

This report contains conversions of Philippine peso amounts into U.S. dollars for your convenience. Unless otherwise specified, these conversions were made at the Philippine Dealing System Reference Rate as at December 31, 2010 of Php43.81 to US\$1.00. You should not assume that such Philippine peso amounts represent such U.S. dollar amounts or could have been or could be converted into U.S. dollars at the rate indicated, or at any particular rate. As at March 29, 2011, the exchange rate quoted through the Philippine Dealing System was Php43.53 to US\$1.00. The weighted average exchange rate of the Philippine peso to the U.S. dollar for a year used in the succeeding discussions in this report was calculated using the average of the daily exchange rates quoted through the Philippine Dealing System during the year.

#### **Capitalization and Indebtedness**

Not applicable.

#### **Reasons for the Offer and Use of Proceeds**

Not applicable.

#### **Risk Factors**

*You should consider carefully all of the information in this annual report, including the risks and uncertainties described below. If any of the following risks actually occurs, it could have a material adverse effect on our business, financial condition or results of operations and the trading price of our ADSs, could decline and you could lose all or part of your investment.*

#### **Risks Relating to Us**

*We face competition from well-established telecommunications operators and may face competition from new entrants that may adversely affect our business, results of operations, financial condition and prospects.*

In 1993, the Philippine government liberalized the Philippine telecommunications industry and opened the Philippine telecommunications market to new entrants. Including the PLDT Group, there are four major LECs, 11 international gateway facility providers and three major cellular service providers in the country. Many entrants into the Philippine telecommunications market have entered into strategic alliances with foreign telecommunications companies, which provide them access to technological and funding support, as well as service innovations and marketing strategies. We cannot assure you that the number of providers of telecommunication services will not further increase or that competition for telecommunications customers will not cause our cellular and fixed line subscribers to switch to other operators or cause us to increase our marketing expenditures or reduce our rates resulting in a reduction in our profitability.

Competition in the cellular telecommunications industry in the Philippines is based primarily on factors such as network coverage, quality of service, product offerings, and price. Recently, competition has increased as operators sought to develop and maintain revenue market share and to attract new subscribers. Our principal cellular competitors, Globe and Digitel, with its *Sun Cellular* brand, have introduced aggressive marketing campaigns and promotions, such as unlimited voice and SMS offers. In addition, the government may allocate additional frequencies and award additional cellular telecommunications licenses in the future, which could lead to increased competition.

As a result of the competitive environment, Smart has not increased its cellular rates since November 1998. Moreover, the level of competition requires Smart to continuously innovate its products and to conduct promotions, which may affect its cellular revenues and revenue growth. For example, in response to fixed rate or “bucket plans” for voice and text services launched by its competitors, Smart launched promotions pursuant to which *Smart Buddy* and *Talk ‘N Text* prepaid subscribers had the option to avail themselves of unlimited on-network (Smart-to-Smart) voice calls or unlimited on-network (Smart-to-Smart) text messages at a fixed rate.

We cannot assure you that the additional marketing expenses incurred by us for these promotions, nor can we assure you that, in response to rate pressures from our competitors, the potential loss of customers or the increase in capital expenditures required for our continued capacity expansion necessary to accommodate the continued

increases expected in call and text volumes as a result of unlimited voice/text offers will not have a material adverse effect on our financial performance.

***The cellular telecommunications industry may not continue to grow.***

The majority of our total revenues is currently derived from cellular services. As a result, we depend on the continued development and growth of the cellular telecommunications industry. The cellular penetration rate in the Philippines is estimated to have reached about 94%, counting multiple SIM card ownership. The growth of the cellular communications market depends on many factors beyond our control, including the continued introduction of new and enhanced cellular devices, the price levels of cellular handsets, consumer preferences and amount of disposable income of existing and potential subscribers. Any economic, technological or other developments resulting in a reduction in demand for cellular services could harm our business.

***Rapid changes in telecommunications technology may adversely affect the economics of our existing businesses and the value of our assets, increase our required capital expenditures and create new competition.***

The telecommunications sector has been characterized by rapid technological changes. We cannot assure you that these developments will not result in competition from providers of new services or the need to make substantial capital expenditures to upgrade our facilities. Furthermore, the NTC has issued to Smart and our competitors licenses covering 3G cellular services, and we have made significant investments in the roll out of these services. We are also continuing to upgrade our fixed line network to a next generation, all-IP network and rolling out a wireless broadband network in order to expand our capability to provide broadband services. We have begun upgrading and modernizing our wireless network in order to achieve greater operating and cost-efficiencies. However, these projects require and will continue to require significant capital expenditures over the next few years.

