-related services ranging from ordinary text to enhanced services from *Smart zed*[TM], increased to ₱1,562.9 million for the period ended March 31, 2006, an increase of 35.5 percent, from ₱1,153.3 million for the same period in 2005. Wireless data accounted for 62.1 percent and 48.5 percent of GSM revenues for the periods ended March 31, 2006 and 2005, respectively.

---

[2]Refers to all text-related services, such as ordinary text, international text, info-text, mobile banking, ring tones, logos and Smart zed-related services, all expressed net of Smart's share of revenues, interconnect expense on SMS, related VAS content provider costs and dealer discounts.
[3]All ARPUs are computed by dividing the revenues for the relevant service (based on actual usage) by the average of the beginning and ending number of subscribers for the particular service for the month.
[4]Gross monthly ARPU is computed by dividing the revenues based on usage (gross of dealer discounts and allocated content provider costs) for the service, including interconnection income by the average number of subscribers (beginning number plus ending number divided by two) for the month. The average monthly ARPU for the period is then calculated as the simple average of the monthly ARPUs during the period.
[5]Net monthly ARPU is calculated the same way as described in Note 4 above but net of dealer discounts and allocated content provider costs and with interconnection income expressed net of interconnection expense.

Below is a table providing a breakdown of Piltel's wireless data revenues:

(In ₱ millions)	For the Three Months Ended Mar 31, 2006	2005	Increase (Decrease) Amount	%
Text messaging				
Standard text messaging	816.7	951.6	(134.9)	(14.2)
25[8] Unlimited Text	548.2	25.8	522.4	2,024.8
International text messaging	47.0	42.0	5.0	11.9
	1,411.9	1,019.4	392.5	38.5
VAS				
Non-zed	98.6	82.8	15.8	19.1
Mobile Banking, Roaming SMS, WAP, *Smart Money*[6], *Pasa Load*	37.0	30.3	6.7	22.1
Smart zed[TM]	15.4	20.8	(5.4)	(26.0)
	151.0	133.9	17.1	12.8
Total	1,562.9	1,153.3	409.6	35.5

Voice

Revenues from voice services, which include all voice traffic, decreased to ₱955.1 million for the period ended March 31, 2006, or 22.0 percent from ₱1,224.9 million for the same period in 2005 as usage shifted from voice calls to SMS and VAS. Voice revenues contributed 37.9 percent of GSM revenues for the period ended March 31, 2006 compared to 51.5 percent for the same period in 2005.

For a complete list of *Talk 'N Text* rates and tariffs, please refer to Annex B.

Subscribers

The *Talk 'N Text* subscriber base increased by 616,244 or 13.0 percent from 4,742,203 as of March 31, 2005 to 5,358,447 as of March 31, 2006. Net activations for the first quarter of 2006 and 2005 are 374,022 and 129,753, respectively.

ARPU

Gross ARPU of *Talk 'N Text* subscribers declined by 8.9 percent to ₱245 in the period ended March 31, 2006 from ₱269 in the same period last year. The decline was attributable to a decrease in the average outbound local voice revenue per subscriber, as well as the average inbound revenue per subscriber, partly offset by an increase in the average text messaging revenue per subscriber. On a net basis, ARPU for the first three months of 2006 decreased to ₱207 or 5.9 percent down from ₱220 for the same period in 2005.

Churn

Piltel calculates the average monthly churn rate for prepaid subscribers by dividing total disconnections by the average of the beginning and ending number of subscribers for the month. While prepaid airtime reloads are valid for a period ranging from one day to two months, a prepaid GSM account is disconnected if the subscriber does not reload within four months after full usage or expiry of the last reload. As a result, a subscriber may not be accounted for in our churn calculations for up to 121 days to six months after the subscriber may have stopped using the service to make calls or send messages (although the subscriber may continue to receive calls and messages).

---

[6] Revenues generated from SMS usage for *Smart Money*-related transactions, such as balance inquiry, are reflected under GSM data revenues.

Prior to June 2004, a prepaid cellular subscriber was recognized as an active subscriber when that subscriber activated and used the SIM card in the handset, which contained pre-stored air time. The pre-stored air time, which can be used for both voice and text, was reduced from ₱100 to ₱50 in April 2004. In May 2005, this was changed to ₱1 plus 50 free SMS which could only be used upon purchase or reload of air time of any value. Subscribers can reload their air time by purchasing prepaid "call and text" cards that are sold in denominations of ₱300, ₱500 and ₱1,000; by purchasing additional air time "over the air" via *Talk 'N Text Load* in smaller denominations of ₱30, ₱60, ₱115, ₱200 and ₱300; and by receiving loads of ₱2, ₱5, ₱10 and ₱15 via *Pasa Load,* or through their handsets using *Smart Money.* Reloads have validity periods ranging from one day to two months, depending on the amount reloaded. A prepaid cellular subscriber is disconnected if the subscriber does not reload within four months after the full usage or expiry of the last load. Piltel's current policy is to recognize a prepaid subscriber "active" only when the subscriber activates and uses the SIM card and reloads at least once during the month of initial activation or in the immediate succeeding month. For example, if a customer activated a SIM card in April but had not reloaded by May 31, this customer would not be counted as a subscriber. The rationale for this change stems from Piltel's observance of "SIM-swapping" activities in the market. "SIM-swapping" refers to the promotional activity wherein subscribers can exchange their current prepaid SIM card for another operator's SIM card at no cost to the subscriber. Piltel believes that these activities have given rise to a situation where certain subscribers swap their SIM cards between mobile operators upon full usage of the pre-stored air time, which may result in subscriber base reflecting a certain number of transient subscribers at any one point in time. In May 2005, Piltel terminated its "SIM swapping" promotions; as a result, Piltel's churn rates increased beginning in the third quarter of 2005 continuing to the end of 2005.

The average monthly churn rate for *Talk 'N Text* subscribers for the period ended March 31, 2006 was 3.7 percent, lower than the 4.6 percent churn rate for the same period in 2005.

AMPS/CDMA Services

Piltel leases out AMPS/CDMA telephone lines to a few corporate subscribers. For the period ended March 31, 2006, net revenues from this service amounted to ₱0.9 million from ₱1.1 million for the same period in 2005. The AMPS/CDMA services were significantly reduced with the decommissioning of all but seven cell sites in 2002. As of March 31, 2006, only six cell sites remain active.

Fixed Line

Piltel operates local exchanges in selected Luzon and Mindanao areas offering wireline service, which accounted for 6.2 percent of Piltel's net revenues as of March 31, 2006 compared to 7.0 percent for the same period in 2005.

Revenues from the fixed line service consist of:

a. monthly basic service charges, including additional local tolls based on the Local Measured Service in excess of the applicable minimum basic monthly charge;
b. outbound usage revenues derived from international and domestic long distance calls but net of interconnection fees corresponding to outgoing usage revenues;
c. incoming revenue share from interconnection with other carriers; and
d. other miscellaneous charges such as installation charges and other one-time fees.

As of March 31, 2006, total subscribers to the fixed line service numbered 46,161, an increase of 1.5 percent from 45,477 a year earlier.

Net revenues from the fixed line service amounted to ₱180.0 million as of March 31, 2006, a decrease of 9.9 percent from ₱199.7 million for the same period in 2005. Gross revenues of ₱208.4 million for the period ended March 31, 2006 decreased by 7.3 percent from last year's ₱224.9 million.

ARPUs for the fixed line service are computed in the same fashion as that of the cellular business. Gross ARPU is calculated by dividing total gross revenues (before deducting interconnection fees) by the average of the beginning and ending subscribers. Average monthly ARPU is then calculated as the simple average of the monthly ARPUs during the period. Gross ARPU for the fixed line service was ₱1,506 as of March 31, 2006 compared with ₱1,619 for the same period in 2005 or a decrease of 7.0 percent.

EXPENSES

Total expenses decreased by ₱255.9 million or 66.5 percent to ₱128.8 million for the three months ended March 31, 2006 from ₱384.7 million for the same period in 2005 as almost all expenditures registered decreases from last year, most notably, cost of handsets and SIM packs sold, and selling and promotions.

	For the Three Months Ended March 31,					
	2006		2005		Increase (Decrease)	
(in ₱ millions)	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
Cost of handsets and SIM packs sold	137.8	107.0	323.1	84.0	(185.3)	(57.4)
Selling and promotions	125.4	97.4	174.1	45.3	(48.7)	(28.0)
Depreciation and amortization	123.6	96.0	80.2	20.8	43.4	54.1
Maintenance	42.9	33.3	17.2	4.5	25.7	149.4
Taxes and licenses	33.0	25.6	68.6	17.8	(35.6)	(51.9)
Professional and other service fees	19.2	14.9	19.4	5.0	(0.2)	(1.0)
Provisions	7.1	5.5	16.9	4.4	(9.8)	(58.0)
Rent	4.7	3.6	6.0	1.6	(1.3)	(21.7)
Insurance and security services	1.7	1.3	0.4	0.1	1.3	325.0
Financing gain	(381.2)	(296.0)	(350.2)	(91.0)	(31.0)	8.9
Others	14.6	11.4	29.0	7.5	(14.4)	49.7
Total Expenses	128.8	100.0	384.7	100.0	(255.9)	(66.5)

Cost of handsets and SIM packs sold decreased by ₱185.3 million or 57.4 percent to ₱137.8 million from ₱323.1 million for the same period in 2005 due mainly to the shift in sales mix to SIM sales in 2006 from phonekit sales in 2005. (See also discussion on "Revenues".)

Selling and promotions decreased by 28.0 percent to ₱125.4 million for the three months ended March 31, 2006 from ₱174.1 million for the same period in 2005 due to a refocusing of efforts by doing on-the-ground selling and promotion activities that are more targeted and efficient as against the more traditional television and radio advertising.

Depreciation and amortization for the three months ended March 31, 2006 increased by ₱43.4 million or 54.1 percent to ₱123.6 million from ₱80.2 million for the same period in 2005 due mainly to the additional capital expenditures for the past year.

Maintenance for the three months ended March 31, 2006 increased by ₱25.7 million or 149.4 percent to ₱42.9 million from ₱17.2 million for the same period in 2005 due mainly to the expenses for the GSM cell sites, which Piltel started acquiring in December 2004.

Taxes and licenses decreased by 51.9 percent to ₱33.0 million for the three months ended March 31, 2006 from ₱68.6 million for the same period in 2005 due mainly to lower real property taxes.

Professional and other service fees decreased by 1.0 percent to ₱19.2 million for the three months ended March 31, 2006 from ₱19.4 million for the same period in 2005. Professional and other service fees are mostly made up of the management fees payable to PLDT and Subictel. Also included under professional and other service fees are audit fees amounting to ₱175.0 thousand for the three months ended March 31, 2006 and 2005. Audit fees represent expenses incurred for the examination of Piltel's financial statements by independent auditors.

Provisions decreased by 58.0 percent to ₱7.1 million for the three months ended March 31, 2006 from ₱16.9 million for the same period in 2005 and pertained mainly to the write-down of *Talk 'N Text* handsets to net realizable value.

	For the Three Months Ended Mar 31,		**Increase (Decrease)**	
(In ₱ millions)	**2006**	**2005**	**Amount**	**%**
Write-down of inventories to net realizable value	7.2	16.9	(9.7)	(57.4)
Doubtful accounts	(0.1)	-	(0.1)	-
Total	7.1	16.9	(9.8)	(58.0)

Rent decreased by 21.7 percent to ₱4.7 million for the three months ended March 31, 2006 from ₱6.0 million for the same period last year, with lower rent expense for the fixed line exchanges.

Insurance and security services increased by 325.0 percent to ₱1.7 million for the three months ended March 31, 2006 from ₱0.4 million for the same period last year due to higher site security expenses.

Piltel recorded a net financing gain of ₱381.2 million for the three months ended March 31, 2006 compared with ₱350.2 million for the same period last year. The increase was due mainly to higher interest income offset by lower foreign exchange gains. The breakdown of net financing gain follows:

	For the Three Months Ended Mar 31,		**Increase (Decrease)**	
(In ₱ millions)	**2006**	**2005**	**Amount**	**%**
Interest expense	244.9	228.1	16.8	7.4
Amortization of debt discount	162.3	166.6	(4.3)	(2.6)
Interest income	(288.0)	(3.0)	(285.0)	95.0
Foreign exchange gains	(500.4)	(741.9)	241.5	32.6
Total	(381.2)	(350.2)	(31.0)	8.9

Interest expense increased by 7.4 percent to ₱244.9 million for the three months ended March 31, 2006 from ₱228.1 million for the same period last year due mainly to higher interest rates.

Amortization of debt discount for the three months ended March 31, 2006 decreased by ₱4.3 million or 2.6 percent from ₱166.6 million for the same period in 2005 due mainly to the appreciation of the peso against the US dollar and Japanese yen.

Interest income increased by ₱285.0 million to ₱288.0 million for the three months ended March 31, 2006 from ₱3.0 million for the same period last year due mainly to the interest charged on Piltel's net receivable from Smart, pursuant to a Memorandum of Agreement signed on May 11, 2005 (see section on "Related Party Transactions"). Interest income on the receivable from Smart for the first three months of 2005 was booked retroactively in May 2005.

The revaluation of Piltel's US dollar and Japanese yen loans resulted in a foreign exchange gains of ₱500.4 million in the first three months ended March 31, 2006 due mainly to the appreciation of the peso against the US dollar and the Japanese yen (see section on "Foreign Currency Risk").

Other operating expenses decreased by ₱14.4 million to ₱14.6 million for the three months ended March 31, 2006 from ₱29.0 million for the same period last year as last year's expense included the payment of PSE fees for the listing of additional common shares of Piltel.

Provision for Income Tax

Piltel recorded provision for income tax of ₱545.9 million for the three months ended March 31, 2006 against ₱269.1 million for the same period in 2005. The provision for income tax consisted of RCIT for the current period of ₱30.7 million and deferred provision for income tax of ₱515.2 million. (see Note 6 – Income Taxes of the notes to consolidated financial statements).

Net Income

Net income for the first three months of 2006 was ₱2,244.6 million against ₱2,181.3 million recorded in the same period a year earlier, a result of the growth in *Talk 'N Text* subscriber base, as well as the savings in cost of handsets and SIM packs sold and selling and promotions.

Liquidity and Capital Resources

The following table sets out Piltel's cash flows, capitalization and other selected financial data as of March 31, 2006 and 2005, and December 31, 2005:

	For the Three Months Ended Mar 31,		Increase (Decrease)	
(In ₱ millions)	2006	2005	Amount	%
Cash Flows				
Net cash provided by (used in) operating activities	3,134.7	(19.3)	3,154.0	16,342.0
Net cash used in investing activities	20.7	508.2	(487.5)	(95.9)
Capital expenditures	65.3	506.4	(441.1)	(87.1)
Net cash used in financing activities	129.7	144.9	(15.2)	(10.5)
	March 31, 2006	Dec 31, 2005		
Capitalization				
Current portion of interest-bearing financial liabilities	207.7	237.1	(29.4)	(12.4)
Interest-bearing financial liabilities	17,126.4	17,432.8	(306.4)	(1.8)
Total interest-bearing financial liabilities	17,334.1	17,669.9	(335.8)	(1.9)
Stockholders' equity	6,735.7	4,491.1	2,244.6	50.0

As of March 31, 2006, Piltel's cash and cash equivalents totaled ₱3,330.9 million.

