# COVER SHEET

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SEC Registration Number

SM PRIME HOLDINGS, INC. AND SUBSIDIARIES

(Company's Full Name)

Building A, SM Corporate Offices, Bay Boulevard, SM Central Business Park, Bay City, Pasay City 1300

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

**Mr. Jeffrey C. Lim**
(Contact Person)

**831-1000**
(Company Telephone Number)

| 0 6 | 3 0 |
|---|---|
| *Month* | *Day* |

(Calendar Year)

**17-Q**
(Form Type)

*Month* *Day*
(Annual Meeting)

(Secondary License Type, If Applicable)

**SEC**
Dept. Requiring this Doc.

Amended Articles Number/Section

Total Amount of Borrowings

Total No. of Stockholders

Domestic

Foreign

---

To be accomplished by SEC Personnel concerned

File Number

LCU

Document ID

Cashier

STAMPS

Remarks: Please use BLACK ink for scanning purposes.

# SM PRIME HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Financial Statements
June 30, 2006 and December 31, 2005

**SECURITIES AND EXCHANGE COMMISSION**
**SEC FORM 17-Q**

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

1. For the quarterly period ended **JUNE 30, 2006**

2. SEC Identification Number **0000-88** 3. BIR Tax Identification No. **003-058-789**

4. Exact name of registrant as specified in its charter **SM PRIME HOLDINGS, INC.**

5. **PHILIPPINES** 6. (SEC Use Only)
Province, Country or other jurisdiction of incorporation or organization — Industry Classification Code:

7. **SM Corporate Offices, Bldg. A, 1000 Bay Blvd.**
**SM Central Business Park, Bay City, Pasay City** **1300**
Address of principal office — Postal Code

8. **831-1000**
Registrant's telephone number, including area code

9. ____________________
Former name, former address, and former fiscal year, if changed since last report.

10. Securities registered pursuant to Sections 4 and 8 of the SRC

| Title of Each Class | Number of Shares of Common Stock Outstanding and Amount of Debt Outstanding |
|---|---|
| **CAPITAL STOCK, P 1 PAR VALUE** | **9,935,294,157** |

11. Are any or all of these securities listed on the Philippine Stock Exchange.
Yes [**X**] No [ ]

12. Indicate by check mark whether the registrant:

(a) has filed all reports required to be filed by Section 11 of the Securities Regulation Code (SRC) and SRC Rule 11(a)-1 thereunder and Sections 26 and 141 of The Corporation Code of the Philippines during the preceding 12 months (or for such shorter period that the registrant was required to file such reports);

Yes [**X**] No [ ]

(b) has been subject to such filing requirements for the past 90 days.
Yes [**X**] No [ ]

## SM PRIME HOLDINGS, INC. AND SUBSIDIARIES
## CONSOLIDATED BALANCE SHEETS

| | June 30, 2006 (Unaudited) | December 31, 2005 (Audited) |
|---|---|---|
| **ASSETS** | | |
| **Current Assets** | | |
| Cash and cash equivalents (Notes 3, 11 and 16) | **₱7,258,635,487** | ₱3,542,166,247 |
| Investments held for trading (Notes 4, 16 and 19) | **1,820,680,687** | 1,646,416,663 |
| Receivables (Notes 5, 16 and 17) | **2,430,390,824** | 2,094,099,214 |
| Available-for-sale investments (Notes 8 and 16) | **2,500,000,000** | – |
| Prepaid expenses and other current assets | **870,185,370** | 625,207,770 |
| Total Current Assets | **14,879,892,368** | 7,907,889,894 |
| **Noncurrent Assets** | | |
| Investment properties - net (Note 6) | **44,663,597,287** | 33,015,622,650 |
| Shopping mall complex under construction (Note 7) | **4,316,274,584** | 12,364,828,436 |
| Available-for-sale investments (Notes 8 and 16) | **2,655,500,000** | 5,154,500,000 |
| Deferred tax assets (Note 14) | **80,528,629** | 107,745,310 |
| Other noncurrent assets | **1,013,641,707** | 878,326,590 |
| Total Noncurrent Assets | **52,729,542,207** | 51,521,022,986 |
| | **₱67,609,434,575** | ₱59,428,912,880 |
| **LIABILITIES AND EQUITY** | | |
| **Current Liabilities** | | |
| Loans payable (Note 9) | **₱8,248,631,500** | ₱3,204,500,000 |
| Accounts payable and other current liabilities (Notes 9, 10, 11, 15 and 16) | **2,200,510,402** | 2,049,492,271 |
| Income tax payable | **205,891,844** | 503,845,660 |
| Current portion of long-term debt (Notes 11, 16 and 19) | **1,291,000,000** | 1,291,000,000 |
| Total Current Liabilities | **11,946,033,746** | 7,048,837,931 |
| **Noncurrent Liabilities** | | |
| Long-term debt - net of current portion (Notes 11, 16 and 19) | **17,830,227,343** | 15,239,493,797 |
| Deferred tax liabilities (Note 14) | **450,166,105** | 411,944,833 |
| Tenants' deposits and others | **3,888,648,403** | 3,301,208,998 |
| Total Noncurrent Liabilities | **22,169,041,851** | 18,952,647,628 |
| **Equity** | | |
| Equity attributable to parent equity holders | | |
| Capital stock | **9,935,294,157** | 9,935,294,157 |
| Additional paid-in capital | **3,099,777,406** | 3,099,777,406 |
| Retained earnings (Note 12): | | |
| Appropriated | **7,000,000,000** | 7,000,000,000 |
| Unappropriated | **12,753,569,063** | 12,615,936,311 |
| Treasury stock (Note 12) | **(101,474,705)** | (101,474,705) |
| | **32,687,165,921** | 32,549,533,169 |
| Minority interests | **807,193,057** | 877,894,152 |
| Total Equity | **33,494,358,978** | 33,427,427,321 |
| | **₱67,609,434,575** | ₱59,428,912,880 |