In addition, we now face growing competition not just from other telcos but also from the so-called “over-the-top” service providers that offer social networking, instant messaging and VoIP services.

Our future success will depend, in part, on our ability to anticipate or adapt to such changes and to offer services that meet customer demands on a competitive and timely basis. We may be unable to obtain new technologies on a timely basis or on satisfactory terms or implement them in an appropriate or effective manner. Future development of new technologies, services or standards could require significant changes to our business model, could negatively impact our existing businesses and could necessitate new investments. In addition, new products and services may be expensive to develop and may result in increased competition. Such strategic initiatives and technological developments could require us to incur significant additional capital expenditures. We cannot assure you that we would be able to adopt or successfully implement new technologies. In addition, there can be no assurance on how emerging and future technological changes will affect our operations or the competitiveness of our services.

***Our results of operations and our financial position could be materially and adversely affected if the Philippine peso significantly fluctuates against the U.S. dollar.***

A substantial portion of our indebtedness, related interest expenses, our capital expenditures and a portion of our expenses are denominated in U.S. dollars and other foreign currencies, while a significant portion of our revenues is denominated in Philippine pesos. Approximately 43% of our total consolidated indebtedness was foreign currency-denominated of which approximately 30% was unhedged as at December 31, 2010.

A depreciation of the Philippine peso against the U.S. dollar increases the amount of our U.S. dollar-denominated debt obligations and operating and interest expenses in Philippine peso terms. In the event that the Philippine peso depreciates against the U.S. dollar, we may be unable to generate enough funds through operations and other means to offset the resulting increase in our obligations in Philippine peso terms. Moreover, a depreciation of the Philippine peso against the U.S. dollar may result in our recognition of significant foreign exchange losses, which could materially and adversely affect our results of operations. A depreciation of the Philippine peso could also cause us not to be in compliance with the financial covenants imposed on us by our lenders under certain loan agreements and other indebtedness. Further, fluctuations in the Philippine peso value and of interest rates impact the mark-to-market gains/losses of certain of our financial debt instruments, which were designated as non-hedged items.

On the other hand, approximately 26% of PLDT Group’s consolidated service revenues are either denominated in U.S. dollars and/or are linked to the U.S. dollar. In this respect, an appreciation of the weighted

average exchange rate of the Philippine peso against the U.S. dollar decreases our revenues, and consequently, our cash flow from operations in Philippine peso terms.

The Philippine peso has been subject to significant fluctuations in recent years. From 2003 to 2004, the Philippine peso depreciated from a high of Php52.02 on May 8, 2003 to a low of Php56.44 on October 14, 2004. While the Philippine peso appreciated in 2005, 2006 and 2007, it depreciated in 2008 to a low of Php49.98 and closed at Php47.65 as at December 31, 2008. In 2009, the Philippine peso again appreciated to a high of Php45.95 and closed at Php46.43 as at December 31, 2009 and continued to appreciate to a high of Php42.52 and closed at Php43.81 as at December 31, 2010. We cannot assure you that the Philippine peso will not depreciate and be subjected to significant fluctuations going forward due to a range of factors, including:

- political and economic developments affecting the Philippines, including the level of remittances from overseas Filipino workers;
- global economic and financial trends;
- the volatility of regional currencies, particularly the Japanese yen;
- any interest rate increases by the Federal Reserve Bank of the United States; and
- changes in the value of the U.S. dollar relative to the Philippine peso resulting from either higher demand for U.S. dollars by both banks and domestic businesses to service their maturing U.S. dollar obligations; and foreign exchange traders including banks covering their short U.S. dollar positions, among others.

***Our results of operations have been, and may continue to be, adversely affected by competition in, and the emergence of new services, which may put additional pressures on, our traditional international and national long distance services.***

The international long distance business has historically been one of our major sources of revenue. However, due to competition and the steep decline in international settlement rates that are paid to us by foreign telecommunications carriers for termination of international calls on our network, revenues generated from our international long distance business have declined in recent years.

We anticipate that revenues from international long distance services will continue to decline in the future, primarily due to:

- increases in competition from other domestic and international telecommunications providers;
- advances in technology;
- alternative providers offering internet telephony, also known as VoIP, and broadband capacity; and
- unauthorized traffic termination and bypass routings by international simple resale operators.