Operating Activities

Cash flow from operations for the period ended March 31, 2006 increased by ₱3,154.0 million to ₱3,134.7 million from a ₱19.3 million cash usage for the same period in 2005 due to the increase in cash operating income, as well as the net collections of accounts receivable of ₱772.2 million in 2006 compared with the net build-up of ₱1,586.5 million in 2005. Piltel's net receivable from Smart decreased by ₱688.1 million from year-end 2005 balance, accounting mostly for the net collections included in the 2006 cash flows.

Investing Activities

Piltel's use of cash for investing activities in the first three months of 2006 decreased by ₱487.5 million to ₱20.7 million from ₱508.2 million for the same period in 2005. The decrease was due mainly to lower capital expenditures for the period.

Financing Activities

Net cash used in Piltel's financing activities for the three months ended March 31, 2006 amounted to ₱129.7 million, compared to ₱144.9 million for the same period in 2005 due to lower interest payments.

Debt Financing

As of March 31, 2006, Piltel had outstanding long-term debt of ₱17,334.1 million (net of debt discount and including current portion), a decrease of ₱335.8 million, or 1.9 percent, from the ₱17,669.9 million balance at year-end 2005 because of the revaluation of US dollar and Japanese yen denominated loans, as the Peso appreciated against those currencies. The unamortized debt discount as of March 31, 2006 was ₱3,924.3 million as against ₱4,198.9 million as of December 31, 2005 (see Note 16 – Interest-bearing Financial Liabilities of the notes to consolidated financial statements).

The scheduled maturities of Piltel's long-term indebtedness (at nominal values) as of March 31, 2006 are as follows:

	Principal Amortization						
	2006	2007	2008	2009	2010	2011 onwards	Total
	(In Million Pesos)						
Peso facility	45.5	218.8	218.8	218.8	218.8	3,403.5	4,324.2
US$ facilities	37.3	179.6	179.6	179.6	179.6	2,793.7	3,549.4
¥ facility	71.4	343.4	343.4	343.4	343.4	5,341.8	6,786.8
Term note facility	0.3	0.3	0.3	0.3	0.3	290.5	292.0
Conversion note facility	65.4	314.6	314.6	314.6	314.6	4,892.5	6,216.3
Total restructured debt	219.9	1,056.7	1,056.7	1,056.7	1,056.7	16,722.0	21,168.7
Unrestructured debt	47.2	–	–	–	–	–	47.2
Liability under capital lease	5.4	1.3	1.4	1.4	1.5	31.5	42.5
Total interest-bearing financial liabilities	272.5	1,058.0	1,058.1	1,058.1	1,058.2	16,753.5	21,258.4

Piltel owes Smart ₱14,730.1 million (at nominal value) or 69.6 percent of the total restructured debt.

Piltel's restructured obligations are secured by substantially all present and future assets of Piltel under the Mortgage Trust Indenture dated June 4, 2001 between Piltel and Chase Manhattan Bank as security agent for the creditors.

Piltel has undertaken, with respect to each financial year (other than the financial year in which the final repayment installment for Tranche B falls due), that the aggregate of earnings before interest, tax, depreciation and amortization plus the available amount under the LOS shall be greater than 1.05 times interest cost.

Piltel likewise agreed to pay into a dedicated account (a Sinking Fund Account) the amount by which (a) earnings before interest, tax, depreciation and amortization, and exceptional items for a financial year is greater than (b) 200 percent of the projected debt service costs and permitted capital expenditure for the following financial year (the Excess Cash Flow). The money in the Sinking Fund Account will be used (before drawings are made under the LOS) to fund cash flow deficiencies of Piltel. Also, if actual capital expenditure for a financial year differs from the projected capital expenditure, Piltel will either pay into the Sinking Fund Account established at the end of that year an amount equal to any over-projection of capital expenditure or will be entitled to withdraw funds, if any, equal to any under-projection. Any credit balance in a Sinking Fund Account after two financial years will be used to prepay all participating creditors.

On May 4, 2006, Piltel delivered notices of partial voluntary prepayment of principal to the Security Agent and the Facility Agents under Piltel's peso facility, US$ facilities, Yen facility and the Trustee under its Notes Indenture. The amount of the voluntary prepayment represents Excess Cash Flow from the operations of Piltel's business. The voluntary prepayment will be made in lieu of depositing those funds into a Sinking Fund Account. The aggregate voluntary prepayment amount is approximately ₱9,200 million or US$177 million, which is being applied proportionally to the various debt facilities as set out in the Intercreditor Agreement dated June 4, 2001. The prepayment will be effected on June 5, 2006, after which Piltel's debt balance will be reduced to approximately US$236 million in principal.

Refer to Note 16 – Interest-bearing Financial Liabilities of the accompanying notes to consolidated financial statements for further details of Piltel's debts.

Equity Financing

As of March 31, 2006, Piltel had an authorized capital of ₱12.8 billion, divided into the following:

a. 12,060 million common shares with a par value of ₱1.00 per share of which 11,771.7 million shares are issued and outstanding.

b. 120.0 million Class I preferred shares, with a par value of ₱2.00 per share of which the following are issued and outstanding:

	In million shares
Series A	1.9
Series C	5.2
Series D	0.1
Series J	4.9
Total	12.1

Class I preferred shares have preference over the common shares in relation to dividends and assets in the event of liquidation, dissolution or winding up.

c. 500.0 million Class II preferred shares, with a par value of ₱1.00 per share of which there are no shares issued and outstanding.

Piltel's stockholders' equity increased by ₱2,244.6 million or 50.0 percent to ₱6,735.7 million as of March 31, 2006 from ₱4,491.1 million as of December 31, 2005, as a result of the net income for the first three months of 2006.

Other Financial Data

(In ₱ millions)

	Mar 31, 2006	Dec 31, 2005	Increase (Decrease) Amount	%
ASSETS				
Noncurrent Assets				
Property, plant & equipment	3,504.5	3,601.8	(97.3)	(2.7)
Investment properties	693.2	693.2	–	–
Long-term receivable from Smart	10,355.8	10,355.8	–	–
Deferred income tax assets	1,485.4	2,000.6	(515.2)	(25.8)
Investments and refundable deposits	77.9	77.9	–	–
Total noncurrent assets	**16,116.8**	**16,729.3**	**(612.5)**	**(3.7)**
Current Assets				
Cash and cash equivalents	3,330.9	344.3	2,986.6	867.4
Trade and other receivables – net	7,145.2	7,735.1	(589.9)	(7.6)
Inventories – at net realizable value	115.8	142.9	(27.1)	(19.0)
Prepayments	339.4	282.4	57.0	20.2
Total current assets	**10,931.3**	**8,504.7**	**2,426.6**	**28.5**
	27,048.1	**25,234.0**	**1,814.1**	**7.2**
LIABILITIES AND STOCKHOLDERS' EQUITY				
Stockholders' equity	**6,735.7**	**4,491.1**	**2,244.6**	**50.0**
Noncurrent Liabilities				
Unearned revenue on co-location (net of current portion)	703.7	804.2	(100.5)	(12.5)
Interest-bearing financial liabilities (net of current portion)	17,126.4	17,432.8	(306.4)	(1.8)
Total noncurrent liabilities	**17,830.1**	**18,237.0**	**(406.9)**	**(2.2)**
Current Liabilities				
Trade and other payables	1,540.9	1,491.8	49.1	3.3
Income tax payable	249.8	219.1	30.7	14.0
Current portion of unearned revenue on co-location	402.1	402.1	–	–
Unearned revenue on sale of prepaid cards	81.8	155.8	(74.0)	(47.5)
Current portion of long-term debt	207.7	237.1	(29.4)	(12.4)
Total current liabilities	**2,482.3**	**2,505.9**	**(23.6)**	**(0.9)**
	27,048.1	**25,234.0**	**1,814.1**	**7.2**

Noncurrent Assets

a. Property, plant and equipment decreased by 2.7 percent to ₱3,504.5 million as of March 31, 2006 from ₱3,601.8 million at year-end 2005 due mainly to the depreciation on the additional capital expenditures for the GSM network for the past year.

b. Investment property, which pertains to the land and buildings rented out to Smart, remained at year-end 2005 level.

c. Long-term receivable from Smart pertained to non-current inter-company transactions.

d. Deferred income tax assets decreased by 25.8 percent to ₱1,485.4 million as of March 31, 2006 from ₱2,000.6 million at year-end 2005 due mainly to lower deferred tax asset on unrealized foreign exchange losses (see Note 6 – Income Taxes of the notes to consolidated financial statements).

e. Investments and refundable deposits remained at year-end 2005 level.

Current Assets

f. Cash and cash equivalents increased by 867.4 percent to ₱3,330.9 million as of March 31, 2006 from ₱344.3 million at year-end 2005. (See accompanying statements of cash flows for details of the increase.)

g. Trade and other receivables decreased by 7.6 percent to ₱7,145.2 million as of March 31, 2006 from ₱7,735.1 million at year-end 2005 primarily as a result of receivables from customers written-off in 2006.

h. Inventories decreased by 19.0 percent to ₱115.8 million as of March 31, 2006 from ₱142.9 million at year-end 2005 due to the decrease in volume of SIM cards and handsets inventory for *Talk 'N Text*.

i. Prepayments of ₱339.4 million as of March 31, 2006 increased by 20.2 percent from ₱282.4 million at year-end 2005 due mainly to the increase in creditable taxes withheld (₱276.7 million as of March 31, 2006 as against ₱213.1 million at year-end 2005).

Stockholders' Equity

j. Stockholders' equity increased by 50.0 percent to ₱6,735.7 million as of March 31, 2006 compared to ₱4,491.1 million at year-end 2005 due to the net income for the first three months of 2006.

Noncurrent Liabilities

k. Unearned revenue on co-location (net of current portion) decreased by 12.5 percent to ₱703.7 million as of March 31, 2006 from ₱804.2 million at year-end 2005 due mainly to the amortization for the period of the co-location income from Smart.

l. Interest-bearing financial liabilities (net of current portion) decreased by 1.8 percent to ₱17,126.4 million as of March 31, 2006 from ₱17,432.8 million at year-end 2005 due mainly to the revaluation foreign exchange gains resulting from the appreciation of the peso against the US dollar and Japanese yen (see discussion on "Foreign Currency Risk").

Current Liabilities

m. Trade and other payables increased by 3.3 percent to ₱1,540.9 million as of March 31, 2006 from ₱1,491.8 million at year-end 2005 due mainly to the increase in accruals for interest on loans and selling and promotions.

n. Income tax payable increased by 14.0 percent to ₱249.8 million as of March 31, 2006 from ₱219.1 million at year-end 2005 due mainly to computed RCIT for the period.

o. Current portion of unearned revenue on co-location remained at year-end 2005 level.

p. Unearned revenues on sale of prepaid cards decreased by 47.5 percent to ₱81.8 million as of March 31, 2006 from ₱155.8 million at year-end 2005 due to lower end-of-period sales.

q. Current portion of interest-bearing financial liabilities decreased by 12.4 percent from ₱237.1 million at year-end 2005 to ₱207.7 million due to the revaluation foreign exchange gains resulting from the appreciation of the peso against the US dollar and Japanese yen (see discussion on "Foreign Currency Risk").

Contractual Obligations

As of March 31, 2006, Piltel had no outstanding short-term contractual obligations.

For a discussion on Piltel's long-term debt obligations, please see the section "Debt Financing".

Piltel entered into an agreement for the financial lease of the Palawan Telecommunications System of the MTPO with the DOTC on June 3, 1994. The MTPO Contract is a 30-year contract for Piltel to lease facilities for PCO stations in the Palawan area, with revenues going to Piltel. In consideration, Piltel pays the DOTC an escalating annual lease fee. The total lease payment for thirty years is ₱482.6 million.

The estimated future annual lease commitments under this lease arrangement are as follows:

(In ₱ Millions)	
Within one year	15.2
After one year but not more than five years	26.0
More than five years	435.6
Total minimum lease payments	476.8
Less amount representing interest	434.3
Present value of net minimum lease payments	42.5
Less current maturities	5.4
Long-term obligations	37.1

The foregoing financial lease is the subject of assessment by the DOTC (see Note 19c - Contingencies of the notes to consolidated financial statements).

Commercial Commitments

As of March 31, 2006, Piltel had no outstanding commercial commitments.

Financial Risk Management Objectives and Policies

Piltel's principal financial instruments comprise bank loans, finance leases, cash and short-term deposits. The main purpose of these financial instruments is to fund Piltel's operations. Piltel has various other financial instruments such as trade payables and trade receivables, which arise directly from its operations. It is, and has been throughout the period under review, Piltel's policy that no trading in financial instruments shall be taken.

The main risks arising from Piltel's financial instruments are interest rate risk, liquidity risk, foreign currency risk and credit risk.

Interest Rate Risk

Piltel is exposed to interest rate risks as its long-term loans are subject to floating interest rates (see Note 16- Interest-bearing Financial Liabilities of the notes to consolidated financial statements). It has not entered into interest rate swaps, however, as its Peso Facility, Dollar Facility and Trade Creditor Agreements provide that indebtedness relating to foreign currency and/or interest rate swaps are subject to a maximum exposure at anytime of US$5.0 million or its equivalent.

The following table sets out the carrying amount, by maturity, of the Company's financial instruments that are exposed to interest rate risk:

	Tranche B Loans	**Tranche C Loans**	**Term Notes Facility**	**Conversion Notes Facility**
Principal Amortization (*In Million Pesos)*	2006 7.5 2007 7.5 2008 7.5 2009 7.5 2010 7.5 2011 onwards 7,481.4	2006 150.7 2007 753.4 2008 753.4 2009 753.4 2010 753.4 2011 onwards 4,354.6	2006 0.3 2007 0.3 2008 0.3 2009 0.3 2010 0.3 2011 onwards 290.5	2006 65.4 2007 314.5 2008 314.5 2009 314.5 2010 314.5 2011 onwards 4,892.7
Interest rate	Peso facility - Philippines 91-day treasury bill rate (T-Bill Rate) or the average of the 91-day T-Bill Rate and the 90-day Philippine inter-bank offered rate (PHIBOR), if 90-day PHIBOR is different from the T-Bill Rate by more than 2.50%, plus 1.00% p.a. U.S. dollar facilities - London interbank rate for U.S. dollar deposits (LIBOR) for three-month deposits plus 1.00% p.a. Yen facility - London interbank rate for Yen deposits for three month deposits plus 1.00% p.a.		181- day T-Bill Rate or the average of the 181-day T-Bill Rate and the 6-months PHIBOR, if 6-months PHIBOR is different from the T-Bill Rate by more than 2.50%, plus 1.00% p.a.	LIBOR for three-month deposits plus 1.00% p.a.
Interest payment dates	Quarterly in arrears		Semi-annually	

Foreign Currency Risk

Piltel has recognized in its consolidated statements of income foreign exchange revaluation gains of ₱500.4 million on its foreign-currency denominated liabilities as of March 31, 2006 as compared with ₱741.9 million gains as of March 31, 2005. This resulted from the movements of the Philippine peso against the US dollar and the Japanese yen as shown in the following table:

	Peso to US dollar	Peso to Japanese yen
December 31, 2004	56.341	0.5495
March 31, 2005	54.747	0.5111
December 31, 2005	53.062	0.4504
March 31, 2006	51.158	0.4347

The following table shows Piltel's foreign currency-denominated monetary assets and liabilities and their peso equivalents as of March 31, 2006 and as of December 31, 2005:

	March 31, 2006			December 31, 2005		
	(In Millions)					
	US dollars	Japanese yen	Pesos	US dollars	Japanese yen	Pesos
Assets						
Cash and cash equivalents	0.0		1.0	0.0		0.9
Liabilities						
Long-term debt	191.8	15,612.7	16,599.6	191.8	15,612.7	17,210.1
Net foreign currency-denominated liabilities	191.8	15,612.7	16,598.6	191.8	15,612.7	17,209.2

In translating the foreign currency-denominated monetary assets and liabilities into peso amounts, Piltel used the exchange rates as shown on the table above.