*See accompanying Notes to Consolidated Financial Statements.*

## SM PRIME HOLDINGS, INC. AND SUBSIDIARIES
## UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

| | Six Months Ended June 30 | |
|---|---|---|
| | **2006** | 2005 |
| **REVENUES** | | |
| Rent (Notes 5, 16 and 17) | **₱5,038,599,161** | ₱4,286,687,231 |
| Cinema ticket sales | **756,444,933** | 632,371,646 |
| Others | **293,180,040** | 274,261,740 |
| | **6,088,224,134** | 5,193,320,617 |
| **OPERATING EXPENSES** (Notes 13, 15, 16 and 17) | **2,546,768,203** | 2,240,086,609 |
| **INCOME FROM OPERATIONS** | **3,541,455,931** | 2,953,234,008 |
| **INTEREST AND OTHERS – Net** | **38,086,313** | 191,065,264 |
| **INCOME BEFORE INCOME TAX** | **3,579,542,244** | 3,144,299,272 |
| **PROVISION FOR INCOME TAX** (Note 14) | | |
| Current | **733,045,312** | 600,567,584 |
| Deferred | **75,849,414** | 2,246,633 |
| | **808,894,726** | 602,814,217 |
| **NET INCOME** | **₱2,770,647,518** | ₱2,541,485,055 |
| **Attributable to:** | | |
| Equity holders of the parent | **₱2,616,742,032** | ₱2,410,710,284 |
| Minority interest | **153,905,486** | 130,774,771 |
| | **₱2,770,647,518** | ₱2,541,485,055 |
| **Earnings Per Share** (Note 20) | **₱0.264** | ₱0.243 |

*See accompanying Notes to Consolidated Financial Statements.*

## SM PRIME HOLDINGS, INC. AND SUBSIDIARIES

## UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

| | Three Months Ended June 30 | |
|---|---|---|
| | **2006** | 2005 |
| **REVENUES** | | |
| Rent (Notes 5, 16 and 17) | **₱2,684,536,334** | ₱2,238,776,738 |
| Cinema ticket sales | **394,961,031** | 325,499,398 |
| Others | **155,302,519** | 143,620,551 |
| | **3,234,799,884** | 2,707,896,687 |
| **OPERATING EXPENSES** (Notes 13, 15, 16 and 17) | **1,401,384,955** | 1,155,709,510 |
| **INCOME FROM OPERATIONS** | **1,833,414,929** | 1,552,187,177 |
| **INTEREST AND OTHERS – Net** | **(15,119,384)** | 42,043,578 |
| **INCOME BEFORE INCOME TAX** | **1,818,295,545** | 1,594,230,755 |
| **PROVISION FOR INCOME TAX** (Note 14) | | |
| Current | **390,240,497** | 293,290,589 |
| Deferred | **68,798,027** | 57,716,295 |
| | **459,038,524** | 351,006,884 |
| **NET INCOME** | **₱1,359,257,021** | ₱1,243,223,871 |
| **Attributable to:** | | |
| Equity holders of the parent | **₱1,279,185,476** | ₱1,173,813,690 |
| Minority interest | **80,071,545** | 69,410,181 |
| | **₱1,359,257,021** | ₱1,243,223,871 |

*See accompanying Notes to Consolidated Financial Statements.*

## SM PRIME HOLDINGS, INC. AND SUBSIDIARIES
## UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

| | Six Months Ended June 30 | |
|---|---|---|
| | **2006** | 2005 |
| **CAPITAL STOCK** - ₱1 par value | | |
| Authorized - 10,000,000,000 shares | | |
| Issued - 9,935,294,157 shares | **₱9,935,294,157** | ₱9,935,294,157 |
| **ADDITIONAL PAID-IN CAPITAL** | **3,099,777,406** | 3,099,777,406 |
| **RETAINED EARNINGS** (Note 12) | | |
| Appropriated for future capital expenditures | **7,000,000,000** | 7,000,000,000 |
| Unappropriated: | | |
| Balance at beginning of period | **12,615,936,311** | 9,953,560,549 |
| Net income attributable to parent equity holders | **2,616,742,032** | 2,410,710,284 |
| Cash dividends – P0.25 a share in 2006 and P0.23 a share in 2005 | **(2,479,109,280)** | (2,310,529,858) |
| Balance at end of period | **12,753,569,063** | 10,053,740,975 |
| | **19,753,569,063** | 17,053,740,975 |
| **TREASURY STOCK** - 18,857,000 shares (Note 12) | **(101,474,705)** | (101,474,705) |
| | **32,687,165,921** | 29,987,337,833 |
| **MINORITY INTERESTS** | | |
| Balance at beginning of period | **877,894,152** | 827,821,782 |
| Net income attributable to minority | **153,905,486** | 130,774,771 |
| Dividends declared | **(224,606,581)** | (226,742,537) |
| Balance at end of period | **807,193,057** | 731,854,016 |
| | **₱33,494,358,978** | ₱30,719,191,849 |