The continued increase in cellular penetration in the Philippines and the prevalence of SMS have negatively impacted our national long distance business in recent years. Although revenues from data and other services have grown significantly in recent years compensating for declines in our traditional fixed line businesses, there can be no assurance that we will be able to generate new revenue streams that may fully offset the declines in our traditional fixed line long distance businesses or that these declines will not materially and adversely affect our financial performance.

Net settlement payments between PLDT and other foreign telecommunications carriers for origination and termination of international call traffic between the Philippines and other countries have been our predominant source of foreign currency revenues. However, in U.S. dollar terms, these payments have been declining in recent years. A continued decline in our foreign currency revenues could increase our exposure to risks from possible future declines in the value of the Philippine peso against the U.S. dollar. We cannot assure you that we will be able to adequately increase our other revenues to make up for any adverse impact of a further decline in our net settlement payments.

***We may not be successful in our acquisitions of and investments in other companies and businesses, and may therefore be unable to fully implement our business strategy.***

As part of our growth strategy, we may, from time to time, make acquisitions and investments in companies or businesses. The success of our acquisitions and investments depends on a number of factors, including:

- our ability to identify suitable opportunities for investment or acquisition;
- our ability to reach an acquisition or investment agreement on terms that are satisfactory to us or at all;
- the extent to which we are able to exercise control over the acquired company;
- the economic, business or other strategic objectives and goals of the acquired company compared to those of the PLDT Group, as well as the ability to execute the identified strategies in order to generate fair returns on the investment; and
- our ability to successfully integrate the acquired company or business with our existing businesses.

Any of our contemplated acquisitions and investments may not be consummated due to reasons or factors beyond our control. Even if any contemplated acquisitions and investments are consummated, we may not be able to realize any or all of the anticipated benefits of such acquisitions and investments and we cannot assure you that the consummation of such acquisitions and investments will not result in losses for us for a prolonged period of time. Moreover, if we are unsuccessful in our contemplated acquisitions and investments, we may not be able to fully implement our business strategy to maintain or grow certain of our businesses and our results of operations and financial position could be materially and adversely affected.

***Our debt instruments contain restrictive covenants which require us to maintain certain financial tests and our indebtedness could impair our ability to fulfill our financial obligations, service our other debt and carry out new financings.***

As at December 31, 2010, we had consolidated total indebtedness of Php89,646 million (US\$2,046 million), and a consolidated ratio of debt to equity (total debt on a consolidated basis divided by total equity attributable to equity holders of PLDT) of 0.9x. Our existing debt instruments contain covenants which, among other things, require PLDT to maintain certain financial ratios, and other financial tests, calculated on the basis of PFRS on a consolidated and non-consolidated basis, and limit our ability to incur indebtedness. For a description of some of these covenants, see Item 5. "Operating and Financial Review and Prospects – Liquidity and Capital Resources – Financing Activities – Debt Covenants."

Our indebtedness and the requirements and limitations imposed by our debt covenants could have important consequences. For example, they could require us to dedicate a substantial portion of our cash flow to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate requirements.

The principal factors that can negatively affect our ability to comply with the financial ratios and other financial tests under our debt instruments are depreciation of the Philippine peso relative to the U.S. dollar, poor operating performance of PLDT and our consolidated subsidiaries, impairment or similar charges in respect of investments or other long-lived assets that may be recognized by PLDT and its consolidated subsidiaries, and increases in our interest expenses. Approximately 43% of our total consolidated debts were denominated in foreign currencies as at December 31, 2010, principally in U.S. dollars, many of these financial ratios and other tests are expected to be negatively affected by any weakening of the Philippine peso.

We have maintained compliance with all of our financial ratios and covenants, as measured under PFRS, under our loan agreements and other debt instruments. However, if negative factors adversely affect our financial ratios, we may be unable to maintain compliance with these ratios and covenants or be unable to incur new debt. Inability to comply with the financial ratios and covenants or raise new financing could result in a declaration of default and acceleration of maturities of some or all of our indebtedness. The terms of some of our debt instruments have no minimum amount for cross-default.

If we are unable to meet our debt service obligations or comply with our debt covenants, we could be forced to restructure or refinance our indebtedness, seek additional equity capital or sell assets. An inability to effect these

measures successfully could result in a declaration of default and an acceleration of maturities of some or all of our indebtedness.