As at May 8, 2006, the peso-dollar exchange rate was ₱51.392 to US$1 and peso-yen exchange rate was ₱0.4622 to ¥1. Using these exchange rates, Piltel's net foreign currency-denominated liabilities as of March 31, 2006 would have increased by ₱474.2 million.

While a certain percentage of Piltel's revenues are US dollar-linked, a substantial portion of Piltel's liabilities are denominated in foreign currencies, particularly in US dollars and Japanese yen. However, Piltel has not entered into a foreign currency swap as its Dollar Facility and Trade Creditor Agreements provide that indebtedness relating to foreign currency and/or interest rate swaps are subject to a maximum aggregate exposure at anytime of US$5.0 million or its equivalent.

As of March 31, 2006, approximately 78.1 percent of Piltel's debts were denominated in foreign currencies. Of the foreign currency-denominated loans, 40.9 percent are in Japanese yen and the balance in US dollars. Thus, any weakening of the peso against the US dollar or Japanese yen will increase both the principal amount of Piltel's foreign currency-denominated debts, and interest expense in peso terms. In addition, many of Piltel's financial ratios and other financial tests will be negatively affected. If, among other things, the value of the peso against the US dollar or the Japanese yen drops from its current level, Piltel may be unable to maintain compliance with these ratios. For further information on Piltel's loan covenants. (see Note 16 – Interest-bearing Financial liabilities of the notes to consolidated financial statements.)

Credit Risk

Piltel trades only with recognized, creditworthy third parties. It is Piltel's 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 ongoing basis with the result that Piltel's exposure to bad debts is not significant.

There is no significant concentration of credit risk within Piltel as Piltel's main business is prepaid GSM service.

With respect to credit risk arising from other financial assets, which comprise cash and cash equivalents, the exposure to credit risk arises from default of the counterparty, with a maximum exposure to the carrying amount of these instruments.

Liquidity Risk
Piltel's current liabilities as of March 31, 2006 are made up of the current portion of interest-bearing financial liabilities of ₱207.7 million, which is less than two percent of its long-term liabilities of ₱17,126.4 million, accrued expenses and trade liabilities with 30-day to 60-day payment terms.

On the other hand, the biggest components of Piltel's current assets are receivable from affiliates and receivable from dealers with credit terms of less than one month. Moreover, Piltel still has available LOS from PLDT of US$50.2 million as of March 31, 2006 to cover any funding shortfall. (Note 16 – Interest-bearing Financial liabilities of the notes to consolidated financial statements.)

Commodity Price Risk
This risk is not applicable to Piltel.

Related Party Transactions

In the ordinary course of business, Piltel has transactions with Smart, PLDT and other related parties. Description of major transactions follows:

Agreements Between Piltel and Smart

a. In December 2004, Piltel entered into an Omnibus Service Agreement (OSA) with Smart to cover in one agreement all the services, which are subject of the existing service agreements between the two companies and define a single revenue sharing arrangement for the year 2004. The OSA provides that Piltel's net revenues will be shared between Piltel and Smart at the rate of 80/20, in favor of Piltel, effective January 1, 2004 up to December 31, 2004. Similar to the provision in the original Facilities Service Agreement (FSA), Piltel's net revenues will consist of: (1) actual usage of the network of Smart by Talk 'N Text subscribers and any unused peso value of expired cards or electronic airtime loads, net of value-added tax and content provider costs in relation to VAS; and (2) revenues from incoming calls and messages to Talk 'N Text subscribers, net of interconnection expenses.

   Under the OSA, Piltel and Smart have also agreed that they will, from time to time, discuss the possible allocation of capital expenditure obligation, which may arise as a result of the provision of the GSM services. As of March 31, 2006, the carrying value of GSM network assets purchased by Piltel under the OSA amounted to ₱1,603.3 million.

   The OSA supersedes the following service agreements between Piltel and Smart:

   1) FSA dated July 14, 2000 for Piltel's use of Smart's existing GSM network and facilities under which Piltel and Smart have a revenue sharing arrangement at the rate of 50/50 applied to Piltel's GSM net revenues.

   2) Facilities Management Agreement (FMA) dated November 13, 2000, the Addendum to FMA dated May 25, 2001, and the Second Addendum Agreement to the FMA in November 2003 under which Smart has undertaken the management, operations and maintenance of Piltel's cellular mobile telephone system, for which services Piltel pays Smart a monthly management fee;

3) Customer Service Agreement (CSA) dated November 13, 2000 and the Addendum to CSA dated May 24, 2001 under which Smart has undertaken the management of Piltel's CMTS customer service operations, for which services Piltel likewise pays Smart monthly management fees; and

4) Administrative Support and Management Services Agreements (ASMSA) dated November 13, 2000 and the Amendment Agreement to the ASMSA dated March 3, 2003 under which Smart provides administrative support and services in certain aspects of Piltel's CMTS business operations, for which services Piltel likewise pays Smart monthly management fees.

The change in revenue sharing arrangement between Piltel and Smart, and the elimination of the management fees payable by Piltel to Smart resulted from a review done by an external professional telecommunications consultant engaged by both companies. The OSA covers the provision of all the services under the previous arrangements, in consideration of a revenue sharing arrangement of 80-20 in favor of Piltel, a ratio which allows Smart to largely recover its costs while providing Smart and Piltel with a more equitable revenue sharing arrangement in the context of the latter's increased subscriber base, the resulting economies of scale, as well as declining network and operating costs per subscriber derived from improvements in productivity and technology.

Piltel entered into an Amendment to the OSA with Smart also in December 2004. The amendment covers the period effective January 1, 2005 and onwards, and seeks to amend the revenue sharing arrangement between the two companies for the said extended period. Both parties agreed that the 80/20 rate provided in the OSA will be adjusted upwards if Piltel meets the gross annual GSM subscriber revenue targets set for a given year.

Smart's share in Piltel's GSM net revenues as of March 31, 2006 and March 31, 2005 under the OSA amounted to ₱665.2 million and ₱652.8 million, respectively.

Also in December 2004, Piltel entered into a Memorandum of Agreement (MOA) with Smart to amend the revenue sharing arrangement and the management fees paid by Piltel to Smart. Under the MOA, Smart will compensate Piltel with the amount of ₱3,707.3 million as a result of Piltel's having achieved a critical mass of subscribers and the resultant economies of scale arising from this achievement, which will be offset against service fees to be paid by Piltel to Smart under the OSA.

In May 2005, Piltel entered into a MOA with Smart, under which both parties agree to pay the other monthly interest charge on net liability based on the 91-day treasury bill rate plus one percent. Interest income on Piltel's net receivable from Smart amounted to ₱272.0 million for the period ended March 31, 2006. The MOA is effective from January 1, 2005.

Outstanding net receivable from Smart arising from these agreements amounted to ₱17,466.9 million and ₱18,155.1 million as of March 31, 2006 and December 31, 2005, respectively. In a MOA dated June 20, 2005, Piltel and Smart agreed to defer the settlement of the outstanding balance as of December 31, 2004 to a date not earlier than December 31, 2006.

b. In February 2000, Piltel entered into a MOA with Smart, under which the parties agreed to cooperate in the establishment of their respective base transceiver stations (BTS) whereby one party can co-locate its BTS on the existing BTS site of the other party subject to certain terms and conditions. Under said agreement, the monthly fee for co-location for each BTS site is ₱45,000, subject to an annual increase of 10 percent. This agreement is renewable every year unless terminated by either party.

In December 2003, Piltel entered into a MOA with Smart whereby Smart advanced the payment for the co-location fees for the period January 1, 2004 up to December 31, 2008. Total advance payment amounted to ₱782.9 million.

In December 2004, Smart paid additional co-location fees for the period January 1, 2004 up to December 31, 2008 amounting to ₱1,227.5 million as a result of a review made by an external professional telecommunications consultant of the existing financial agreements regarding the co-location fees for the use by Smart of Piltel's transmission facilities.

Co-location income under this agreement amounted to ₱100.5 million and ₱101.8 million as of March 31, 2006 and 2005. As of March 31, 2006, the unamortized balance of the unearned co-location fees was ₱1,105.8 million.

c. In November 2001, Piltel entered into a Billing Service Agreement with Smart for the printing and delivery of the billing statements of Piltel's LEC subscribers. Under the agreement, Piltel agrees to pay Smart an average of ₱4.60 per bill printed and an average of ₱5.40 per bill delivered. Total fees under this agreement amounted to ₱1.4 million and ₱1.3 million for the three months ended March 31, 2006 and 2005, respectively.

Agreement Between Piltel and PLDT

On July 19, 2001, Piltel entered into a FMA with PLDT under which PLDT undertakes the management, operation and maintenance of Piltel's regional telecommunication and E.O. 109 network operations and services, including E.O. 109 fixed line build out installations, public calling offices, and payphone facilities and the systems required to support these services.

The agreement covers Piltel's RTS in Baguio, Puerto Princesa, Masbate, and Boac and E.O. 109 service in Alabel, Banga, Dapitan, Davao, Digos, Dipolog, General Santos, Kiamba, Koronadal, Pagadian, Polomolok and Surallah.

Under the agreement, PLDT also undertakes the management of the computer system, billing, revenue assurance and inter-carrier settlements reporting of Piltel's regional telecommunication service in Olongapo and Subic.

The monthly management fee payable by Piltel is based on cost, and for cost components where margin is allowed, 15 percent will be applied. All third party invoices will be passed on to Piltel at cost, including value-added tax.

The agreement, effective for three years until July 2004, was extended for six months until October 20, 2004 on July 28, 2004. The agreement shall be automatically renewed at the end of every renewal quarter for another three-month period under the same terms and conditions.

Total management fees under these agreements amounted to ₱15.7 million and ₱13.1 million as of March 31, 2006 and 2005, respectively.

Agreement Between Piltel and Subictel

On September 5, 2001, Piltel and SubicTel, a subsidiary of PLDT, entered into a FMA of the regional telephone network, customer operations, network operations and payphones of Piltel in Subic and Olongapo City. The monthly management fee payable by Piltel is based on cost, and for cost components where margin is allowed, 15 percent will be applied. In addition, Piltel will pay a monthly variable cost per account in the amount of ₱44.00 for repairs and maintenance and ₱6.00 for bill delivery from an exchange to a subscriber. Total management fees under this agreement amounted to ₱5.3 million and ₱5.2 million as of March 31, 2006 and 2005, respectively. The agreement, effective for three years until July 2004, was extended for six months until October 2, 2004 on July 28, 2004. The agreement shall be automatically renewed at the end of every renewal quarter for another three-month period under the same terms and conditions.

PART II - OTHER INFORMATION

Recent Developments

Aside from the items discussed in the preceding sections, no material change or event transpired from December 31, 2005, the end of the last fiscal year to date, which would affect the financial condition or results of operations of Piltel.

ANNEX A

Glossary of Terms

In this document, unless the context otherwise requires, the following words and expressions shall have the following meanings:

AMPS	Advanced Mobile Phone System
ARPU	Average Revenue Per User
BTS	Base Transceiver Station
CDMA	Code Digital Multiple Access
D-AMPS	Digital-Advanced Mobile Phone System
DOJ	Department of Justice
DOTC	Department of Transportation and Communication
EBIT	Earnings Before Interest and Taxes
E.O.109	Executive Order 109
GMA	Greater Manila Area
GSM	Global System for Mobile Communications
IAS	International Accounting Standard
IGF	International Gateway Facility
LEC	Local Exchange Carrier
LOS	Letter of Support
MCIT	Minimum Corporate Income Tax
MTPO	Municipal Telephone Public Office
N-AMPS	Narrow-Advanced Mobile Phone System
NOLCO	Net Operating Loss Carryover
NTC	National Telecommunications Commission
PCO	Public Call Office
Piltel	Pilipino Telephone Corporation
PLDT	Philippine Long Distance Telephone Company
PLDT CPS	Convertible Preferred Stock of PLDT
PSE	Philippine Stock Exchange
RCIT	Regular Corporate Income Tax
RTS	Regional Telephone Service
Series J Stock	Piltel Class I Series J Preferred Stock
Series K Stock	Piltel Class I Series K Preferred Stock
SIM	Subscriber Identity Module
Smart	Smart Communications, Inc.
SMS	Short Messaging Service
SRF	Supervision and Regulatory Fees
Subictel	Subic Telecommunications Company, Inc.
VAS	Value-Added Service

ANNEX B

RATES AND TARIFFS

Talk 'N Text

Piltel holds promotions with varying rates for calls and SMS/VAS. These promotions and the corresponding rates are discussed in the section on revenues. The rates for regular call and SMS/VAS follow:

<u>*Call Rates*</u>

Beginning January 2004, *Talk 'N Text* subscribers pay the following airtime rates per minute:

Talk 'N Text-to-*Talk 'N Text* subscribers	₱5.50
Talk 'N Text-to-Other Mobile Operators and Fixed Lines	6.50
NDD	6.50

<u>*SMS/VAS Rates*</u>

Charge for point-to-point SMS for *Talk 'N Text* subscribers is ₱1.00 per message, and charges for SMS-based VAS are as follows:

- ₱15.00 per international text;
- ₱2.50 per SMS for e-text and information-on-demand services (such as news, stock and entertainment updates);
- ₱15.00 per download of ring tones, logos, picture messages and MMS wallpapers;
- ₱2.50 per *Mobile Banking* and *Smart Money* transaction (such as balance inquiry and funds transfer);
- ₱30 and ₱45 per ringtune depending on property rights; and
- ₱30 per videoke download.

Pasa Load comes in denominations of ₱2, ₱5, ₱10 and ₱15, all carrying a one-day load expiry. *Talk 'N Text* subscribers who reload other *Talk 'N Text* or Smart subscribers via *Pasa Load* are charged ₱1.

Like all prepaid accounts, accounts using *Talk 'N Text Load* and *Pasa Load* will be disconnected if the subscriber does not reload within four months after full usage or expiry of the last reload.

SIGNATORIES

Pursuant to the requirements of the Securities Regulation Code, Pilipino Telephone Corporation has duly caused this report to be signed on its behalf by the following persons in their capacities stated below in the City of Makati on May 9, 2006.

PILIPINO TELEPHONE CORPORATION

By:

NAPOLEON L. NAZARENO
President & CEO

AILEEN M. MALTO
Controller

PILIPINO TELEPHONE CORPORATION
AND SUBSIDIARIES
(A Subsidiary of Smart Communications, Inc.)

Unaudited Consolidated Financial Statements
March 31, 2006 and December 31, 2005
And For The Three Months Ended
March 31, 2006 and 2005

PILIPINO TELEPHONE CORPORATION AND SUBSIDIARIES
(A Subsidiary of Smart Communications, Inc.)