*See accompanying Notes to Consolidated Financial Statements.*

## SM PRIME HOLDINGS, INC. AND SUBSIDIARIES
## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Six Months Ended June 30 | |
|---|---|---|
| | **2006** | 2005 |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Income before income tax | **₱3,579,542,244** | ₱3,144,299,272 |
| Adjustments for: | | |
| Depreciation | **861,738,413** | 698,050,649 |
| Interest and dividend income | **(385,873,486)** | (599,151,018) |
| Interest expense | **331,533,346** | 204,881,297 |
| Amortization of debt issuance costs | **33,010,893** | 24,108,413 |
| Net unrealized foreign exchange loss (gain) | **(64,266,176)** | 7,326,630 |
| Operating income before working capital changes | **4,355,685,234** | 3,479,515,243 |
| Decrease (increase) in: | | |
| Receivables | **(198,187,239)** | 204,167,744 |
| Prepaid expenses and other current assets | **(244,977,600)** | (207,362,941) |
| Increase in: | | |
| Accounts payable and other current liabilities | **33,095,488** | 156,260,390 |
| Tenants' deposits | **588,839,405** | 91,184,408 |
| Cash generated from operations | **4,534,455,288** | 3,723,764,844 |
| Income taxes paid | **(1,030,999,128)** | (945,909,744) |
| Net cash provided by operating activities | **3,503,456,160** | 2,777,855,100 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Decrease (increase) in: | | |
| Shopping mall complex under construction | **(3,337,717,921)** | (3,162,282,923) |
| Investment properties | **(558,255,468)** | (513,829,289) |
| Investments held for trading | **(167,981,636)** | 596,857,937 |
| Other noncurrent assets | **(145,726,578)** | (97,951,283) |
| Interest and dividends received | **247,769,115** | 618,352,554 |
| Net cash used in investing activities | **(3,961,912,488)** | (2,558,853,004) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Proceeds from availment of loans | **8,078,523,903** | – |
| Payments of: | | |
| Dividends | **(2,479,109,280)** | (2,310,529,858) |
| Interests | **(915,689,690)** | (685,314,366) |
| Loans | **(497,444,000)** | (461,608,413) |
| Decrease in minority interest | **(87,713,403)** | (67,033,828) |
| Net cash provided by (used in) financing activities | **4,098,567,530** | (3,524,486,465) |
| **EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS** | **76,358,038** | (26,186,631) |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | **3,716,469,240** | (3,331,671,000) |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD** | **3,542,166,247** | 5,676,232,530 |
| **CASH AND CASH EQUIVALENTS AT END OF PERIOD** | **₱7,258,635,487** | ₱2,344,561,530 |

*See accompanying Notes to Consolidated Financial Statements.*

# SM PRIME HOLDINGS, INC. AND SUBSIDIARIES
# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 1. Corporate Information

SM Prime Holdings, Inc. (the Parent Company) was incorporated in the Philippines and registered with the Securities and Exchange Commission (SEC) on January 6, 1994. Its subsidiaries are also incorporated in the Philippines. The Parent Company and its subsidiaries (collectively referred to as "the Company") develop, conduct, operate and maintain the business of modern commercial shopping centers and all businesses related thereto such as the conduct, operation and maintenance of shopping center spaces for rent, amusement centers, or cinema theaters within the compound of the shopping centers. Its main sources of revenue include rent income from leases in mall and food court, cinema ticket sales and amusement income from bowling, ice skating and others.

The Parent Company's shares of stock are publicly traded in the Philippine Stock Exchange.

The Parent Company is 52.77% directly and indirectly-owned by SM Investments Corporation (SMIC), a Philippine corporation which listed its common shares with the Philippine Stock Exchange in 2005.

The registered office and principal place of business of the Parent Company is Building A, SM Corporate Offices, Bay Boulevard, SM Central Business Park, Bay City, Pasay City 1300.

## 2. Summary of Significant Accounting Policies

<u>Basis of Preparation</u>

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the Philippines (GAAP) as set forth in Philippine Financial Reporting Standards (PFRS). PFRS includes statements named PFRS and Philippine Accounting Standards (PAS), including interpretations, issued by the Philippine Accounting Standards Council.

The consolidated financial statements have been prepared on a historical cost basis, except for financial instruments held for trading and available-for-sale investments that have been measured at fair value. The consolidated financial statements are presented in Philippine peso, which is the Company's functional and presentation currency under PFRS. All values are rounded to the nearest peso except when otherwise indicated.

<u>Basis of Consolidation</u>
The consolidated financial statements include the accounts of the Parent Company, First Asia Realty Development Corporation (FARDC), a 54.37%-owned subsidiary and the following wholly owned subsidiaries: Premier Central, Inc., Consolidated Prime Development Corp. (CPDC) and Premier Southern Corp. (PSC). The Parent Company holds its interest in SM Megamall, SM City Dasmarinas and SM City Batangas through FARDC, CPDC and PSC, respectively. The financial statements of the subsidiaries are prepared for the same reporting year as the Parent Company, using consistent accounting policies.

All intracompany balances, transactions, income and expenses resulting from intracompany transactions are eliminated in full.

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

Judgements
In the process of applying the Company's accounting policy pertaining to operating lease commitments, management has determined that it retains all the significant risks and rewards of ownership of these properties which are leased out as operating leases.