***Our subsidiaries could be limited in their ability to pay dividends to us due to internal cash requirements and their creditors having superior claims over their assets and cash flows, which could materially and adversely affect our financial condition.***

A majority of our total revenues and cash flow from operations is derived from our subsidiaries, particularly Smart. Smart has significant internal cash requirements for debt service, capital expenditures and operating expenses and as a result, may be financially unable to pay any dividends to PLDT. Although Smart has been making dividend payments to PLDT regularly since December 2002, there can be no assurance that PLDT will continue to receive these dividends or other distributions, or otherwise be able to derive liquidity from Smart or any other subsidiary or investee in the future.

Creditors of our subsidiaries will have priority claims over our subsidiaries' assets and cash flows. We and our creditors will effectively be subordinated to the existing and future indebtedness and other liabilities, including trade payables, of our subsidiaries, except that we may be recognized as a creditor with respect to loans we have made to subsidiaries. If we are recognized as a creditor of a subsidiary, our claim will still be subordinated to any indebtedness secured by assets of the subsidiary and any indebtedness of the subsidiary otherwise deemed senior to the indebtedness we hold.

We may have difficulty meeting debt payment obligations if we do not continue to receive cash dividends from our subsidiaries and our financial condition could be materially and adversely affected as a result.

***Our businesses require substantial capital investment, which we may not be able to finance.***

Our projects under development and the continued maintenance and improvement of our networks and services, including Smart's projects, networks, platforms and services, require substantial ongoing capital investment. Our consolidated capital expenditures totaled Php28,766 million and Php28,069 million in 2010 and 2009, respectively. Our 2011 budget for consolidated capital expenditures is approximately Php34.4 billion, of which approximately Php13.5 billion is budgeted to be spent by PLDT and approximately Php19.5 billion is budgeted to be spent by Smart; the balance represents the budgeted capital spending of our other subsidiaries. PLDT's capital spending is intended principally to finance the continued build-out and upgrade of its broadband data and IP infrastructures and for its fixed line data services and the maintenance of its network. Smart's capital spending is focused on expanding and upgrading its transmission network from the backbone up to last mile facilities to meet anticipated increased demand for cellular and broadband services in a highly-competitive playing field, including improvement of quality and subscriber experience, expansion of capacity and its accelerated network modernization program in order to achieve a greater operational and cost efficiencies.

Future strategic initiatives could require us to incur significant additional capital expenditures. We may be required to finance a portion of our future capital expenditures from external financing sources, which have not yet been fully arranged. There can be no assurance that financing for new projects will be available on terms acceptable to us. If we cannot complete our development programs and other capital projects, our growth, results of operations and financial condition could be materially and adversely affected.

***Our businesses depend on the reliability of our network infrastructure which is subject to physical, technological and other risks.***

We depend, to a significant degree, on an uninterrupted operation of our network to provide our services. We also depend on robust information technology systems to enable us to conduct our operations. The development and operation of telecommunications networks are subject to physical, technological and other risks, which may cause interruptions in service or reduced capacity for customers. These risks include:

- physical damage;
- power loss;
- capacity limitation;

- cable theft;
- software defects; and
- breaches of security by computer viruses, break-ins or otherwise.

The occurrence of any of these risks could have a material adverse effect on our ability to provide services to customers. While we are undertaking initiatives to prevent and/or mitigate the occurrence of said risks, including the preparation of a disaster recovery plan that aims to allow restoration of service at the earliest possible time from occurrence of an incident, there can be no assurance that these risks will not occur or that our initiatives will be effective should such risks occur.

***A significant number of PLDT's shares are held by three shareholders, which may not act in the interests of other shareholders or stakeholders in PLDT.***

The First Pacific Group has beneficial ownership of approximately 26% in PLDT's outstanding common stock as at February 28, 2011. This is the largest block of PLDT's common stock that is directly or indirectly under common ownership.

Pursuant to publicly available filings made with the PSE, as at February 28, 2011, NTT Communications and NTT DoCoMo together beneficially owned approximately 21% of PLDT's outstanding common stock. First Pacific and certain of its affiliates, or the FP Parties, NTT Communications, NTT DoCoMo and PLDT entered into a Cooperation Agreement, dated January 31, 2006, pursuant to which, among other things, certain rights of NTT Communications under the Stock Purchase and Strategic Investment Agreement dated September 28, 1999, or the Strategic Agreement, and the Shareholders Agreement dated March 24, 2000, or the Shareholders Agreement, were extended to NTT DoCoMo. See Item 7. "Major Shareholders and Related Party Transactions" for further details regarding the shareholdings of NTT Communications and NTT DoCoMo in PLDT. As a result of the Cooperation Agreement, NTT Communications and NTT DoCoMo, in coordination with each other, have contractual veto rights over a number of major decisions and transactions that PLDT could make or enter into, including:

- capital expenditures in excess of US\$50 million;
- any investments, if the aggregate amount of all investments for the previous 12 months is greater than US\$25 million in the case of all investments to any existing investees and US\$100 million in the case of all investments to any new or existing investees, determined on a rolling monthly basis;
- any investments in a specific investee, if the cumulative value of all investments made by us in that investee is greater than US\$10 million in the case of an existing investee and US\$50 million in the case of a new investee;
- issuance of common stock or stock that is convertible into common stock;
- new business activities other than those we currently engage in; and
- merger or consolidation.

Moreover, as a result of the Shareholders Agreement, the Cooperation Agreement and their respective stockholdings, the FP Parties and/or, NTT Communications and/or NTT DoCoMo are able to influence our actions and corporate governance, including:

- elections of PLDT's directors; and
- approval of major corporate actions, which require the vote of common stockholders.

Additionally, pursuant to amendments effected by the Cooperation Agreement to the Stock Purchase and Strategic Investment Agreement and the Shareholders Agreement, upon NTT Communications and NTT DoCoMo and their respective subsidiaries owning in the aggregate 20% or more of PLDT's shares of common stock and for as long as they continue to own in the aggregate at least 17.5% of PLDT's shares of common stock then outstanding, NTT DoCoMo has additional rights under the Stock Purchase and Strategic Investment Agreement and Shareholders Agreement, including that:

- NTT DoCoMo is entitled to nominate one additional NTT DoCoMo nominee to the board of directors of each of PLDT and Smart;

- PLDT must consult NTT DoCoMo no later than 30 days prior to the first submission to the board of PLDT or certain of its committees of any proposal of investment in an entity that would primarily engage in a business that would be in direct competition or substantially the same business opportunities, customer base, products or services with business carried on by NTT DoCoMo, or which NTT DoCoMo has announced publicly an intention to carry on;
- PLDT must procure that Smart does not cease to carry on its business, dispose of all of its assets, issue common shares, merge or consolidate, or effect winding up or liquidation without PLDT first consulting with NTT DoCoMo no later than 30 days prior to the first submission to the board of PLDT or Smart, or certain of its committees; and
- PLDT must first consult with NTT DoCoMo no later than 30 days prior to the first submission to the board of PLDT or certain of its committees for the approval of any transfer by any member of the PLDT Group of Smart common capital stock to any person who is not a member of the PLDT Group.

The FP Parties and/or NTT Communications and/or NTT DoCoMo may exercise their respective influence over these decisions and transactions in a manner that could be contrary to the interests of other shareholders or stakeholders in PLDT.

***If a major shareholder sells its interest in PLDT, the transaction may result in an event of default under certain circumstances.***

If First Pacific Group or NTT Communications sells all or a portion of their equity interest in PLDT, under certain circumstances, such sale may give rise to an obligation for PLDT to make an offer to purchase its outstanding debt under its US\$250 million 11.375% notes due 2012. As at December 31, 2010, Php6,387 million in principal amount of PLDT's indebtedness is directly subject to a redemption upon any change in the major shareholding of PLDT or to an offer to purchase requirement. In such event, if PLDT fails to complete an offer to purchase the affected debts, all of its debt could become immediately due and payable as a result of various cross-default and acceleration provisions.

***The franchise of Smart may be revoked due to its failure to conduct a public offering of its shares.***

In order to diversify the ownership base of public utilities, the Public Telecommunications Policy Act of the Philippines, Republic Act, or R.A., 7925, requires a telecommunications entity with regulated types of services to make a public offering through the stock exchanges representing at least 30% of its aggregate common shares within a period of five years from: (a) the date the law became effective; or (b) the entity's first start of commercial operations, whichever date is later. As the timeframe has lapsed without Smart having conducted a public offering of its shares, the Philippine Congress may revoke the franchise of Smart for its failure to comply with the requirement under R.A. 7925 on the public offering of its shares. A *quo warranto* case may also be filed against Smart by the Office of the Solicitor General of the Philippines for the revocation of the franchise of Smart on the ground of violation of R.A. 7925.