CONSOLIDATED BALANCE SHEETS
AS OF MARCH 31, 2006 AND DECEMBER 31, 2005
(In Million Pesos, Except Par Value Per Share Amounts)

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
ASSETS		
Noncurrent Assets		
Property, plant and equipment - net (Notes 3, 8, 16 and 18)	**3,504.5**	3,601.8
Investment properties (Notes 3 and 9)	**693.2**	693.2
Long-term receivable from Smart (Note 18)	**10,355.8**	10,355.8
Deferred income tax assets (Notes 3 and 6)	**1,485.4**	2,000.6
Investments and refundable deposits (Note 10)	**77.9**	77.9
Total Noncurrent Assets	**16,116.8**	16,729.3
Current Assets		
Cash and cash equivalents (Notes 3, 11 and 21)	**3,330.9**	344.3
Trade and other receivables - net (Notes 3, 12 and 18)	**7,145.2**	7,735.1
Inventories - at net realizable value (Note 13)	**115.8**	142.9
Prepayments (Note 14)	**339.4**	282.4
Total Current Assets	**10,931.3**	8,504.7
	27,048.1	25,234.0
STOCKHOLDERS' EQUITY AND LIABILITIES		
Stockholders' Equity (Notes 15 and 16)		
Preferred stock, Class I, ₱2 par value, authorized 120,000,000 shares; issued and outstanding 12,145,363 shares; Class II, ₱1 par value, authorized 500,000,000 shares; no shares issued and outstanding	**24.3**	24.3
Common stock, ₱1 par value, authorized 12,060,000,000 shares; issued and outstanding 11,771,748,431 shares	**11,771.7**	11,771.7
Additional paid-in capital	**25,051.1**	25,051.1
Deficit	**(30,075.4)**	(32,320.0)
Cost of treasury stock held	**(36.0)**	(36.0)
Stockholders' Equity	**6,735.7**	4,491.1
Noncurrent Liabilities		
Unearned revenue on co-location - net of current portion (Note 18)	**703.7**	804.2
Interest-bearing financial liabilities - net of current portion (Notes 15, 16, 19 and 21)	**17,126.4**	17,432.8
Total Noncurrent Liabilities	**17,830.1**	18,237.0
Current Liabilities		
Trade and other payables (Notes 3, 16, 17, 18 and 19)	**1,540.9**	1,491.8
Income tax payable (Note 6)	**249.8**	219.1
Current portion of unearned revenue on co-location (Note 18)	**402.1**	402.1
Unearned revenue on sale of prepaid cards	**81.8**	155.8
Current portion of interest-bearing financial liabilities (Notes 15, 16, 19 and 21)	**207.7**	237.1
Total Current Liabilities	**2,482.3**	2,505.9
	27,048.1	25,234.0

See accompanying Notes to Consolidated Financial Statements.

PILIPINO TELEPHONE CORPORATION AND SUBSIDIARIES
(A Subsidiary of Smart Communications, Inc.)

UNAUDITED CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005
(In Million Pesos, Except Per Share Amounts)

	2006	2005
REVENUES		
Service revenues (Note 18)	**2,694.4**	2,578.6
Sale of handsets and SIM packs	**117.2**	151.0
Other income (Notes 18 and 19)	**107.7**	105.5
	2,919.3	2,835.1
EXPENSES		
Cost of handsets and SIM packs sold	**137.8**	323.1
Selling and promotions	**125.4**	174.1
Depreciation and amortization (Note 8)	**123.6**	80.2
Maintenance	**42.9**	17.2
Taxes and licenses	**33.0**	68.6
Professional and other service fees (Note 18)	**19.2**	19.4
Provisions (Note 5)	**7.1**	16.9
Rent	**4.7**	6.0
Insurance and security services	**1.7**	0.4
Financing gain (Notes 5 and 20)	**(381.2)**	(350.2)
Other expenses	**14.6**	29.0
	128.8	384.7
INCOME BEFORE INCOME TAX	**2,790.5**	2,450.4
PROVISION FOR INCOME TAX (Note 6)	**545.9**	269.1
NET INCOME (Note 7)	**2,244.6**	2,181.3
Earnings Per Common Share (Note 7)		
Basic	**0.1813**	0.1759
Diluted	**0.1803**	0.1750

See accompanying Notes to Consolidated Financial Statements.

PILIPINO TELEPHONE CORPORATION AND SUBSIDIARIES
(A Subsidiary of Smart Communications, Inc.)

UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (CAPITAL DEFICIENCY)
FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005
(In Million Pesos)

	Preferred Stock Class I	Common Stock	Additional Paid-in Capital	Deficit	Treasury Stock	Total
Balances at December 31, 2004	24.3	11,771.7	25,051.1	(45,778.7)	(36.0)	(8,967.6)
Net income for the period	–	–	–	2,181.3	–	2,181.3
Balances at March 31, 2005	24.3	11,771.7	25,051.1	(43,597.4)	(36.0)	(6,786.3)
Balances at December 31, 2005	24.3	11,771.7	25,051.1	(32,320.0)	(36.0)	4,491.1
Net income for the period	–	–	–	2,244.6	–	2,244.6
Balances at March 31, 2006	24.3	11,771.7	25,051.1	(30,075.4)	(36.0)	6,735.7

See accompanying Notes to Consolidated Financial Statements.

PILIPINO TELEPHONE CORPORATION AND SUBSIDIARIES
(A Subsidiary of Smart Communications, Inc.)

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005
(In Million Pesos)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before income tax	**2,790.5**	2,450.4
Adjustments:		
Interest expense (Note 5)	**244.9**	228.1
Amortization of debt discount (Note 5)	**162.3**	166.6
Foreign exchange gains (Note 5)	**(500.4)**	(741.9)
Depreciation and amortization (Note 8)	**123.6**	80.2
Provisions (Note 5)	**7.1**	16.9
Loss (gain) on sale of property, plant and equipment	**(0.4)**	2.6
Interest income (Note 5)	**(288.0)**	(3.0)
Operating income before working capital changes	**2,539.6**	2,199.9
Decrease (increase) in:		
Trade and other receivables	**772.2**	(1,586.5)
Inventories	**19.9**	16.6
Prepayments	**(56.9)**	(313.1)
Decrease in:		
Trade and other payables	**(66.1)**	(312.1)
Unearned revenue on sale of prepaid cards	**(74.0)**	(24.1)
Net cash provided by (used in) operating activities	**3,134.7**	(19.3)
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to property, plant and equipment	**(26.3)**	(514.0)
Proceeds from sale of property, plant and equipment	**0.3**	2.2
Interest received	**5.3**	3.2
Decrease (increase) in investments and refundable deposits	–	0.4
Net cash used in investing activities	**(20.7)**	(508.2)
CASH FLOWS FROM FINANCING ACTIVITIES		
Interest paid	**(129.7)**	(144.9)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**2.3**	(5.5)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**2,986.6**	(677.9)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	**344.3**	723.4
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**3,330.9**	45.5

See accompanying Notes to Consolidated Financial Statements.

PILIPINO TELEPHONE CORPORATION AND SUBSIDIARIES
(A Subsidiary of Smart Communications, Inc.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Corporate Information

Pilipino Telephone Corporation (Piltel) is the third largest cellular mobile telephone service (CMTS) provider in the Philippines as measured by the number of subscribers. Piltel also provides fixed line telephone services.

Piltel was incorporated in the Philippines with limited liability on July 18, 1968, and listed on the Philippine Stock Exchange (PSE) in July 1995. Until 1991, Piltel's sole business was providing fixed line telecommunications services in eight cities and municipalities in the Philippines. Since 1991, Piltel also operated cellular telephone services using various technologies ranging from the analog AMPS technology to the digital CDMA technology. These services were substantially closed down in 2002. In April 2000, Piltel launched a digital prepaid cellular service, under the *Talk 'N Text* brand, using the GSM platform of Smart Communications, Inc. (Smart), which has since become the main component of its business.

Piltel operates under the jurisdiction of the Philippine National Telecommunications Commission (NTC) and the Subic Bay Metropolitan Authority (SBMA) for the Subic and Olongapo exchanges, which jurisdiction extends, among other things, to approving major services offered, including the rates charged by Piltel to its subscribers.

Piltel is 92.1 percent-owned by Smart as of March 31, 2006.

As a result of outsourcing fully its activities to the Philippine Long Distance Telephone Company (PLDT) Group (Note 18), Piltel has no employees as of March 31, 2006.

Piltel's registered office address is at 25th Floor, SMART Tower, 6799 Ayala Avenue, Makati City.

The accompanying consolidated financial statements were reviewed by and authorized for issuance by the Board of Directors on May 9, 2006.

2. Status of Operations

From 1997 until 2003, Piltel had incurred significant losses, which affected its ability to service its maturing obligations on a timely basis. Piltel entered into discussions with its creditors to determine options to resolve its financial situation.

In 2001, Piltel completed the restructuring of approximately ₱41.1 billion of indebtedness and other claims. By 2003, about ₱0.9 billion more of claims were restructured. Since the restructuring, Piltel met its interest payments and principal repayment obligations on its financial indebtedness on a timely basis. As of March 31, 2006, only convertible bonds of US$0.9 million (₱47.2 million) have not been restructured.

To sustain its recovery efforts and attain long-term stability, Piltel adopted a marketing strategy in response to the market demands for value-based services. In April 2000, Piltel began offering prepaid GSM cellular services under a Facilities Service Agreement (FSA) (Note 18) with Smart. The FSA was superseded by the Omnibus Service Agreement in 2004, which changed the revenue sharing between Piltel and Smart from 50/50 to 80/20 in favor of Piltel. Piltel is now the country's third largest GSM service provider in terms of subscriber base. Piltel continually implements marketing programs to sustain subscriber interest in its products, the sales of which are not materially affected by seasonality or cyclicality.

From 2004 to present Piltel posted net income, resulting to a stockholders' equity of ₱6,735.7 million as of March 31, 2006.

Piltel's results of future operations are dependent upon its ability to generate sufficient cash flows to meet its maturing obligations on a timely basis and to comply with the provisions of the financing agreements (Note 16).

3. Summary of Significant Accounting Policies

Basis of Preparation

Piltel's unaudited consolidated financial statements were presented in conformity with the provisions of Philippine Accounting Standard or PAS 34, Interim Financial Reporting.

Piltel's unaudited consolidated financial statements have been prepared based on historical cost convention as modified by the revaluation of financial instruments and the investment properties that have been measured at fair value.

The unaudited consolidated financial statements of Piltel include, in the opinion of management, all adjustments consisting of normal recurring adjustments, necessary to present fairly the results of operations for the interim periods. The results of operations for the three months ended March 31, 2006 are not necessarily indicative of the results of operations that may be expected for the full year.

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

Statement of Compliance

Piltel applied the accounting principles set forth below to all the periods presented. Piltel's unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the Philippines as set forth in Philippine Financial Reporting Standards, or PFRSs.

Basis of Consolidation

The unaudited consolidated financial statements include the accounts of Piltel and the following wholly owned subsidiaries (collectively known as "the Company"):

Name of Subsidiary	**Place of Incorporation**	**Principal Activity**
Telecommunication Service Providers, Inc. (Telserv)	Philippines	Operator services
Piltel International Holdings Corporation (PIHC)	British Virgin Islands	Issuance of bonds convertible into common shares of Piltel
Piltel (Cayman) Ltd.	Cayman Islands	Bring into the debt restructuring plan holders of Piltel's convertible bonds

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

Consolidated financial statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances. Material intercompany balances and transactions are eliminated in the consolidation.

Foreign Currency Translations

The functional and presentation currency of Piltel is the Philippine peso. Transactions in foreign currencies are initially recorded in the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the consolidated statements of income, except for foreign exchange losses that qualified as capitalizable borrowing costs during construction period. For income tax purposes, exchange gains or losses are treated as taxable income or deductible expenses in the period such are realized.

Financial statements of consolidated foreign subsidiaries that are integral to the operations of Piltel are translated as if the transactions of the foreign operations had been those of Piltel. At each balance sheet date, foreign currency monetary items are translated using the closing rate, nonmonetary items which are carried at historical cost are translated using the historical rate as of the date of the acquisition and nonmonetary items which are carried at fair value are translated using the exchange rate that existed when the values were determined. Income and expense items are translated at the exchange rates on the dates of the transactions. Resulting exchange differences are recognized in the consolidated statements of income.

Property, Plant and Equipment

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

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

Depreciation and amortization are calculated using the straight-line method over the estimated useful lives of the assets.

The useful lives, residual values and depreciation and amortization method are reviewed periodically 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 and other direct costs. Property under construction is not depreciated until such time that the relevant assets are completed and put into operational 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 activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the assets are ready for their intended use. If the resulting carrying amount of the asset exceeds its recoverable amount, an impairment loss is recognized. Borrowing costs include interest charges and other costs incurred in connection with borrowing of funds, as well as exchange differences arising from foreign currency borrowings used to finance these projects to the extent that they are regarded as an adjustment to interest cost.

All other borrowing costs are generally expensed as incurred.

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

Installation Materials, Parts, and Supplies

Installation materials, parts and supplies are stated at cost less any impairment in value. Cost is determined based on weighted average cost. These are classified in the consolidated balance sheets as part of property, plant and equipment.

Asset Retirement Obligation

The net present value of legal and constructive obligations associated with the retirement of an item of property, plant and equipment that resulted from the acquisition, construction or development and the normal operation of property, plant and equipment is recognized in the period in which it is incurred.

Investment Properties

Initially, investment properties are measured at cost including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met; and excludes the costs of day to day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the balance sheet date. Gains or losses arising from changes in the fair values of investment properties are included in the consolidated statement of income in the year in which they arise.

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

Asset Impairment

Property, plant and equipment, investments and other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognized in the consolidated statements of income. The recoverable amount is the higher of the asset's net selling price or value in use. The net selling price is the amount obtainable from the sale of an asset in an arm's-length transaction while value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset or from its disposal at the end of its useful life. Recoverable amounts are estimated for individual assets or, if it is not possible, for the cash-generating unit to which the asset belongs. Reversal of impairment losses recognized in prior years is recorded when there is an indication that the impairment losses recognized for the asset no longer exist or have decreased. The reversal is recorded as income. However, the increased carrying amount of an asset due to a reversal of an impairment loss is recognized to the extent it does not exceed the carrying amount that would have been determined had the impairment loss not been recognized for that asset in prior years, net of depreciation.

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 and with original maturities of three months or less from date of acquisition and that are subject to an insignificant risk of change in value.

Receivables

Receivables are stated at face value, net of allowance for doubtful accounts.

Allowance for Doubtful Accounts

Allowance for doubtful accounts is maintained at a level considered adequate to provide for potentially uncollectible receivables. The level of allowance is evaluated by management based on past collection experience and other factors that may affect the collectibility of the individual accounts. A review of the receivables, designed to identify accounts to be provided with allowance, is made on a regular basis. Bad debts are written off when identified.

Inventories
Inventories consisting of terminal units and accessories are stated at the lower of cost or net realizable value. Cost is determined using weighted average cost method. Net realizable value is the current replacement cost.

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

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

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

Financial Assets and Liabilities
Piltel recognizes a financial asset or a financial liability in its consolidated balance sheets when it becomes a party to the contractual provisions of the instrument and derecognizes a financial asset when it no longer controls the contractual rights to the cash flows that comprise the financial instrument which is normally the case when the instrument is sold, or all the cash flows attributable to the instrument have already expired or are passed through to an independent third party. A financial liability (or a part of a financial liability) is derecognized when the financial obligation is extinguished. In the case of a regular way purchase or sale of financial assets, recognition and derecognition, as applicable, are done using settlement date accounting.

Transaction costs are included in the initial measurement of all financial assets and liabilities, except for financial instruments measured at fair value through profit and loss. Fair value is determined by reference to the transaction price or other market prices. If such market prices are not reliably determinable, the fair value of the consideration is estimated as the sum of all future cash payments or receipts, discounted using the prevailing market rates of interest for similar instruments with similar maturities.

After initial recognition, the following financial assets and liabilities are measured at amortized cost using the effective interest rate method: (a) loans and receivables; (b) held-to-maturity investments; and (c) financial liabilities other than liabilities measured at fair values through profit and loss.