Use of Estimates
The key assumptions that may have significant risks of causing material adjustments to the carrying amounts of assets and liabilities within the next financial year are discussed below:

*Estimated Useful Lives*. The useful life of each of the Company's investment property is estimated based on the period over which the asset is expected to be available for use. Such estimation is based on a collective assessment of industry practice, internal technical evaluation and experience with similar assets. The estimated useful life of each asset is reviewed periodically and updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limitations on the use of the asset. It is possible, however, that future results of operations could be materially affected by changes in the amounts and timing of recorded expenses brought about by changes in the factors mentioned above. A reduction in the estimated useful life of any investment property would increase the recorded operating expenses and decrease investment properties.

*Allowance for Doubtful Accounts.* The Company recognizes provision for doubtful accounts at a level considered adequate to cover potential uncollectible receivables. Provision for doubtful accounts is made based on the length of the Company's relationship with the tenants, the tenant's payment behavior and other known market factors. The Company continuously reviews the age and status of receivables and identifies accounts that need a provision for doubtful accounts.

*Deferred Income Tax Assets.* The Company's assessment on the recognition of deferred tax assets on deductible temporary differences is based on the projected taxable income in the following periods. This projection is based on the Company's past and future results of operations.

*Impairment of Assets.* The Company assesses at each reporting date whether there is an indication that investment properties may be impaired. An investment property's recoverable amount is the higher of an investment property's fair value less costs to sell and its value in use. When the carrying amount of an investment property exceed its recoverable amount, the investment property is considered impaired and is written down to its recoverable amount.

Cash and Cash Equivalents
Cash includes cash on hand and in banks. Cash equivalents are highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of change in value.

Rent Receivables
Rent receivables, which generally have terms of 30-90 days, are recognized and carried at original invoice amounts or face amount less allowance for any uncollectible amounts. Provision for doubtful accounts is made when there is objective evidence that the Company will not be able to collect the receivables. Bad debts are written off when identified.

Investment Properties
Investment properties represent land and buildings, structures, equipment and improvements of the shopping malls.

Investment properties are measured initially at cost, including transaction costs less accumulated depreciation and accumulated impairment in value, if any. 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.

Depreciation is calculated on a straight-line basis over the following estimated useful lives:

| | |
|---|---|
| Buildings and improvements | 35 years |
| Building equipment, furniture and others | 3-15 years |

The asset's residual values, useful lives and method of depreciation are reviewed and adjusted, if appropriate, at each financial year-end.

When each major inspection is performed, its cost is recognized in the carrying amount of the investment properties as a replacement, if the recognition criteria are met.

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

Transfers of shopping mall complex under construction to investment property are made when there is a change in use, evidenced by completion of construction of shopping mall complex.

Shopping Mall Complex Under Construction
Shopping mall complex under construction is stated at cost and includes cost of land, construction costs, property and equipment, and other direct costs. Cost also includes interest on borrowed funds incurred during the construction period, provided that the carrying amount does not exceed the amount realizable from the use or sale of the asset. Shopping mall complex under construction is not depreciated until such time the relevant assets are completed and put into operational use.

Financial Assets and Liabilities
Financial assets and financial liabilities are recognized initially at fair value. 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.

The Company recognizes a financial asset or a financial liability in the balance sheets when it becomes a party to the contractual provisions of the instrument. In the case of a regular way purchase or sale of financial assets, recognition and derecognition, as applicable, is done using settlement date accounting.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends, gains and losses relating to a financial instrument or a component that is a financial liability, are reported as expense or income. Financial instruments are offset when there is a legally enforceable right to offset and intention to settle either on a net basis or to realize the asset and settle the liability simultaneously.

Financial assets and financial liabilities are further classified into the following categories:

a. Financial asset or financial liability at fair value through profit or loss

   A financial asset or financial liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the near term or upon initial recognition. Assets or liabilities classified under this category are carried at fair value in the consolidated balance sheet. Changes in the fair value of such assets and liabilities are accounted for in the consolidated statements of income. Financial assets at fair value through profit and loss are presented as "Investments held for trading" in the consolidated balance sheet.

b. Loans and receivables

   Loans and receivables are nonderivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Company provides money, goods or services directly to a debtor with no intention of trading the receivables. Loans and receivables are carried at cost or amortized cost in the balance sheet. Amortization is determined using the effective interest rate method.

c. Held-to-maturity

   Held-to-maturity investments are nonderivative financial assets with fixed or determinable payments and fixed maturities wherein the Company has the positive intention and ability to hold to maturity. Held-to-maturity assets are carried at cost or amortized cost in the balance sheet. Amortization is determined by using the effective interest rate method.

d. Available-for-sale

   Available-for-sale financial assets are nonderivatives that are either designated in this category or not classified in any of the other categories. Available-for-sale assets are carried at fair value in the consolidated balance sheet. Changes in the fair value of such assets are accounted for in equity. The Company's investments in redeemable preferred shares classified as available-for-sale investments were stated at cost since these are unquoted. It is the intention of the issuer to offer these investments on a private placement basis and to qualified buyers only.

The Company determines the classification at initial recognition and reevaluates this designation at every reporting date.

Financial assets and liabilities are classified as current if the maturity is within twelve months from the balance sheet date, otherwise, these are classified as noncurrent.

The fair value of investments that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date.

Impairment of Financial Assets
The Company assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

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

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

*Assets Carried at Cost.* If there is objective evidence that an impairment loss has been incurred in an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

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

No impairment losses were recognized during the period.

Debt Issuance Costs
Debt issuance costs are deducted against long-term debt and are amortized over the terms of the related borrowings using the effective interest rate method.

Revenue
Revenue is recognized when it is probable that the economic benefits associated with the transaction will flow to the Company and the amount of the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:

*Rent Income.* Revenue is recognized on a straight-line basis over the lease term or based on the terms of the lease, as applicable.