Smart maintains the position that it has not violated the provision in its franchise to make a public offering of its shares within a certain period, since it believes such provision is merely directory. Further, Smart believes that the policy underlying the requirement for telecommunications entities to conduct a public offering should be deemed to have been achieved when PLDT acquired a 100% equity interest in Smart in 2000, since PLDT was then and continues to be a publicly listed company. In September 2004, Senate Bill No. 1675 was filed seeking to declare that a telecommunications entity shall be deemed to have complied with the requirement of making a public offering of its shares if two-thirds of its outstanding voting stock are owned and controlled directly or indirectly, by a listed company. However, there can be no assurance that such bill will be enacted or that Philippine Congress will not revoke the franchise of Smart or the Office of Solicitor General of the Philippines will not initiate a *quo warranto* proceeding against Smart for the revocation of its franchise for failure to comply with the provision under R.A. 7925 on the public offering of shares.

***Our business is significantly affected by governmental laws and regulations, including regulations in respect of our franchises, rates and taxes.***

We operate our business under franchises, each of which is subject to amendment, termination or repeal by the Philippine Congress. Additionally, PLDT operates pursuant to various provisional authorities and CPCNs, which were granted by the NTC and will expire between now and 2028. For a description of our licenses, see Item 4.

“Information on the Company – Licenses and Regulation.” Some of PLDT’s CPCNs and provisional authorities have already expired. However, PLDT filed applications for extension of these CPCNs and provisional authorities prior to their respective expiration dates and is therefore entitled to continue to conduct its business under its existing CPCNs and provisional authorities pending the NTC’s decisions on these extensions. Because PLDT filed the applications for extension on a timely basis, we expect that these extensions will be granted. However, we cannot assure you that the NTC will grant these extensions. Smart also operates its cellular, international long distance, national long distance and global mobile personal communications via satellite services as well as international private leased circuits pursuant to CPCNs, which will expire upon the expiration of its franchise. Smart’s franchise is due to expire on March 27, 2017, 25 years after the date on which its current franchise was granted.

The NTC also regulates the rates we are permitted to charge for services that have not yet been deregulated, such as local exchange services. We cannot assure you that the NTC will not impose additional obligations on us that could lead to the revocation of our licenses if not adhered to and/or reduction in our total revenues or profitability. In addition, the NTC could adopt changes to the regulations governing our interconnection with other telecommunications companies or the rates and terms upon which we provide services to our customers that could have a material adverse effect on our results of operations.

The PLDT Group is also subject to a number of national and local taxes. We cannot assure you that PLDT Group will not be subject to new and/or additional taxes and that PLDT Group would be able to impose additional charges or fees to compensate for the imposition of such taxes.

There are bills in the 14th Philippine Congress which propose to tax telecommunications services. HB No. 1469 proposes to re-impose a 5% franchise tax on gross receipts of telephone and telegraph services in lieu of the VAT. HB No. 1560, which proposes to impose a franchise tax of 3.5% in the first year and 7% thereafter on gross receipts of telecommunications and broadcast companies, in lieu of the VAT. Other bills filed proposed to tax or regulate fees for telecommunications services. Among them, a proposed tax on mobile phone companies on all text entries to text games; a Php0.50 specific tax on each SMS to be borne by the cellular phone companies; and a 10% ad valorem tax on all cellular phone calls using 3G, a proposal to prohibit telecommunications companies from imposing fees and/or charges on text messaging between subscribers of the same telecommunications company and providing for free text messages until the prepaid load has been fully consumed.

The Committee on Oversight of Congress also held discussions on the possibility of linking up the BIR and NTC with the telecommunications companies through an electronic “metering device,” which discussions led to a proposal to impose an additional Php0.10 tax on text messaging.

In the Upper House, Senate Bill No. 2402 proposes to establish a Health and Education Acceleration Program Fund for special projects on educational development from the proceeds of income tax imposed on telecommunications companies at the rate of 20% of their gross receipts from short messaging service or text sent from and through their networks which would be remitted to the fund for a period of five years. This tax may not be passed on to consumers. Under the proposed bill, telecommunications companies shall no longer pay for the regular income tax on their income from these transactions during the five-year period that the special gross receipts tax on text messaging is imposed. The income tax scheme for text messaging shall revert to the regular income tax for corporations after the five-year period. Moreover, the bill proposes to allow telecommunications companies to deduct 10% of the tax remitted to the fund from their other income as ordinary business expense over a period of ten years. See Item 4. “Information on the Company – Licenses and Regulations – Material Effects of Regulation on our Business”. If any of these bills are enacted into law, such legislation could have a material adverse effect on our results of operations and financial condition. We cannot assure you that we would be able to impose additional charges or fees to compensate for the imposition of such taxes or charges, or for the loss of fees and/or charges. The 15th Philippine Congress from June 2010 to June 2013, requested Smart to attend a hearing concerning HB No. 1224 or the Corporate Social Responsibility Act Bill filed by Rep. Gloria Macapagal-Arroyo and Rep. Diosdado Macapagal-Arroyo. However, both the Upper House and Lower House have pending bills concerning Anti-Trust, Competition and the setting up of a Fair Trade Commission. The PLDT Group has submitted its position papers on both matters.