Amortizations of discounts and premiums are taken directly to net profit or loss for the year. Changes in the fair value of financial assets and liabilities measured at fair value of (a) all derivatives (except for those eligible for hedge accounting); (b) other items intended to be actively traded; and (c) any item designated as held "at fair value through profit and loss" at origination, are taken directly to net profit or loss for the year. Changes in the fair value of available-for-sale securities are recognized in equity, except for the foreign exchange fluctuations on available-for-sale debt securities and the interest component which is taken directly to net profit or loss for the year based on the asset's effective yield.

Financial assets and liabilities include financial instruments which may be a primary instrument, such as receivables, payables and equity securities, or a derivative instrument, such as financial options, futures and forwards, interest rate swaps and currency swaps.

Financial instruments are classified as a financial liability, or a financial asset or an equity in accordance with the substance of the contractual arrangement. Financial instruments that contain both liability and equity elements are classified separately as financial liabilities, financial assets or equity instruments. Interest, dividends, gains and losses relating to a financial instrument or a component that is a financial liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity net of any related income tax benefits. Financial instruments are offset when Piltel has a legally enforceable right to offset and Piltel intends to settle either on a net basis or to realize the asset and settle the liability simultaneously.

Provisions

Provisions are recognized when Piltel has present obligations, legal or constructive, as a result of past events, if 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. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, 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 an additional provision. Where Piltel expects some or all of the provision to be reimbursed, the reimbursement is recognized.

Leases

Lease obligations having provisions for bargain purchase options, ownership transfer at the end of the lease term, or the present value of minimum lease payments, which approximate the fair market value of the property are capitalized. Any initial direct cost of the lessee is added to the amount capitalized. The related obligations are recognized as liabilities. Finance lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

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

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased assets and liabilities and recognized over the lease term on the same basis as the lease income. Operating lease payments are recognized as expense in the consolidated statements of income on a straight-line basis over the lease term. For income tax reporting purposes, expenses that should have been incurred under lease agreements are considered as deductible expenses.

Revenue Recognition

Revenues for all telecommunications services provided, including prepaid and electronic load related to GSM services, are recorded under the accrual basis, excluding value added tax and net of the related share in telecommunications administration costs under existing interconnection agreements. In addition, revenues related to GSM services are net of the share of Smart pursuant to the Omnibus Service Agreement (Note 18a).

Service Revenues

Subscriptions

Piltel provides telephone communication services under postpaid payment arrangements to its fixed line subscribers. Revenues, including fees for installation and activation, are accrued upon subscription.

Air time, traffic and value-added services

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

Non-service Revenues

Sales of handsets and SIM packs are recorded net of handset discounts and commissions. The cost of handsets and SIM packs sold is shown as cost of sales in the consolidated statements of income.

Other Income

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

Income Tax

Current Tax

Current 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 as at the balance sheet date.

Deferred Tax

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

Deferred income tax liabilities are recognized for all taxable temporary differences. Deferred income tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits from excess minimum corporate income tax, or MCIT, and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carryforward of unused tax credits and unused tax losses can be utilized. Deferred income tax, however, is not recognized when it 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.

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

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

Income tax relating to items recognized directly in equity is recognized in equity and not in the consolidated statement of income.

Earnings Per Share (EPS)

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

Diluted EPS is calculated in the same manner assuming that, at the beginning of the period or at the time of issuance during the period, convertible preferred shares are converted to common shares and appropriate adjustments to the net income are effected for the related expenses and income on preferred shares.

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

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

Management's Use of Estimates and Judgment

Piltel's consolidated financial statements prepared in Philippine GAAP requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements and related notes. In preparing these consolidated financial statements, Piltel has made its best estimates and judgments of certain amounts, giving due consideration to materiality. Piltel believes the following represent a summary of these significant estimates and judgments and related impact and associated risks in its consolidated financial statements:

Estimating Useful Lives of Property, Plant and Equipment
The useful lives of property, plant and equipment are estimated based on the period over which the assets are expected to be available for use. The estimated useful lives of the property, plant and equipment are reviewed at least annually and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets. In addition, the estimation of the useful lives of the property, plant and equipment is based on a collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future results of operations could be materially affected by changes in estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of property, plant and equipment would increase the recorded operating expenses and decrease noncurrent assets (see Note 8).

The carrying value of property, plant and equipment as of March 31, 2006 and December 31, 2005 amounted to ₱3,504.5 million and ₱3,601.8 million, respectively (see Note 8).

Asset Impairment
Philippine GAAP requires that an impairment review be performed when certain impairment indicators are present.

Determining the value of property, plant and equipment and investments, which require the determination of future cash flows expected to be generated from the continued use and ultimate disposition of such assets, requires Piltel to make estimates and assumptions that can materially affect its consolidated financial statements. Future events could cause Piltel to conclude that property, plant and equipment, and investment are impaired. Any resulting impairment loss could have a material adverse impact on Piltel's financial condition and results of operations.

The preparation of the estimated future cash flows involves significant judgment and estimations. While Piltel believes that its assumptions are appropriate and reasonable, significant changes in these assumptions may materially affect Piltel's assessment of recoverable values and may lead to future additional impairment charges under Philippine GAAP.

Investment Properties
Piltel has adopted the fair value approach in determining the carrying value of its investment properties. While Piltel has opted to rely on independent appraisers to determine the fair value of its investment properties in land, such fair value was determined based on recent prices of similar properties, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices. The amounts and timing of recorded changes in fair value for any period would differ if Piltel made different judgments and estimates or utilized different basis for determining fair value.

Total investment properties as at March 31, 2006 and December 31, 2005 amounted to ₱693.2 million (see Note 9).

Deferred Tax Assets
Piltel reviews the carrying amounts at each balance sheet date and reduces deferred tax assets to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. However, there is no assurance that Piltel will generate sufficient taxable profit to allow all or part of its deferred tax assets to be utilized.

Unrecognized deferred tax assets as of March 31, 2006 and December 31, 2005 amounted to ₱5,149.1 million and ₱5,579.8 million, respectively (see Note 6).

Financial Assets and Liabilities
Philippine GAAP requires that Piltel carry certain of its financial assets and liabilities at fair value, which requires extensive use of accounting estimates and judgment. In addition, certain liabilities acquired through debt restructuring are required to be carried at fair value at the time of the restructuring. While significant components of fair value measurement were determined using verifiable objective evidence (i.e. foreign exchange rates, interest rates, volatility rates), the amount of changes in fair value would differ if Piltel utilized different valuation methodology. Any changes in fair value of these financial assets and liabilities would affect directly Piltel's profit and loss and equity.

Financial assets and liabilities as of March 31, 2006 amounted to ₱20,831.9 million and ₱18,875.0 million, respectively. Financial assets and liabilities as of December 31, 2005 amounted to ₱18,671.7 million and ₱19,161.7 million, respectively (see Note 21).

Estimating Allowance for Doubtful Accounts
The allowance for doubtful accounts relating to trade receivables is estimated based on two methods. The amounts calculated using each of these methods are combined to determine the total amount reserved. First, specific accounts are evaluated based on information that certain customers may be unable to meet their financial obligations. In these cases, judgment is used, based on the best available facts and circumstances, including but not limited to, the length of relationship with the customer and the customer's current credit status based on third party credit reports and known market factors, to record specific reserves against amounts due to reduce receivable amounts expected to be collected. These specific reserves are re-evaluated and adjusted as additional information received impacts the amounts estimated. Second, a collective assessment of historical collection, write-off, experience and customer payment terms, is determined. Full allowance is provided for receivables from permanently disconnected subscribers and from customers with accounts more than 90 days old.

The amount and timing of recorded expenses for any period would therefore differ based on the judgments or estimates made. An increase in Piltel's allowance for doubtful accounts would increase its recorded operating expenses and decrease its current assets.

Trade and other receivables, net of allowance for doubtful accounts, amounted to ₱7,145.2 million and ₱7,735.1 million as of March 31, 2006 and December 31, 2005, respectively (see Note 12).

Revenue Recognition
Piltel's revenue recognition policies require it to make use of estimates and assumptions that may affect the reported amounts of its revenues and receivables.

Piltel's 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 Piltel. Initial recognition of revenues is based on Piltel's observed traffic adjusted by its normal experience adjustments, which historically are not material in Piltel's consolidated financial statements. Differences between the amounts initially recognized and actual settlements are taken up in the accounts upon reconciliation. However, there is no assurance that such use of estimates may not result to material adjustments in future periods.

Contingencies
Piltel is currently involved in various legal and administrative proceedings. Piltel's estimate of the probable costs for the resolution of these claims has been developed in consultation with its counsel handling the defense in these matters and is based upon an analysis of potential results. Piltel currently does not believe these proceedings will have a material adverse effect on the consolidated financial statements. It is possible, however, that future results of operations could be materially affected by changes in estimates or in the effectiveness of strategies relating to these proceedings (see Note 19).

Outstanding provisions to cover these contingencies amounted to ₱138.0 million and ₱113.9 million as of March 31, 2006 and December 31, 2005, respectively (see Note 19).

4. Segment Information

Piltel derives its revenues from the cellular and fixed line services. Most of the revenues are derived from the Philippines. The revenues derived outside the Philippines consist primarily of revenues from incoming international calls to the Philippines.

The segment assets and results of operations of Piltel's reportable segments as of March 31, 2006 and December 31, 2005 and for the months ended March 31, 2006 and 2005 reported under accounting principles generally accepted in the Philippines are as follows:

	Cellular	Fixed Line	Total
		(In Million Pesos)	
As of and for the Three Months ended March 31, 2006			
Revenues			
Service revenues	2,518.9	175.5	2,694.4
Sale of handsets and SIM packs	117.2	–	117.2
Other income	103.2	4.5	107.7
Total revenues	2,739.3	180.0	2,919.3
Results			
Segment income before income tax	2,709.9	80.6	2,790.5
Other segment information			
Segment depreciation and amortization	80.3	43.3	123.6
Segment provisions	7.2	(0.1)	7.1

	Cellular	Fixed Line	Total
		(In Million Pesos)	
Assets			
Segment assets	19,891.2	1,701.9	21,593.1
Unallocated corporate assets			5,455.0
Total assets			27,048.1
For the Three Months ended March 31, 2005			
Revenues			
Service revenues	2,379.3	199.3	2,578.6
Sale of handsets and SIM packs	151.0	–	151.0
Other income	105.1	0.4	105.5
Total revenues	2,635.4	199.7	2,835.1
Results			
Segment income before income tax	2,324.9	125.5	2,450.4
Other segment information			
Segment depreciation and amortization	46.2	34.0	80.2
Segment provisions	16.9	–	16.9
As of December 31, 2005			
Assets			
Segment assets	20,613.8	1,698.6	22,312.4
Unallocated corporate assets			2,921.6
Total assets			25,234.0

5. **Revenues and Expenses**

Financing gain consist of:

	As of March 31,	
	2006	2005
	(In Million Pesos)	
Interest expense	**244.9**	228.1
Amortization of debt discount	**162.3**	166.6
Interest income	**(288.0)**	(3.0)
Foreign exchange gain (see Note 20)	**(500.4)**	(741.9)
	(381.2)	(350.2)

Provisions pertain to:

	As of March 31,	
	2006	2005
	(In Million Pesos)	
Write-down of inventories to net realizable value	**7.2**	16.9
Doubtful accounts	**(0.1)**	–
	7.1	16.9

6. **Income Taxes**

The components of Piltel's net deferred income tax assets recognized in the consolidated balance sheets are as follows:

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
	(In Million Pesos)	
Deferred income tax assets on:		
Unrealized foreign exchange losses	**1,337.3**	1,556.9
Asset impairment	**1,317.2**	1,372.9
Unearned revenues on co-location charges	**387.0**	422.2
Allowance for doubtful accounts	**128.2**	–
Unearned revenues on sale of prepaid cards	**28.6**	54.6
Others	**(387.9)**	34.4
Deferred income tax liabilities on:		
Debt discount	**(1,284.0)**	(1,400.9)
Investment property	**(41.0)**	(39.5)
	1,485.4	2,000.6

Piltel recognized most of its deferred tax assets except for certain assets which have been reduced to the extent that part or all of these assets may not be utilized mainly due to certain restrictions. Deferred tax assets which have not been recognized in the consolidated balance sheets are as follows:

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
	(In Million Pesos)	
Asset impairment	**5,144.4**	5,144.4
NOLCO	**4.7**	4.6
Allowance for doubtful accounts	**–**	430.8
	5,149.1	5,579.8

Provision for income tax consists of:

	As of March 31,	
	2006	2005
	(In Million Pesos)	
Current	**30.7**	42.8
Deferred	**515.2**	226.3
	545.9	269.1

The reconciliation between the provision for income tax at the applicable statutory tax rate and the actual provision for income tax follows:

	As of March 31, 2006	2005
	(In Million Pesos)	
Provision for tax at statutory tax rate	**976.7**	784.1
Tax effects of:		
Net changes in unrecognized deferred income tax assets	**(430.7)**	(514.6)
Others	**(0.1)**	(0.4)
Actual provision for income tax	**545.9**	269.1

The deferred income tax assets and the provision for income tax include the effect of the change in income tax rates under Republic Act (RA) No. 9337 which took effect on November 1, 2005. RA 9337 provides that, starting November 1, 2005, the income tax rate on the taxable income of domestic corporations shall be 35 percent, provided that, effective January 1, 2009, the income tax rate shall be 30 percent. Prior to the effective date of RA 9337, income tax rate of domestic corporations is 32 percent.

As of March 31, 2006, Piltel has unutilized NOLCO as follows:

Year Incurred	Year Expiring	Amount
		(In Million Pesos)
2003	2006	2.5
2004	2007	1.2
2005	2008	9.3
		13.0
Tax benefit		4.6

7. Earnings Per Common Share

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

	As of March 31, 2006		2005	
	Basic	Diluted	Basic	Diluted
	(In Million Pesos Except Per Share Amounts)			
Net income of the parent company for the period	2,244.9	2,244.9	2,181.6	2,181.6
Dividends on preferred stock	(111.2)	(110.9)	(111.2)	(110.2)
Net income applicable to common stock	2,133.7	2,134.0	2,070.4	2,071.4
Common shares, beginning	11,771.7	11,771.7	11,771.7	11,771.7
Convertible preferred shares - Class I Series A, C & D	–	29.2	–	29.2
Unrestructured convertible bonds	–	35.3	–	37.8
Weighted average number of common shares	11,771.7	11,836.2	11,771.7	11,838.7
Earnings per common share	0.1813	0.1803	0.1759	0.1750

8. **Property, Plant and Equipment**

This account consists of:

	Land	Building and Improvements	Telecom-munications Equipment	Transportation Equipment, Furniture and Tools	Installation Materials, Parts and Supplies	Total
			(In Million Pesos)			
At December 31, 2005						
Cost	108.0	439.5	11,655.8	1,005.0	49.1	13,257.4
Accumulated depreciation and amortization	–	(236.1)	(2,766.2)	(1,000.4)	–	(4,002.7)
Accumulated impairment losses	–	–	(5,652.9)	–	–	(5,652.9)
Net book value	108.0	203.4	3,236.7	4.6	49.1	3,601.8
For the Period Ended March 31, 2006						
Opening net book value	108.0	203.4	3,236.7	4.6	49.1	3,601.8
Additions	–	1.3	61.7	0.6	1.7	65.3
Disposals/retirement:						
Cost	–	–	–	(0.9)	(39.0)	(39.9)
Accumulated depreciation and amortization	–	–	–	0.9	–	0.9
Depreciation and amortization	–	(3.2)	(119.8)	(0.6)	–	(123.6)
Net book value	108.0	201.5	3,178.6	4.6	11.8	3,504.5
At March 31, 2006						
Cost	108.0	440.8	11,717.5	1,004.7	11.8	13,282.8
Accumulated depreciation and amortization	–	(239.3)	(2,886.0)	(1,000.1)	–	(4,125.4)
Accumulated impairment losses	–	–	(5,652.9)	–	–	(5,652.9)
Net book value	108.0	201.5	3,178.6	4.6	11.8	3,504.5

Cellular Assets

Piltel has AMPS/CDMA assets with carrying value of ₱229.5 million as of March 31, 2006 (₱241.8 million as of December 31, 2005). Piltel also has GSM assets with carrying value of ₱1,603.3 million as of March 31, 2006 (₱1,651.6 million as of December 31, 2005). The GSM network assets were purchased in connection with the Omnibus Service Agreement between Piltel and Smart (see Note 18).