*Cinema Ticket Sales, Amusement and Others.* Revenue is recognized upon receipt of cash from the customer.

*Interest.* Revenue is recognized as the interest accrues.

*Dividends.* Revenue is recognized when the shareholders' right to receive the payment is established.

Management Fees
Management fees are recognized as an expense in accordance with the terms of the agreements.

Pension Expense
The Parent Company is a participant to the SM Corporate and Management Companies Employer Retirement Plan. The Plan is a funded, noncontributory defined benefit retirement plan administered by a Board of Trustees covering all of its regular full-time employees. The cost of providing benefits under the defined benefit plan is determined using the projected unit credit actuarial valuation method. This method reflects service rendered by employees to the date of valuation and incorporates assumptions concerning the employees' projected salaries. Pension expense includes current service cost, interest cost, expected return on plan assets, amortization of unrecognized past service costs, recognition of actuarial gains (losses) and effect of any curtailments or settlements. Past service cost is amortized over a period until the benefits become vested. The portion of the actuarial gains and losses is recognized when it exceeds the "corridor" (10% of the greater of the present value of obligation or market related value of the plan assets) at the previous reporting date, divided by the expected average remaining working lives of active plan members.

The amount recognized as defined benefit liability is the net of the present value of the defined benefit obligation at the balance sheet date, plus any actuarial gains not recognized minus past service cost not recognized minus the fair value of plan assets at the balance sheet date out of which the obligations are to be settled directly.

Taxes

*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 enacted by the balance sheet date.

*Deferred Tax.* Deferred income tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognized for all taxable temporary differences, except for those that are stated under the standard.

Deferred income tax assets are recognized for all deductible temporary differences, carryforward benefits of minimum corporate income tax (MCIT) and net operating loss carryover (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward benefits of MCIT and NOLCO can be utilized, except for those that are stated under the standard.

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.

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

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

Foreign Currency Translation

The financial statements are presented in Philippine peso, which is the Company's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange at the balance sheet date. All differences are taken to the consolidated statements of income.

Derecognition of Financial Assets and Liabilities

*Financial Assets.* A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired;
- the Company retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the Company has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

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

Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, 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. No provisions were recognized during the year.

Derivatives and Hedging Instruments

The Parent Company enters into long-term foreign currency swap agreements to manage its foreign currency exposures relating to certain long-term foreign currency-denominated loans. It also enters into interest rate swaps to manage its interest rate exposures on underlying floating-rate loans.

Translation gains or losses on foreign currency swaps entered into as hedges are computed by multiplying the swap notional amounts by the difference between the spot exchange rate prevailing on balance sheet date and the spot exchange rate on the contract inception date (or the last reporting date). The resulting translation gains or losses are offset against the translation losses or gains on the underlying foreign currency-denominated liabilities. The Parent Company also enters into interest rate swaps to manage its interest rate exposure on underlying floating-rate loans. Swap costs accruing on foreign currency swaps and interest rate swaps that are currently due to or from the swap counterparties are charged to current operations.

Borrowing Costs

Borrowing costs are generally expensed as incurred. Borrowing costs are capitalized if they are directly attributable to the acquisition or construction of a qualifying asset. Capitalization of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the assets are substantially ready for their intended use. If the carrying amount of the asset exceeds its recoverable amount, an impairment loss is recognized. Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds used to finance the shopping mall.

For income tax reporting purposes, borrowing costs are treated as deductible expenses in the year such are incurred.

Earnings Per Share (EPS)

EPS is computed by dividing the net income for the year by the weighted average number of issued and outstanding shares of stock during the year.

Business Segment

The Company has one primary business segment, which is shopping mall operations.

## 3. Cash and Cash Equivalents

This account consists of:

| | **June 30, 2006** | December 31, 2005 |
|---|---|---|
| Cash on hand and in banks | **₱447,296,262** | ₱242,807,779 |
| Temporary investments | **6,811,339,225** | 3,299,358,468 |
| | **₱7,258,635,487** | ₱3,542,166,247 |

Cash in banks earns interest at the respective bank deposit rates. Temporary investments are made for varying periods depending on the immediate cash requirements of the Company, and earn interest at the respective temporary investment rates (see Notes 11 and 16).

## 4. Investments Held for Trading

This account consists of investments in government bonds with fixed interest rates ranging from 5.980% to 14.00%. These investments are Philippine peso and US dollar-denominated and will mature on various dates starting November 22, 2008 until February 02, 2030.

## 5. Receivables

This account consists of:

| | **June 30, 2006** | December 31, 2005 |
|---|---|---|
| Rent (see Note 16) | **₱1,786,551,466** | ₱1,569,488,741 |
| Accrued interest and others | **643,839,358** | 524,610,473 |
| | **₱2,430,390,824** | ₱2,094,099,214 |

Accrued interests are normally settled throughout the financial year (see Note 16).