***The NTC may implement proposed changes in existing regulations and introduce new regulations, which may result in increased competition and/or changes in rates, each of which could have material adverse effects on our revenues and profitability.***

The NTC may regulate the rates and manner in which we charge the customers of our business.

For example, on July 3, 2009, NTC issued Memorandum Circular No. 03-07-2009 promulgating an extension of expiration of prepaid loads from two months to various expiration periods ranging from three days to 120 days. Smart has been implementing the new validity period of prepaid loads since July 19, 2009.

In addition, on July 7, 2009, the NTC issued another Memorandum Circular No. 04-07-2009, further amending the Memorandum Circular No. 03-03-2005A (Rules and Regulation on Broadcast Messaging), which prohibits content and/or information providers from initiating push messages. The Memorandum Circular No. 04-07-2009, further provides that subscribers must be the party to take the initiative with the public telecommunications entities and/or content providers to initiate any service and requires that a notification be sent to subscribers to give subscribers an option whether to continue with the availed service.

In addition, on July 23, 2009 the NTC issued Memorandum Circular No. 05-07-2009 mandating cellular operators, including Smart, to bill subscribers on a maximum six-second pulse basis instead of the previous per minute basis. The NTC granted Smart the provisional authority to charge new rates for the CMTS service and also directed Smart to implement a six seconds per pulse billing scheme on December 5, 2009. Smart subsequently implemented the six seconds per pulse directive by billing on a six second per pulse basis, if subscribers entered additional dialing numbers as a prefix before the actual number. The NTC opposed Smart's implementation of the six seconds per pulse directive. As at the date of this annual report, the matter is pending before the Court of Appeals and is the subject of a temporary restraining order preventing the NTC from implementing its six second per pulse billing directive.

Furthermore, from time to time, the NTC issues consultative documents on the development of a competition policy framework for the information communications sector and related matters.

For example, on August 24, 2006, the NTC issued a consultative document specifically focusing on its proposal to impose asymmetric regulations on carriers with significant market power, or SMP, including a discussion on its proposed roadmap for implementing such SMP obligations. On October 23, 2006, we submitted our response to such consultative paper to the NTC.

In formulating our responses, we took into account both industry interests and the broader context of our nation's economic development, drawing on the experience in other countries. We believe that the basis for the need for regulatory reform is unclear and the envisioned SMP regime is inappropriate for the Philippines, as the market is highly competitive and well-functioning. In addition, the imposition of asymmetric regulations on SMP would discourage capital investments in a sector on which the Philippine economy is highly dependent. We have therefore proposed that the NTC explore its full range of options available on a cost-benefit basis, taking into consideration the specific local context of the Philippine marketplace.

Furthermore, in 2008, in connection with the NTC's efforts to enhance competition within the telecommunications industry in the Philippines, the NTC issued Memorandum Circulars on the following:

- (a) guidelines on the mandatory interconnection of backhaul networks to the cable landing station, which were issued on October 7, 2008 and became effective on October 23, 2008; and
- (b) guidelines on the interconnection of LECs in local calling areas that eliminate interconnection access charges between LECs within a local calling area, which were issued on May 30, 2008 and became effective on June 17, 2008.

In addition, on April 14, 2009, the NTC released implementing guidelines on developing reference access offers, which are statements of the prices, terms and conditions under which a telecommunications carrier proposes to provide access to its network or facilities to another such carrier or value-added service provider.

During the last quarter of 2010, the NTC has begun holding public hearings on a proposed Memorandum Order concerning the minimum speed of broadband internet.

We cannot assure you that the NTC will not impose changes to the current regulatory framework, which could lead to increased competition or affect the rates we charge for our services. Any such changes could have a material adverse effect on our business, results of operations and prospects.