Fixed Line Assets

Piltel carries out annual impairment tests on its assets based on the net present value of future cash flows from the continued use of these assets. The tests resulted in impairment charges on Piltel's E.O. 109 fixed line network assets of ₱1,438.2 million and ₱4,214.7 million in 2003 and 2002, respectively. Impairment reviews carried out in December 2005 and 2004, however, showed that no further impairment charge is required since the net present value of future cash flows arising from the E.O. 109 fixed line business is greater than the net book value of the assets as of December 31, 2005 and 2004. Critical to the impairment review done in 2005 is the assumption that the E.O. 109 fixed line business would generate cash flows of about ₱78.0 million a year from 2006 until 2016, when bulk of the E.O. 109 assets would have been fully depreciated. The net book value of the remaining E.O. 109 fixed wireline assets amounted to ₱516.5 million as of March 31, 2006 (₱528.0 million as of December 31, 2005).

In addition to the E.O. 109 fixed line assets, Piltel also has Regional Telephone System (RTS) assets with a carrying value of ₱1,158.0 million as of March 31, 2006 and ₱1,183.2 million as of December 31, 2005. Piltel also carried out an impairment review of the RTS assets in December 2005 and is of the opinion that no impairment charge is required since the net present value of future cash flows from the RTS fixed line business is greater than the net book value of these assets as of December 31, 2005. Annual cash flows from the RTS assets is projected at ₱408.0 million from 2006 to 2012, when bulk of the RTS assets would have been fully depreciated.

The useful lives of the assets are estimated as follows:

Building and improvements	10 to 25 years
Telecommunications equipment	10 to 25 years
Transportation equipment, furniture and tools	5 years

9. Investment Properties

This account consists of:

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
	(In Million Pesos)	
Beginning balance	**693.2**	693.2
Net gain from fair value adjustment	**–**	–
Ending balance	**693.2**	693.2

Investment properties are stated at fair value, which has been determined based on valuations performed by a qualified independent appraiser in December 2005. The valuation undertaken was based on an open market value, supported by market evidence in which assets could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's length transaction at the date of valuation.

10. Investments and Refundable Deposits

This account consists of:

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
	(In Million Pesos)	
Investments in shares of stock:		
At cost:		
ACeS Philippines Cellular Satellite Corporation (ACeS)	**280.4**	280.4
Others	**20.0**	20.0
	300.4	300.4
Less allowance for impairment loss	**300.4**	300.4
	–	–
At equity	**0.1**	0.1
Total investments	**0.1**	0.1
Refundable deposits	**64.8**	64.8
Others	**13.0**	13.0
	77.9	77.9

11. Cash and Cash Equivalents

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

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
	(In Million Pesos)	
Cash on hand and in banks	**24.4**	16.3
Temporary investments	**3,306.5**	328.0
	3,330.9	344.3

12. Trade and Other Receivables

This account consists of:

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
	(In Million Pesos)	
Smart (Note 18)	**7,111.1**	7,799.3
Dealers	**159.4**	9.0
Customers	**32.5**	966.3
Others	**208.6**	191.3
	7,511.6	8,965.9
Allowance for doubtful accounts	**(366.4)**	(1,230.8)
	7,145.2	7,735.1

Long-outstanding receivables from AMPS/CDMA subscribers amounting to ₱864.4 million and ₱1,139.7 million were written-off in March 2006 and December 2005, respectively. The receivables, fully provided with valuation allowance, were certified as uncollectible by third party collection agents. The write-offs were approved by Piltel's Board of Directors on May 9, 2006 and January 31, 2006.

13. Inventories and Supplies

This account consists of:

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
	(In Million Pesos)	
Terminal and cellular phone units:		
At net realizable value	**108.8**	121.1
At cost	**128.1**	134.8
Spare parts and supplies:		
At net realizable value	**7.0**	21.8
At cost	**7.0**	21.8
	115.8	142.9

14. **Prepayments**

This account consists of:

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
	(In Million Pesos)	
Taxes withheld	**276.7**	213.1
Prepayments	**62.7**	69.3
	339.4	282.4

15. **Capital Stock**

Preferred stock and common stock consist of:

	March 31, 2006 (Unaudited)		December 31, 205 (Audited)	
	Shares	**Amount**	Shares	Amount
	(In Millions, Except Per Share Amounts)			
Preferred Stock				
Class I - 10% cumulative serial preferred stock - ₱2 par value				
Authorized	**120.0**		120.0	
Issued and outstanding				
Series A	**1.9**	**3.8**	1.9	3.8
Series C	**5.2**	**10.4**	5.2	10.4
Series D	**0.1**	**0.2**	0.1	0.2
Series J	**4.9**	**9.9**	4.9	9.9
	12.1	**24.3**	12.1	24.3
Class II - cumulative nonconvertible serial preferred stock - ₱1 par value				
Authorized	**500.0**		500.0	
Issued and outstanding				
Series A	**–**	**–**	–	–
Series B	**–**	**–**	–	–
	–	**–**	–	–
Common Stock - ₱1 par value				
Authorized	**12,060.0**		12,060.0	
Issued and outstanding	**11,771.7**	**11,771.7**	11,771.7	11,771.7
Treasury Stock	**2.0**	**36.0**	2.0	36.0

<u>Preferred Stock</u>
Piltel's preferred stock consists of Class I and Class II preferred shares. The preferred shares are redeemable and carry no voting rights apart from those specifically granted by law. Class

I preferred shares have preference over the common shares as to dividend and assets in the event of liquidation, dissolution or winding up. Class II Series A and B preferred shares, aggregating ₱450.0 million, were included in Piltel's debt restructuring.

There are currently four series of Class I preferred shares issued and outstanding, namely: Series A, Series C, Series D and Series J. The Class I preferred shares issued as Series A are entitled to an annual cash dividend of up to ₱124,600; those issued as Series C and Series D shares are entitled to a quarterly cash dividend of up to 10 percent per annum on the par value. Series J shares are entitled to annual cumulative dividends of ₱90.00 per share. Series A, C and D shares are convertible into common shares of Piltel.

As part of Piltel's drawings under the Letter of Support (LOS), PLDT subscribed to a total of 4,927,093 Series J preferred shares of Piltel at a subscription price of ₱1,000 per share comprising of 209,100 shares for ₱209.1 million in 2003, 362,100 shares for ₱362.1 million in 2002, 2,755,893 shares for ₱2,755.9 million in 2001 and 1,600,000 shares for ₱1,600.0 million in 2000.

Piltel may, beginning on the day following the earlier of (i) the fifteenth anniversary of the date of issue of the Series J preferred shares; or (ii) the full repayment of the restructured indebtedness of Piltel under the MRA, redeem all or a portion of the outstanding Series J preferred shares pro-rata, at issue value plus any accrued and unpaid dividends.

Piltel issued Series K Class I convertible preferred shares in exchange for the conversion of 50 percent of the restructured debt in June 2001 (see Note 16). On July 2, 2004, Smart entered into a Sale and Purchase Agreement with PLDT to acquire PLDT's 59.3 million shares of Series K Stock in Piltel (representing total outstanding shares of Series K Stock at that time) for ₱2,066 million. Smart converted 4.825 million shares of Series K Stock into 820.3 million shares of Piltel common stock on July 9, 2004, and the remaining 54.5 million shares of Series K Stock to 9,259.5 million shares of common stock on December 28, 2004.

As of December 31, 2004, Smart held a total of 10,079.8 million shares of Piltel common stock, equivalent to 85.6 percent of the total outstanding common stock of Piltel, while PLDT had 767.0 million shares of Piltel common stock, equivalent to 6.5 percent of the total outstanding common stock of Piltel.

On April 25, 2005, Smart entered into a Subscription and Assignment Agreement with PLDT pursuant to which Smart acquired PLDT's 767.0 million Piltel common shares in exchange for 11.3 million preferred shares of Smart to be issued by Smart for a total issue price of ₱157.2 million. Smart also acquired 120 Piltel common shares through the PSE on April 22, 2005.

As of March 31, 2006 and December 31, 2005, Smart holds 10,846.8 million shares of Piltel common stock, representing 92.1 percent of the total outstanding common stock of Piltel, while PLDT no longer has any shares of Piltel common stock.

As of March 31, 2006, cumulative dividends accruing to Piltel preferred shareholders totaled ₱2,192.6 million, of which only ₱4.9 million has been booked. Cumulative dividends do not include dividends pertaining to the Series K stock, which were converted to common stock.

Common Stock
On September 20, 1996, the Securities and Exchange Commission (SEC) approved the registration of 145,828,349 common shares to provide for the future conversion of Class I preferred stock into common stock and the conversion of 1.75 percent convertible bonds into Piltel's common stock. As of March 31, 2006, 43,640 shares of Class I Series C preferred stock have been approved for conversion to common stock.

Increase in Authorized Capital Stock
On December 23, 2004, the SEC approved the increase in authorized capital stock to ₱12.8 billion, divided into:

a. 12,060.0 million common shares, with a par value of ₱1 per share of which 11,771.7 million shares are issued and outstanding;

b. 120.0 million Class I preferred shares, with a par value of ₱2 per share of which 12.1 million shares are issued and outstanding; and 500.0 million Class II preferred shares, with a par value of ₱1 per share of which there are no shares issued and outstanding.

The increase in authorized capital stock and the corresponding amendment to Article VII of the Articles of Incorporation were approved by Piltel's Board of Directors on June 30, 2004, and by Piltel's stockholders on September 3, 2004.

16. Interest-bearing Financial Liabilities

This account consists of:

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
	(In Million Pesos)	
Restructured debt	**17,244.4**	17,578.4
Unrestructured debt	**47.2**	49.0
Liability under capital lease	**42.5**	42.5
	17,334.1	17,669.9
Less current portion	**207.7**	237.1
	17,126.4	17,432.8

Of the total restructured debt of ₱17,244.4 million and ₱17,578.4 million as of March 31, 2006 and December 31, 2005, respectively, ₱12,207.1 million and ₱12,432.1 million is owed to Smart.

		March 31, 2006 (Unaudited)		December 31, 2005 (Audited)
		(In Millions)		
Restructured Debt				
Peso:				
10-year Tranche B		**₱1,720.5**		₱1,702.0
15-year Tranche C		**1,715.8**		1,697.6
15-year Term Notes Facility		**207.4**		205.6
		₱3,643.7		₱3,605.2
US Dollar:				
10-year Tranche B	**US$27.2**	**₱1,394.6**	US$26.9	₱1,430.1
15-year Tranche C	**26.9**	**1,375.5**	26.6	1,409.9
15-year Conversion Notes Facility	**92.7**	**4,741.1**	91.5	4,855.5
	US$146.8	**₱7,511.2**	US$145.0	₱7,695.5
Japanese Yen:				
10 year Tranche B	**JP¥7,087.7**	**₱3,081.0**	JP¥7,055.2	₱3,177.7
15 year Tranche C	**6,920.8**	**3,008.5**	6,882.9	3,100.0
	JP¥14,008.5	**₱6,089.5**	JP¥13,938.1	₱6,277.7
Total		**₱17,244.4**		₱17,578.4
Unrestructured Debt				
US Dollar:				
Convertible bonds	**US$0.9**	**₱47.2**	US$0.9	₱49.0

Maturities, at nominal values, of Piltel's interest-bearing financial liabilities are as follows:

	Principal Amortization						
	2006	2007	2008	2009	2010	2011 onwards	Total
	(In Million Pesos)						
Peso facility	45.5	218.8	218.8	218.8	218.8	3,403.5	4,324.2
US$ facilities	37.3	179.6	179.6	179.6	179.6	2,793.7	3,549.4
¥ facility	71.4	343.4	343.4	343.4	343.4	5,341.8	6,786.8
Term note facility	0.3	0.3	0.3	0.3	0.3	290.5	292.0
Conversion note facility	65.4	314.6	314.6	314.6	314.6	4,892.5	6,216.3
Total restructured debt	219.9	1,056.7	1,056.7	1,056.7	1,056.7	16,722.0	21,168.7
Unrestructured debt	47.2	–	–	–	–	–	47.2
Liability under capital lease	5.4	1.3	1.4	1.4	1.5	31.5	42.5
Total interest-bearing financial liabilities	272.5	1,058.0	1,058.1	1,058.1	1,058.2	16,753.5	21,258.4

On June 4, 2001, Piltel completed the restructuring of approximately ₱41.1 billion of indebtedness and other claims owed to banks, trade creditors, bondholders and preferred shareholders (herein referred to as the financial debt), representing 98 percent of its total liabilities as of that date.

As a result of the restructuring, 50 percent of the financial debt of each participating creditor was released in consideration for the allotment of Piltel Class I Series K convertible preferred shares, which shares were immediately and mandatorily converted into PLDT convertible preferred shares. One PLDT Series V, VI or VII convertible preferred share was issued for every five (5) Piltel Class I Series K convertible preferred shares. Approximately half of the remaining 50 percent of all participating creditors' (except for bondholders and preferred shareholders) financial debt became their participation in a Tranche B Loan in the same currency as their previous financial debt and the other half became their participation in a

Tranche C Loan also in the same currency as their previous financial debt. In the case of bondholders and preferred shareholders, the remaining 50 percent of their financial debt became their participation in the Conversion Notes Facility and in a single Tranche Peso loan (the Term Notes Facility), respectively.

Additional creditors participated in the debt restructuring plan in 2002 and 2003, such that only convertible bonds with principal amount of US$0.7 million (approximately US$0.9 million redemption price at the option of the holders) remain unrestructured.

On July 2, 2004, Smart acquired US$289.3 million (US dollar equivalent) or approximately 69.4 percent of Piltel's US$416.9 million (US dollar equivalent) restructured debt from Piltel's creditors in exchange for US$283.2 million in new Smart debt and US$1.5 million in cash. In addition, Smart had received, from a significant portion of Piltel creditors who did not participate in the transaction, waivers to certain provisions of the agreements governing Piltel's restructured indebtedness, which allowed Smart to close the transaction.

On May 4, 2006, Piltel delivered notices of partial voluntary prepayment of principal to the Security Agent and the Facility Agents under Piltel's peso facility, US$ facilities, Yen facility and the Trustee under its Notes Indenture. The amount of the voluntary prepayment represents Excess Cash Flow from the operations of Piltel's business. The voluntary prepayment will be made in lieu of depositing those funds into a Sinking Fund Account. The aggregate voluntary prepayment amount is approximately ₱9,200 million or US$177 million, which is being applied proportionally to the various debt facilities as set out in the Intercreditor Agreement dated June 4, 2001. The prepayment will be effected on June 5, 2006, after which Piltel's debt balance will be reduced to approximately US$236 million in principal.