## 6. Investment Properties

| | Land | Buildings and Improvements | Building Equipment, Furniture and Others | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| Balance at beginning of period | ₱7,911,099,802 | ₱28,177,412,861 | ₱6,615,135,820 | ₱42,703,648,483 |
| Additions | 37,252,625 | 275,073,219 | 245,929,624 | 558,255,468 |
| Reclassifications | 572,199,287 | 9,639,281,271 | 1,129,233,273 | 11,340,713,831 |
| Balance at end of period (Carried Forward) | 8,520,551,714 | 38,091,767,351 | 7,990,298,717 | 54,602,617,782 |

| | Land | Buildings and Improvements | Building Equipment, Furniture and Others | Total |
|---|---|---|---|---|
| Balance at end of period (Brought Forward) | ₱8,520,551,714 | ₱38,091,767,351 | ₱7,990,298,717 | ₱54,602,617,782 |
| **Accumulated Depreciation** | | | | |
| Balance at beginning of period | – | 5,855,253,184 | 3,222,028,899 | 9,077,282,083 |
| Depreciation | – | 557,168,036 | 304,570,376 | 861,738,412 |
| Balance at end of period | – | 6,412,421,220 | 3,526,599,275 | 9,939,020,495 |
| **Net Book Value** | ₱8,520,551,714 | ₱31,679,346,131 | ₱4,463,699,442 | ₱44,663,597,287 |

The fair value of investment properties determined based on valuations performed by an independent appraiser as of December 31, 2004, amounted to ₱107,774 million.

The fair value represents the amount at which the assets can be exchanged between a knowledgeable, willing seller in an arm's length transaction at the date of valuation, in accordance with International Valuation Standards.

## 7. Shopping Mall Complex Under Construction

Movement of this account follows:

| | **June 30, 2006** | December 31, 2005 |
|---|---|---|
| Balance at beginning of period | **₱11,754,084,686** | ₱6,440,286,551 |
| Additions | **3,902,903,729** | 9,031,112,769 |
| Reclassifications | **(11,340,713,831)** | (3,717,314,634) |
| Balance at end of period | **₱4,316,274,584** | ₱11,754,084,686 |

Shopping mall complex under construction mainly pertains to costs incurred for the development of "SM Supercenter Pasig," "SM City North Edsa Annex 3" and "SM City Lipa".

Interest capitalized during construction amounted to ₱565 million for the six months ended June 30, 2006 and ₱1,365 million for the year 2005.

## 8. Available-for-Sale Investments

This account consists of investments in redeemable preferred shares with annual dividend rates of 6.5% to 10.46%. The preferred shares have preference over the issuer's common shares in the payment of dividends and in the distribution of assets in case of dissolution and liquidation. These investments are unquoted and therefore are stated at cost.

## 9. Loans Payable

Loans payable consist of Philippine peso-denominated and US dollar-denominated loans obtained from banks amounting to ₱2,850 million and ₱5,399 million (US$101.65 million) as of June 30, 2006 and ₱550 million and ₱2,655 million (US$50 million) as of December 31, 2005. The loans bear interest at prevailing market rates.

## 10. Accounts Payable and Other Current Liabilities

This account consists of:

| | **June 30, 2006** | December 31, 2005 |
|---|---|---|
| Trade | **₱985,892,763** | ₱1,175,494,096 |
| Accrued interest (see Notes 9, 11 and 16) | **356,220,819** | 375,191,354 |
| Accrued operating expenses and others (see Note 16) | **858,396,820** | 498,806,821 |
| | **₱2,200,510,402** | ₱2,049,492,271 |

The terms and conditions of the above financial liabilities:

- Trade payables are noninterest-bearing and are normally settled within a 30-day term.
- Accrued expenses and other payables are noninterest-bearing and are payable on demand.

## 11. Long-term Debt

This account consists of:

| | **June 30, 2006** | December 31, 2005 |
|---|---|---|
| Parent Company - | | |
| U.S. dollar-denominated five-year syndicated loan | **₱7,840,784,857** | ₱7,817,895,366 |
| Philippine peso-denominated loans: | | |
| Five-year and seven-year fixed rate notes | **4,969,167,910** | 4,965,643,165 |
| Five-year floating rate notes | **2,972,306,774** | – |
| Five-year syndicated loan | **1,057,546,097** | 1,269,021,152 |
| Other bank loans | **997,690,083** | 996,840,610 |
| Subsidiaries - | | |
| Philippine peso-denominated five-year syndicated loans | **1,283,731,622** | 1,481,093,504 |
| | **19,121,227,343** | 16,530,493,797 |
| Less current portion | **1,291,000,000** | 1,291,000,000 |
| | **₱17,830,227,343** | ₱15,239,493,797 |

Parent Company

US dollar-denominated Five-Year Syndicated Loan
The US$150.0 million unsecured loan was obtained on October 18, 2004 and will mature on October 18, 2009. The loan is a five-year bullet term loan which carries interest rate based on a certain percentage plus London Inter-Bank Offered Rate (see Note 19).

Philippine Peso-denominated Five-Year and Seven-Year Fixed Rate Notes
This represents a five-year and seven-year fixed rate notes obtained on July 8, 2005 amounting to ₱3,500 million (₱2,000 million of which was obtained by SMIC) and ₱1,500 million, respectively. The loans bear fixed interest rates of 10.535% and 11.562%, and will mature on July 8, 2010 and 2012, respectively (see Notes 16 and 19).

Philippine Peso-denominated Five-Year Floating Rate Notes
The ₱3,000 million unsecured loan was obtained June 21, 2006 and will mature on June 21, 2011. The loan is a five-year bullet term loan which carries interest rate based on a certain percentage plus MART-1.

Philippine Peso-denominated Five-Year Syndicated Loan
This represents a five-year syndicated term loan obtained on November 21, 2003, originally amounting to ₱1,700 million, payable in equal quarterly installments of ₱106 million starting February 2005 up to November 2008 and bears a fixed interest rate of 8% payable quarterly.