***If we are unable to install and maintain telecommunications facilities and equipment in a timely manner, we may not be able to maintain our current market share and the quality of our services, which could have a material adverse effect on our results of operations and financial condition.***

Our business requires the regular installation of new, and the maintenance of existing, telecommunications transmission and other facilities and equipment, which are being undertaken. The installation and maintenance of these facilities and equipment are subject to risks and uncertainties relating to:

- shortages of equipment, materials and labor;
- work stoppages and labor disputes;
- interruptions resulting from inclement weather and other natural disasters;
- unforeseen engineering, environmental and geological problems; and
- unanticipated cost increases.

Any of these factors could give rise to delays or cost overruns in the installation of new facilities or equipment or could prevent us from properly maintaining the equipment used in our networks, and hence could affect our ability to maintain existing services and roll out new services, etc., which could have a material adverse effect on our results of operations and financial condition.

***Failure to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 could adversely impact investor confidence and the market price of our common shares and ADSs.***

Effective internal controls over financial reporting are necessary for us to provide reasonable assurance with respect to our financial reports and to effectively prevent fraud. If we are unable to provide reasonable assurance with respect to our financial reports and effectively prevent fraud, our reputation and results of operations could be harmed.

We are required to comply with various Philippine and U.S. laws and regulations on internal controls. For example, pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, beginning with the Annual Report on Form 20-F for the fiscal year ended December 31, 2006, we have been required to include a report by our management on our internal control over financial reporting in our Annual Reports on Form 20-F that contains an assessment by our management of the effectiveness of our internal control over financial reporting. In addition, an independent registered public accounting firm must express an opinion on our internal control over financial reporting based on their audits.

Internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Therefore, even effective internal control over financial reporting can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. If we fail to maintain the adequacy of our internal control over financial reporting, including our failure to implement required new or improved controls, or if we experience difficulties in their implementation, our business and operating results could be harmed, we could fail to meet our reporting obligations and there could be a material adverse effect on the market prices of our common shares and ADSs.

## Risks Relating to the Philippines

### ***PLDT's business may be affected by political or social or economic instability in the Philippines.***

The Philippines is subject to political, social and economic volatility that, directly or indirectly, could have a material adverse impact on our ability to sustain our business and growth.

For example, the Philippines has experienced a number of street protests and violent civil unrest, including coup d'état attempts against the former President Arroyo's administration.

Furthermore, the Philippine economy has experienced periods of slow growth and significant depreciation of the Philippine peso. The Philippine government is also facing a fiscal deficit that the government is aiming to eliminate in the near future by implementing a number of economic reforms.

The fiscal deficit position of the Philippine government and the ongoing political uncertainty have resulted in increased concerns about the political and economic stability of the country. We cannot assure you that the political environment in the Philippines will be stable or that the current or any future government will adopt economic policies that are conducive to sustained economic growth or which do not impact adversely on the current regulatory environment for the telecommunications and other companies.

### ***If foreign exchange controls were to be imposed, our ability to meet our foreign currency payment obligations could be adversely affected.***

The Philippine government has, in the past, instituted restrictions on the conversion of the Philippine peso into foreign currencies and the use of foreign exchange received by Philippine companies to pay foreign currency-denominated obligations. The Monetary Board of the BSP has statutory authority, with the approval of the President of the Philippines, during a foreign exchange crisis or in times of national emergency, to:

- suspend temporarily or restrict sales of foreign exchange;
- require licensing of foreign exchange transactions; or
- require the delivery of foreign exchange to the BSP or its designee banks.

We cannot assure you that foreign exchange controls will not be imposed in the future. If imposed, these restrictions could materially and adversely affect our ability to obtain foreign currency to service our foreign currency obligations.

### ***The occurrence of natural catastrophes could materially disrupt our operations.***

The Philippines has experienced a number of major natural catastrophes over the years, including typhoons, floods, volcanic eruptions and earthquakes that may materially disrupt and adversely affect our business operations. The frequency and severity of the occurrence of natural catastrophes and challenges may be further exacerbated through effects of the ongoing global climate change. We cannot assure you that we are fully capable to deal with these situations and that the insurance coverage we maintain will fully compensate us for all the damages and economic losses resulting from these catastrophes.

## **Item 4. Information on the Company**

### **Overview**

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

PLDT is the leading fixed line service provider in the Philippines with over 60% of the total reported fixed line subscribers nationwide as at December 31, 2010. Smart is the leading cellular service provider in the country, with approximately 52% of total reported cellular subscribers nationwide as at December 31, 2010. We have interests in the information and communications technology sectors, including the operation of our Vitro™ data center, customer relationship management and knowledge processing solutions business, and internet and online gaming services.