The following are summaries of the key economic terms relating to the restructuring of the financial debt taking the form of Tranche B Loan, Tranche C Loan, Term Notes Facility and Conversion Notes Facility.

	Tranche B Loans	**Tranche C Loans**	**Term Notes Facility**	**Conversion Notes Facility**
Final maturity	10 years from June 4, 2001	15 years from June 4, 2001	15 years plus 10 days from June 4, 2001	15 years from June 4, 2001
Amortization	Years 1 and 2 0.00% Years 3 to 9 0.10% Year 10 99.30%	Years 1 and 2 0.00% Years 3 and 4 0.10% Year 5 2.00% Years 6 to 14 10.00% Year 15 7.80%	Years 1 and 2 0.00% Years 3 to 14 0.10% Year 15 98.80%	Years 1 and 2 0.00% Years 3 and 4 0.10% Year 5 1.05% Years 6 to 9 5.05% Year 10 54.65% Years 11 to 14 5.00% Year 15 3.90%

	Tranche B Loans	Tranche C Loans	Term Notes Facility	Conversion Notes Facility
Interest rate	Peso facility - Philippines 91-day treasury bill rate (T-Bill Rate) or the average of the 91-day T-Bill Rate and the 90-day Philippine inter-bank offered rate (PHIBOR), if 90-day PHIBOR is different from the T-Bill Rate by more than 2.50%, plus 1.00% p.a. U.S. dollar facilities - London interbank rate for U.S. dollar deposits (LIBOR) for three-month deposits plus 1.00% p.a. Yen facility - London interbank rate for Yen deposits for three month deposits plus 1.00% p.a.		181- day T-Bill Rate or the average of the 181-day T-Bill Rate and the 6-months PHIBOR, if 6-months PHIBOR is different from the T-Bill Rate by more than 2.50%, plus 1.00% p.a.	LIBOR for three-month deposits plus 1.00% p.a.
Interest payment dates	Quarterly in arrears		Semi-annually	

Under the terms of the restructuring, PLDT issued a LOS for the benefit of Piltel and its creditors under which PLDT has agreed to cover any funding shortfalls of Piltel up to a maximum amount of US$150.0 million less all amounts paid or committed to be paid to or on behalf of Piltel or any of its subsidiaries or affiliates on or after March 23, 2000. Under the LOS, PLDT shall provide funding to Piltel in the event that the cash flows from Piltel's operations fall short of the amount required by it to discharge in full its obligations to any creditor of Piltel and all its operating and financing subsidiaries and affiliates. As of March 31, 2006, the undrawn balance available under the PLDT LOS is US$50.2 million (December 31, 2005 - US$50.2 million) due to prior investments made from March 2000 to December 2002 aggregating to US$99.8 million through PLDT's subscription to Class I Series J preferred shares of Piltel.

Piltel's restructured obligations are secured by substantially all present and future assets of Piltel under the Mortgage Trust Indenture (MTI) dated June 4, 2001 between Piltel and Chase Manhattan Bank as security agent for the creditors, which established the security arrangements relating to the restructured debts. The participating creditors (other than the participating holders of the Peso Term Notes Facility) will share equally in first ranking security, while non-participating creditors and the participating holders of the Peso Term Notes Facility will share equally in second ranking security created under the MTI. Such mortgage was approved by at least two-thirds of Piltel's stockholders at its annual meeting on April 18, 2001 and by the NTC on May 18, 2001.

Piltel has undertaken, with respect to each financial year (other than the financial year in which the final repayment installment for Tranche B falls due), that the aggregate of earnings before interest, tax, depreciation and amortization plus the available amount under the LOS shall be greater than 1.05 times debt service and 1.5 times interest cost.

Piltel likewise agreed to pay into a dedicated account (a Sinking Fund Account) the amount by which (a) earnings before interest, tax, depreciation and amortization, and exceptional items for a financial year is greater than (b) 200 percent of the projected debt service costs and permitted capital expenditure for the following financial year (the Excess Cashflow). The money in that Sinking Fund Account will be used (before drawings are made under the LOS) to fund cash flow deficiencies of Piltel. Also, if actual capital expenditure for a financial year differs from the projected capital expenditure, Piltel will either pay into the Sinking Fund Account established at the end of that year an amount equal to any over-projection of capital expenditure or will be entitled to withdraw funds, if any, equal to any under-projection. Any credit balance in a Sinking Fund Account after two financial years will be used to prepay all participating creditors ratably.

As of March 31, 2006, Piltel is not in compliance with the terms of convertible bonds with principal amount of US$0.7 million (approximately US$0.9 million redemption price at the option of the holders). Accordingly, the amount was presented as part of current portion of interest-bearing financial liabilities.

Piltel may not be able to restructure or otherwise pay the claims of its unrestructured debt. However, default on and acceleration of Piltel's unrestructured indebtedness does not create a cross-default under Piltel's restructured indebtedness or any indebtedness of PLDT.

If Piltel's non-participating creditors take forceful measures to enforce their claims, it is possible that Piltel would be required to submit to a court-supervised rehabilitation proceeding or an involuntary insolvency proceeding seeking liquidation. All of Piltel's creditors that participated in the debt restructuring agreed that they would submit Piltel to a rehabilitation proceeding in those circumstances and petition for the adoption of a plan of rehabilitation that includes the financial terms of the debt-restructuring plan. However, the laws and procedures governing a rehabilitation proceeding in the Philippine courts remain untested in significant respects. It cannot be assured that a rehabilitation plan, which incorporates the financial terms of the debt-restructuring plan would be adopted promptly or at all. Even if such a rehabilitation plan was adopted, it cannot be assured that Piltel would prove to be financially viable afterwards.

Liability under capital lease

Piltel entered into an agreement for the financial lease of the Palawan Telecommunications System of the Municipal Telephone Public Office (MTPO) with the Department of Transportation and Communication (DOTC) on June 3, 1994. The MTPO Contract is a 30-year contract for Piltel to lease facilities for public call office (PCO) stations in the Palawan area, with revenues going to Piltel. In consideration, Piltel pays the DOTC an escalating annual lease fee. The total lease payment for thirty years is ₱482.6 million.

Telecommunications equipment include the following amounts for leases that have been capitalized as of March 31, 2006 and December 31, 2005:

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
	(In Million Pesos)	
Cost	**46.3**	46.3
Less accumulated depreciation	**21.8**	21.3
	24.5	25.0

The estimated future annual lease commitments under these lease arrangements are as follows:

	Amounts
	(In Million Pesos)
Within one year	15.2
After one year but not more than five years	26.0
More than five years	435.6
Total minimum lease payments	476.8
Less amount representing interest	434.3
Present value of net minimum lease payments	42.5
Less current maturities	5.4
Long-term obligations	37.1

The foregoing financial lease is the subject of assessment by the DOTC (Note 19c).

17. **Trade and Other Payables**

This account consists of:

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
	(In Million Pesos)	
Trade	**278.7**	275.5
Accruals:		
Rent, utilities and maintenance	**405.6**	405.8
Taxes, licenses and fees (Notes 3 and 19)	**311.0**	418.1
Selling and promotions	**310.5**	272.2
Interest on various loans (Note 16)	**216.3**	101.1
Others	**18.8**	19.1
	1,540.9	1,491.8

18. **Related Party Transactions**

In the ordinary course of business, Piltel has transactions with PLDT, Smart and other related parties. Description of major transactions follows:

<u>Agreements Between Piltel and Smart</u>

a. In December 2004, Piltel entered into an Omnibus Service Agreement (OSA) with Smart to cover in one agreement all the services, which are subject of the existing service agreements between the two companies and define a single revenue sharing arrangement for the year 2004. The OSA provides that Piltel's net revenues will be shared between Piltel and Smart at the rate of 80/20, in favor of Piltel, effective January 1, 2004 up to December 31, 2004. Similar to the provision in the original Facilities Service Agreement (FSA), Piltel's net revenues will consist of: (1) actual usage of the network of Smart by

Talk 'N Text subscribers and any unused peso value of expired cards or electronic airtime loads, net of value-added tax and content provider costs in relation to VAS; and (2) revenues from incoming calls and messages to Talk 'N Text subscribers, net of interconnection expenses.

Under the OSA, Piltel and Smart have also agreed that they will, from time to time, discuss the possible allocation of capital expenditure obligation, which may arise as a result of the provision of the GSM services. As of March 31, 2006, the carrying value of GSM network assets purchased by Piltel under the OSA amounted to ₱1,603.3 million.

The OSA supersedes the following service agreements between Piltel and Smart:

1) FSA dated July 14, 2000 for Piltel's use of Smart's existing GSM network and facilities under which Piltel and Smart have a revenue sharing arrangement at the rate of 50/50 applied to Piltel's GSM net revenues.

2) Facilities Management Agreement (FMA) dated November 13, 2000, the Addendum to FMA dated May 25, 2001, and the Second Addendum Agreement to the FMA in November 2003 under which Smart has undertaken the management, operations and maintenance of Piltel's cellular mobile telephone system, for which services Piltel pays Smart a monthly management fee;

3) Customer Service Agreement (CSA) dated November 13, 2000 and the Addendum to CSA dated May 24, 2001 under which Smart has undertaken the management of Piltel's CMTS customer service operations, for which services Piltel likewise pays Smart monthly management fees; and

4) Administrative Support and Management Services Agreements (ASMSA) dated November 13, 2000 and the Amendment Agreement to the ASMSA dated March 3, 2003 under which Smart provides administrative support and services in certain aspects of Piltel's CMTS business operations, for which services Piltel likewise pays Smart monthly management fees.

The change in revenue sharing arrangement between Piltel and Smart, and the elimination of the management fees payable by Piltel to Smart resulted from a review done by an external professional telecommunications consultant engaged by both companies. The OSA covers the provision of all the services under the previous arrangements, in consideration of a revenue sharing arrangement of 80-20 in favor of Piltel, a ratio which allows Smart to largely recover its costs while providing Smart and Piltel with a more equitable revenue sharing arrangement in the context of the latter's increased subscriber base, the resulting economies of scale, as well as declining network and operating costs per subscriber derived from improvements in productivity and technology.

Piltel entered into an Amendment to the OSA with Smart also in December 2004. The amendment covers the period effective January 1, 2005 and onwards, and seeks to amend the revenue sharing arrangement between the two companies for the said extended period. Both parties agreed that the 80/20 rate provided in the OSA will be adjusted upwards if Piltel meets the gross annual GSM subscriber revenue targets set for a given year.

Smart's share in Piltel's GSM net revenues as of March 31, 2006 and March 31, 2005 under the OSA amounted to ₱665.2 million and ₱652.8 million, respectively.

Also in December 2004, Piltel entered into a Memorandum of Agreement (MOA) with Smart to amend the revenue sharing arrangement and the management fees paid by Piltel to Smart. Under the MOA, Smart will compensate Piltel with the amount of ₱3,707.3 million as a result of Piltel's having achieved a critical mass of subscribers and the resultant economies of scale arising from this achievement, which will be offset against service fees to be paid by Piltel to Smart under the OSA.

In May 2005, Piltel entered into a MOA with Smart, under which both parties agree to pay the other monthly interest charge on net liability based on the 91-day treasury bill rate plus one percent. Interest income on Piltel's net receivable from Smart amounted to ₱272.0 million for the period ended March 31, 2006. The MOA is effective from January 1, 2005.

Outstanding net receivable from Smart arising from these agreements amounted to ₱17,466.9 million and ₱18,155.1 million as of March 31, 2006 and December 31, 2005, respectively. In a MOA dated June 20, 2005, Piltel and Smart agreed to defer the settlement of the outstanding balance as of December 31, 2004 to a date not earlier than December 31, 2006.

b. In February 2000, Piltel entered into a MOA with Smart, under which the parties agreed to cooperate in the establishment of their respective base transceiver stations (BTS) whereby one party can co-locate its BTS on the existing BTS site of the other party subject to certain terms and conditions. Under said agreement, the monthly fee for co-location for each BTS site is ₱45,000, subject to an annual increase of 10 percent. This agreement is renewable every year unless terminated by either party.

   In December 2003, Piltel entered into a MOA with Smart whereby Smart advanced the payment for the co-location fees for the period January 1, 2004 up to December 31, 2008. Total advance payment amounted to ₱782.9 million.

   In December 2004, Smart paid additional co-location fees for the period January 1, 2004 up to December 31, 2008 amounting to ₱1,227.5 million as a result of a review made by an external professional telecommunications consultant of the existing financial agreements regarding the co-location fees for the use by Smart of Piltel's transmission facilities.

   Co-location income under this agreement amounted to ₱100.5 million and ₱101.8 million as of March 31, 2006 and 2005. As of March 31, 2006, the unamortized balance of the unearned co-location fees was ₱1,105.8 million.

c. In November 2001, Piltel entered into a Billing Service Agreement with Smart for the printing and delivery of the billing statements of Piltel's LEC subscribers. Under the agreement, Piltel agrees to pay Smart an average of ₱4.60 per bill printed and an average of ₱5.40 per bill delivered. Total fees under this agreement amounted to ₱1.4 million and ₱1.3 million for the three months ended March 31, 2006 and 2005, respectively.

Agreement Between Piltel and PLDT

On July 19, 2001, Piltel entered into a FMA with PLDT under which PLDT undertakes the management, operation and maintenance of Piltel's regional telecommunication and E.O. 109 network operations and services, including E.O. 109 fixed line build out installations, public calling offices, and payphone facilities and the systems required to support these services.

The agreement covers Piltel's RTS in Baguio, Puerto Princesa, Masbate, and Boac and E.O. 109 service in Alabel, Banga, Dapitan, Davao, Digos, Dipolog, General Santos, Kiamba, Koronadal, Pagadian, Polomolok and Surallah.

Under the agreement, PLDT also undertakes the management of the computer system, billing, revenue assurance and inter-carrier settlements reporting of Piltel's regional telecommunication service in Olongapo and Subic.

The monthly management fee payable by Piltel is based on cost, and for cost components where margin is allowed, 15 percent will be applied. All third party invoices will be passed on to Piltel at cost, including value-added tax.

The agreement, effective for three years until July 2004, was extended for six months until October 20, 2004 on July 28, 2004. The agreement shall be automatically renewed at the end of every renewal quarter for another three-month period under the same terms and conditions.

Total management fees under these agreements amounted to ₱15.7 million and ₱13.1 million as of March 31, 2006 and 2005, respectively.

Agreement Between Piltel and Subictel

On September 5, 2001, Piltel and SubicTel, a subsidiary of PLDT, entered into a FMA of the regional telephone network, customer operations, network operations and payphones of Piltel in Subic and Olongapo City. The monthly management fee payable by Piltel is based on cost, and for cost components where margin is allowed, 15 percent will be applied. In addition, Piltel will pay a monthly variable cost per account in the amount of ₱44.00 for repairs and maintenance and ₱6.00 for bill delivery from an exchange to a subscriber. Total management fees under this agreement amounted to ₱5.3 million and ₱5.2 million as of March 31, 2006 and 2005, respectively. The agreement, effective for three years until July 2004, was extended for six months until October 2, 2004 on July 28, 2004. The agreement shall be automatically renewed at the end of every renewal quarter for another three-month period under the same terms and conditions.

Compensation of Key Management Personnel of the Company

None of the officers of Piltel received compensation from Piltel in 2006 and 2005. Piltel's directors do not receive compensation from Piltel, except per diem of ₱8,000 for each meeting of the BOD attended.