Other Bank Loans
This represents a two-year and five-year unsecured loans obtained on December 1, 2004 amounting to ₱466 million and ₱534 million, respectively. The loans bear fixed interest rates of 10.87% and 12.54%, respectively, and will mature on December 1, 2006 and December 1, 2009, respectively.

Subsidiaries

Philippine Peso-denominated Five-Year Syndicated Loans
In 2004, CPDC and PSC obtained a five-year term loan, which originally amounted to ₱1,600 million to finance the construction of shopping malls. The five-year term loan is payable in equal quarterly installments of ₱100 million starting in October 2005 up to July 2009 and bears a fixed interest rate of 9.66% payable quarterly in arrears. The loan is guaranteed by the Parent Company.

As of June 30, 2006, temporary investments amounting to ₱1,933 million is pledged to secure the loans in compliance with the requirements of the Bangko Sentral ng Pilipinas (BSP). In accordance with the loan agreement, the Parent Company has the option to substitute the pledged investments held for trading with other assets as collateral, in accordance with the regulations of the BSP (see Note 16).

The loan agreements provide certain restrictions and requirements principally with respect to maintenance of required financial ratios and material change in ownership or control. As of June 30, 2006 and December 31, 2005, the Company is in compliance with the terms of its loan covenants.

Repayment Schedule
Repayments of long-term debt are scheduled as follows:

| Year | Amount |
|---|---|
| 2006 | ₱1,291,000,000 |
| 2007 | 825,000,000 |
| 2008 | 612,500,000 |
| 2009 | 8,600,500,000 |
| 2010-2012 | 8,000,000,000 |
| | ₱19,329,000,000 |

## 12. Retained Earnings

The retained earnings account is restricted for the payment of dividends to the extent of ₱101 million, representing the cost of shares held in treasury and accumulated equity in net earnings of subsidiaries totaling ₱4,403 million and ₱4,259 million as of June 30, 2006 and December 31, 2005, respectively. These earnings are not available for dividend distribution until such time that the Parent Company receives the dividends from the subsidiaries.

## 13. Operating Expenses

This account consists of:

| | **June 30, 2006** | June 30, 2005 |
|---|---|---|
| Depreciation | **₱861,738,413** | ₱698,050,649 |
| Administrative (see Notes 15, 16 and 17) | **602,072,819** | 695,740,972 |
| Film rentals | **400,312,209** | 327,810,036 |
| Business taxes and licenses | **343,220,620** | 250,937,168 |
| Others (see Note 16) | **339,424,142** | 267,547,784 |
| | **₱2,546,768,203** | ₱2,240,086,609 |

14. **Income Tax**

The components of deferred tax assets and liabilities follow:

| | **June 30, 2006** | December 31, 2005 |
|---|---|---|
| Deferred tax assets - | | |
| Accrued expenses, unrealized foreign exchange losses and others | **₱80,528,629** | ₱107,745,310 |
| Deferred tax liabilities - | | |
| Undepreciated capitalized interest, unrealized foreign exchange gains and others | **₱450,166,105** | ₱411,944,833 |

15. **Retirement Plan**

The Parent Company has a funded, noncontributory defined benefit retirement plan covering all of its regular full-time employees. As of December 1, 2005, the date of latest actuarial valuation, the actuarial liability amounted to ₱2 million. The annual normal cost amounted to ₱388,003. The principal actuarial assumptions used to determine the pension benefits include salary increase of 10% a year and a return on plan assets of 12% a year. Actuarial valuations are made at least once every three years.

16. **Related Party Transactions**

Transactions with related parties have been entered into at terms no less favorable than could have been obtained if the transactions were entered into with unrelated parties. The amounts included in the consolidated financial statements with respect to these transactions follow:

a. The Company has existing lease agreements with the SM Retail Group and SM Banking Group. Total rent revenue amounted to ₱1,594 million and ₱1,363 million for the six months period June 30, 2006 and 2005, respectively. Rent receivable, included under "Receivables" account in the consolidated balance sheets, amounted to ₱581 million as of June 30, 2006 and ₱569 million as of December 31, 2005.

b. The Company leases the land where two of its malls are located from SMIC and Shoemart, Inc. respectively, for a period of 50 years, renewable upon mutual agreement of the parties. The Company shall pay a minimum fixed amount or a certain percentage of its gross rental income, whichever is higher. Rent expense amounted to ₱36 million and ₱22 million for the six months period June 30, 2006 and 2005, respectively. Rent payable, included under "Accounts payable and other current liabilities" account in the consolidated balance sheets, amounted to ₱10 million as of June 30, 2006 and ₱5 million as of December 31, 2005.

c. The Company pays management fees to Shopping Center Management Corporation, Leisure Center, Inc., West Avenue Theaters Corporation and Family Entertainment Center, Inc. for managing the operations of the mall. Total management fees amounted to ₱189 million and

₱150 million for the six months period June 30, 2006 and 2005, respectively. Accrued management fees, included under "Accounts payable and other current liabilities" account in the consolidated balance sheets, amounted to ₱15 million and ₱20 million as of June 30, 2006 and December 31, 2005, respectively.

d. The Company has certain bank accounts and cash placements that are maintained with the SM Banking Group. Cash and cash equivalents, including investments held for trading amounted to ₱7,258 million as of June 30, 2006 and ₱3,681 as of December 31, 2005. Pledged short-term deposits of ₱1,933 million is deposited with Banco de Oro (BDO) (see Note 11). Interest income amounted to ₱109 million and ₱293 million for the six months period June 30, 2006 and 2005, respectively. Accrued interest receivable, included under "Receivables" account in the consolidated balance sheets, amounted to ₱75 million and ₱50 million as of June 30, 2006 and December 31, 2005, respectively.