19. Contingencies

Except as disclosed in the following paragraphs, the Company is not a party to, and no property of the Company is subject to, any other pending material legal proceedings.

a. NTC Supervision and Regulation Fees (SRF)

Piltel had been assessed by the NTC for deficiency SRF. The total amount assessed was ₱1,306.3 million, including penalties of ₱500.9 million, as of December 31, 2003. Piltel protested the assessments in good faith.

On December 8, 2004, the Department of Justice (DOJ) issued an opinion in response to the query of the NTC on whether the latter can recompute the SRF due on Piltel and whether it can validly impose penalties and surcharges in view of the pending protests of Piltel over the NTC's computation of the SRF. The DOJ ruled that the NTC can recompute Piltel's SRF to exclude subscriptions issued by virtue of a debt rehabilitation scheme. Likewise, the DOJ ruled that the imposition of surcharges and penalties constitutes deprivation of property without due process of law because the NTC must first pass upon the protests of Piltel before it can impose such penalties and surcharges.

In a decision received by Piltel on February 8, 2005, the NTC recomputed the SRF due from Piltel. Pursuant to the said decision, Piltel was required to pay SRF in the amount of ₱549.6 million and ₱9.2 million. The foregoing amounts were tendered by Piltel to the NTC, and received by the NTC, on February 11, 2005.

In an assessment dated August 4, 2005, the NTC required Piltel to pay SRF of ₱81.4 million for the year 2005. The assessment, which was paid on September 30, 2005 already reflects the new computation based on the DOJ ruling. Consequently, Piltel adjusted its accrual for NTC SRF to reflect the latest assessment.

b. Bureau of Internal Revenue (BIR) Assessments

Piltel received the following assessment notices from the BIR:

Year	Tax Assessment Type	Basic	Interest	Total
			(In Million Pesos)	
1998	Value Added Tax	85.8	68.7	154.5
	Overseas Communications Tax	31.8	25.5	57.3
	Income Tax	12.4	9.4	21.8
	Administrative Penalties	0.1	-	0.1
1999	VAT	94.5	67.8	162.3
	Income Tax	22.7	13.8	36.5
2001	VAT	56.2	35.1	91.3
	Income Tax	13.4	8.9	22.3

In response, Piltel has filed applications for compromise settlement with the BIR for the deficiency tax assessments of 1998 and 1999, citing as basis for the compromise settlement its financial incapacity on account of networth and earnings deficit. On June 22, 2005, however, Piltel received a letter from the BIR dated May 9, 2005 denying the applications for compromise settlements.

On June 16, 2005, Piltel filed an administrative protest against the 2001 deficiency income tax and VAT assessments arising from a letter notice. The BIR granted the request for reconsideration by virtue of the tax verification notice dated June 29, 2005, which was received by Piltel on July 1, 2005. In its letter dated August 30, 2005, which Piltel received on September 19, 2005, the BIR issued its final decision on the disputed assessment, which denied the administrative protest filed by Piltel. On October 19, 2005, Piltel filed a petition for review with the Court of Tax Appeals (CTA) relative to this tax assessment.

On December 12, 2005, Piltel filed a collective application for compromise settlement with the BIR for the deficiency tax assessments arising from taxable years 1998, 1999 and 2001, citing "reasonable doubt as to the validity of the tax assessments" as basis. The prescribed minimum percentage of compromise settlement for such basis is forty percent (40%) of the basic assessed tax. On January 27, 2006, Piltel received the favorable recommendation and approval from the BIR on the said application for compromise settlement. On January 31, 2006, Piltel settled the total amount of ₱113.9 million, which is equivalent to forty percent (40%) of the basic taxes per final assessment notices received, to effect the immediate cancellation of the tax assessments.

Piltel also availed of the BIR's Enhanced Voluntary Assessment Program (EVAP) on December 29, 2005. Said program grants last priority in audit for taxpayers paying the required increase in tax payment from the base year or the minimum EVAP payment, whichever is higher. Piltel's EVAP availment covered the income tax for the taxable year 2003 and the expanded withholding tax for the taxable years 2003 and 2004. Piltel still awaits the issuance of an EVAP Certificate of Qualification from the BIR.

c. Finance Lease

Piltel has an existing finance lease agreement for the Palawan Telecommunications System of the MTPO with the DOTC (Note 16). Presently, the eighteen (18) PCO stations, which were put up pursuant to the MTPO Contract are no longer working. The last payment by Piltel to the DOTC was made in July 2000. No payments have been made since that time. In two letters dated April 4, 2003, Piltel has been assessed by the DOTC for interest due on the late payment of unpaid accounts in the total amount of ₱208.1 thousand. Piltel informed the DOTC, in a letter dated March 27, 2003, that it will pre-terminate the MTPO Contract effective immediately. The DOTC replied in a letter dated May 19, 2003 which Piltel received on August 21, 2003, that Piltel's intention to pre-terminate the MTPO Contract may result in the imposition of sanctions in the form of liquidated damages. It should be noted that the MTPO Contract provides for the payment of liquidated damages in the amount of ₱23.0 million for non-compliance with the terms of the MTPO Contract that results in the cancellation or termination thereof. In the meantime, Piltel received from the DOTC on January 9, 2004 a letter stating, among others that "unless superseded by another agreement, the agreement entered into by and between DOTC and Piltel shall be in force". Piltel has since then been receiving statements of accounts for unpaid annual lease amounts, plus interest and penalties from the DOTC. In March 2005, Piltel received a statement of account as of February 28, 2005 for ₱9.1 million, inclusive of interest and penalty charges.

On July 19, 2005, Piltel again wrote a letter to the DOTC reiterating that, as manifested during the meeting held at the DOTC office and as stated in the letter dated March 27, 2003, Piltel is no longer capable of maintaining the facilities under the Palawan MTPO Contract and thus, Piltel pre-terminated the aforementioned Palawan MTPO Contract in the March 27, 2003 letter. Piltel, likewise, stated that it was willing to meet with the DOTC to discuss a mutually beneficial compromise agreement for the pre-termination of the Palawan MTPO contract.

No meeting has taken place since then and Piltel continues to receive from the DOTC statements of account, the latest of which is dated August 8, 2005, which states that as of July 31, 2005 Piltel has an unpaid balance of ₱12.2 million, inclusive of penalties and interest.

d. Others

Piltel is also involved in certain other legal actions and claims arising in the ordinary course of its business.

Piltel's management believes that, based on the opinion of its legal counsel, the ultimate disposition of the above matters will not have any material adverse effect on the Company's operations or its financial condition taken as a whole.

20. **Financial Risk Management Objectives and Policies**

Piltel's principal financial instruments comprise bank loans, finance leases, cash and short-term deposits. The main purpose of these financial instruments is to fund Piltel's operations. Piltel has various other financial instruments such as trade payables and trade receivables, which arise directly from its operations. It is, and has been throughout the period under review, Piltel's policy that no trading in financial instruments shall be taken.

The main risks arising from Piltel's financial instruments are interest rate risk, liquidity risk, foreign currency risk and credit risk.

<u>Interest Rate Risk</u>

Piltel is exposed to interest rate risks as its long-term loans are subject to floating interest rates (Note 16). It has not entered into interest rate swaps, however, as its Peso Facility, Dollar Facility and Trade Creditor Agreements provide that indebtedness relating to foreign currency and/or interest rate swaps are subject to a maximum exposure at anytime of US$5.0 million or its equivalent.

The following table sets out the carrying amount, by maturity, of the Company's financial instruments that are exposed to interest rate risk:

<table>
<tr><th></th><th>Tranche B Loans</th><th>Tranche C Loans</th><th>Term Notes Facility</th><th>Conversion Notes Facility</th></tr>
<tr><td>Principal Amortization (In Million Pesos)</td><td>2006 7.5
2007 7.5
2008 7.5
2009 7.5
2010 7.5
2011 onwards 7,481.4</td><td>2006 150.7
2007 753.4
2008 753.4
2009 753.4
2010 753.4
2011 onwards 4,354.6</td><td>2006 0.3
2007 0.3
2008 0.3
2009 0.3
2010 0.3
2011 onwards 290.5</td><td>2006 65.4
2007 314.5
2008 314.5
2009 314.5
2010 314.5
2011 onwards 4,892.7</td></tr>
<tr><td>Interest rate</td><td colspan="2"><u>Peso facility</u> - Philippines 91-day treasury bill rate (T-Bill Rate) or the average of the 91-day T-Bill Rate and the 90-day Philippine inter-bank offered rate (PHIBOR), if 90-day PHIBOR is different from the T-Bill Rate by more than 2.50%, plus 1.00% p.a.
<u>U.S. dollar facilities</u> - London interbank rate for U.S. dollar deposits (LIBOR) for three-month deposits plus 1.00% p.a.
<u>Yen facility</u> - London interbank rate for Yen deposits for three month deposits plus 1.00% p.a.</td><td>181- day T-Bill Rate or the average of the 181-day T-Bill Rate and the 6-months PHIBOR, if 6-months PHIBOR is different from the T-Bill Rate by more than 2.50%, plus 1.00% p.a.</td><td>LIBOR for three-month deposits plus 1.00% p.a.</td></tr>
<tr><td>Interest payment dates</td><td colspan="2">Quarterly in arrears</td><td colspan="2">Semi-annually</td></tr>
</table>

Foreign Currency Risk

Piltel has recognized in its consolidated statement of income foreign exchange revaluation gains of ₱500.4 million on its foreign-currency denominated liabilities as of March 31, 2006 as compared with ₱741.9 million gains as of March 31, 2005. This resulted from the movements of the Philippine peso against the US dollar and the Japanese yen as shown in the following table:

	Peso to US Dollar	Peso to Japanese Yen
December 31, 2004	56.341	0.5495
March 31, 2005	54.747	0.5111
December 31, 2005	53.062	0.4504
March 31, 2006	51.158	0.4347

The following table shows Piltel's foreign currency-denominated monetary assets and liabilities and their peso equivalents as of March 31, 2006 and December 31, 2005:

	March 31, 2006			December 31, 2005		
	US dollars	**Japanese Yen**	**Pesos**	US dollars	Japanese Yen	Pesos
			(In Millions)			
Assets						
Cash and cash equivalents	**0.0**		**1.0**	0.0		0.9
Liabilities						
Long-term debt (nominal values)	**191.8**	**15,612.7**	**16,599.6**	191.8	15,612.7	17,210.1
Net foreign currency-denominated liabilities	**191.8**	**15,612.7**	**16,598.6**	191.8	15,612.7	17,209.2

In translating the foreign currency-denominated monetary assets and liabilities into peso amounts, Piltel used the exchange rates as shown on the table above.

As at May 8, 2006, the peso-dollar exchange rate was ₱51.392 to US$1 and peso-yen exchange rate was ₱0.4622 to ¥1. Using these exchange rates, Piltel's net foreign currency-denominated liabilities as of March 31, 2006 would have increased by ₱474.2 million.

While a certain percentage of Piltel's revenues are US dollar-linked, a substantial portion of Piltel's liabilities are denominated in foreign currencies, particularly in US dollars and Japanese yen. However, Piltel has not entered into a foreign currency swap as its Dollar Facility and Trade Creditor Agreements provide that indebtedness relating to foreign currency and/or interest rate swaps are subject to a maximum aggregate exposure at anytime of US$5.0 million or its equivalent.

As of March 31, 2006, approximately 78.1 percent of Piltel's debts were denominated in foreign currencies. Of the foreign currency-denominated loans, 40.9 percent are in Japanese yen and the balance in US dollars. Thus, any weakening of the peso against the US dollar or Japanese yen will increase both the principal amount of Piltel's foreign currency-denominated debts, and interest expense in peso terms. In addition, many of Piltel's financial ratios and other financial tests will be negatively affected. If, among other things, the value of the peso against the US dollar or the Japanese yen drops from its current level, Piltel may be unable to maintain compliance with these ratios. For further information on Piltel's loan covenants, see Note 16.

Credit Risk

Piltel trades only with recognized, creditworthy third parties. It is Piltel's 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 ongoing basis with the result that Piltel's exposure to bad debts is not significant.

There is no significant concentration of credit risk within Piltel as Piltel's main business is prepaid GSM service.

With respect to credit risk arising from other financial assets, which comprise cash and cash equivalents, the exposure to credit risk arises from default of the counterparty, with a maximum exposure to the carrying amount of these instruments.

Liquidity Risk
Piltel's current liabilities as of March 31, 2006 are made up of the current portion of interest-bearing financial liabilities of ₱207.7 million, which is less than two percent of its long-term liabilities of ₱17,126.4 million, accrued expenses and trade liabilities with 30-day to 60-day payment terms.

On the other hand, the biggest components of Piltel's current assets are receivable from affiliates and receivable from dealers with credit terms of less than one month. Moreover, Piltel still has available LOS from PLDT of US$50.2 million as of March 31, 2006 to cover any funding shortfall (see Note 16).

21. Financial Instruments

The carrying value and the estimated fair value of the financial instruments, included in the respective account captions as of March 31, 2006 and December 31, 2005, are as follows:

	Carrying Value		**Fair Value**	
	March 31, 2006	December 31, 2005	**March 31, 2006**	December 31, 2005
	(In Million Pesos)			
Financial Assets				
Cash and cash equivalents	**3,330.9**	344.3	**3,330.9**	344.3
Accounts receivable	**17,501.0**	18,090.9	**17,501.0**	18,090.9
Total Assets	**20,831.9**	18,435.2	**20,831.9**	18,435.2
Financial Liabilities				
Trade and other payables	**1,540.9**	1,491.8	**1,540.9**	1,491.8
Long-term debt (including current portion)	**17,334.1**	17,669.9	**17,334.1**	17,669.9
Total Liabilities	**18,875.0**	19,161.7	**18,875.0**	19,161.7

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:

Cash and cash equivalents: The carrying amount reported in the consolidated balance sheets approximates fair value due to the short-term nature of the transactions.

Accounts receivable: The net carrying value represents the fair value due to the short-term maturities of these receivables. The carrying value of the long-term receivable approximates fair value because of recent and regular repricing based on market conditions.

Trade and other payables: The carrying value reported in the consolidated balance sheets approximates the fair value due to the short-term maturities of these liabilities.

Long-term debt: Piltel's long-term indebtedness consists of variable rate loans for which carrying value approximates fair value because of recent and regular repricing based on market conditions.

SUPPLEMENTARY SCHEDULES

PILIPINO TELEPHONE CORPORATION
Aging of Accounts Receivable
March 31, 2006
In Million Pesos

Type of Accounts Receivable	Total	Current	30-59 Days	60-89 Days	90-119 Days	120 days and over
I. Trade Receivables						
Customers						
Fixed Line	₱ 31.4	₱ 31.4	₱ -	₱ -	₱ -	₱ -
Paging	1.1	-	-	-	-	1.1
Subtotal Customers	₱ 32.5	₱ 31.4	₱ -	₱ -	₱ -	₱ 1.1
Dealers	159.4	-	-	-	-	159.4
Due From Smart	17,466.9	7,111.1	-	-	-	10,355.8
Total Trade Receivables	17,658.8	7,142.5	-	-	-	10,516.3
II. Non-Trade Receivables						
Other Receivables	208.6	-	-	-	-	208.6
Subtotal	208.6	-	-	-	-	208.6
Total Accounts Receivable	17,867.4	7,142.5	-	-	-	10,724.9
Less: Allowance for doubtful accounts (net of VAT)						
Customers	4.0	-	-	-	-	4.0
Dealers	215.2	-	-	-	-	215.2
Other Receivables	147.2	-	-	-	-	147.2
Total Allowance for D/A	366.4	-	-	-	-	366.4
Net Receivables	₱ 17,501.0	₱ 7,142.5	₱ -	₱ -	₱ -	₱ 10,358.5