e. As of June 30, 2006 and December 31, 2005, outstanding loans payable and long-term debt from the SM Banking Group and SMIC amounted to ₱4,922 million and ₱3,900 million, respectively. Interest expense amounted to ₱211 million and ₱58 million for the six months period June 30, 2006 and 2005, respectively. Accrued interest payable, included under "Accounts payable and other current liabilities" account in the consolidated balance sheets, amounted to ₱131 million and ₱118 million as of June 30, 2006 and December 31, 2005, respectively.

f. As of June 30, 2006 and December 31, 2005, a portion of available-for-sale investments amounting to ₱2,656 million and ₱2,655 million pertains to preferred shares of BDO (see Note 8). Dividend income amounted to ₱91 million and ₱89 million for the six months ended June 30, 2006 and 2005, respectively. Dividends receivable included under "Receivables" account in the consolidated balance sheets, amounted to ₱213 million and ₱84 million as of June 30, 2006 and December 31, 2005, respectively.

g. Total compensation paid to key management personnel of the Company amounted to ₱4 million for each of the six months period June 30, 2006 and 2005. Aside from the usual monthly salaries and government mandated bonus, there are no other special benefits paid to management personnel.

## 17. Lease Agreements

The Company's lease agreements with its tenants are generally granted for a term of one year, with the exception of some of the larger tenants operating nationally, which are granted initial lease terms of five years, renewable on an annual basis thereafter. Tenants pay either a fixed monthly rent, which is calculated with reference to a fixed sum per square meter of area leased, or pay rent on a percentage rental basis, which comprises a basic monthly amount and a percentage of gross sales.

The Company also leases certain parcels of land where some of its malls are constructed. The terms of the lease shall be for a period ranging from 25 to 50 years, renewable for the same period under the same terms and conditions. Rental payments are generally computed based on a certain percentage of the Company's gross rental income or a certain fixed amount.

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

The Company's principal financial instruments, other than derivatives, comprise of bank loans, available-for-sale investments, and investments held for trading and cash and cash equivalents. The main purpose of these financial instruments is to finance the Company's operations. The Company has various other financial assets and liabilities such as rent receivables and trade payables, which arise directly from its operations.

The Company also enters into derivative transactions, including principally interest rate swaps and foreign currency swaps. The purpose is to manage the interest rate and currency risks arising from the Company's operations and its sources of finance.

The main risks arising from the Company's financial instruments are interest rate risk, foreign currency risk, credit risk and liquidity risk. The Company's BOD and management review and agree on the policies for managing each of these risks as summarized below.

Interest Rate Risk
The Company's exposure to interest rate risk relates primarily to the Company's financial instruments with a floating interest rate and fixed interest rate. Fixed rate financial instruments are subject to fair value interest rate risk while floating rate financial instruments are subject to cash flow interest rate risk. Repricing of floating rate financial instruments is done every three to six months. Interest on fixed rate financial instruments is fixed until maturity of the instrument. Details of financial instruments that are exposed to interest rate risk are disclosed in Notes 4, 8, 9 and 11.

The Company's policy is to manage its interest cost using a mix of fixed and floating rate debts. To manage this mix in a cost-efficient manner, the Company enters into interest rate swaps, in which the Company agrees to exchange, at specified intervals, the difference between fixed and floating rate interest amounts calculated by reference to an agreed-upon notional principal amount. These swaps are designated to hedge underlying debt obligations. As of June 30, 2006, after taking into account the effect of interest rate swaps, approximately 65% of the Company's long-term borrowings are at a fixed rate of interest.

Foreign Currency Risk
As of June 30, 2006, the Company's foreign currency-denominated monetary assets and liabilities amounted to ₱10,038 million (US$189 million) and ₱9,666 million (US$182 million), respectively, and as of December 31, 2005, ₱6,955 million (US$131 million) and ₱6,902 million (US$130 million), respectively.

In translating the foreign currency-denominated monetary assets and liabilities into peso amounts, the exchange rates used were ₱53.110 to US$1.00 and ₱53.090 to US$1.00, the Philippine peso to US dollar exchange rates as of June 30, 2006 and December 31, 2005, respectively.

To manage foreign exchange risks, stabilize cash flows, and improve investment and cash flow planning, the Company enters into foreign currency swaps aimed at reducing and/or managing the adverse impact of changes in foreign exchange rates on operating results and cash flows.

Credit Risk
It is the Company's policy that all prospective tenants be subject to screening procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Company's exposure to bad debts is not significant.

With respect to credit risk arising from the other financial assets of the Company, which comprise of cash and cash equivalents, available-for-sale investments, investments held for trading and certain derivative instruments, the Company's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

Since the Company trades only with recognized third parties, there is no requirement for collateral.

The Parent Company may be exposed to credit risk as a result of a transaction guaranteeing the loan of its wholly-owned subsidiaries, PSC and CPDC. In the event that PSC and CPDC fails to perform its obligations, its maximum exposure is equal to the carrying amount of the loan (see Note 11).

Liquidity Risk
The Company seeks to manage its liquidity profile to be able to finance its capital expenditures and service its maturing debts. The Company's objective is to maintain a balance between continuity of funding and flexibility through valuation of projected and actual cash flow information.

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19. **Financial Instruments**

Fair Values
The fair values and carrying amounts of investments held for trading amounted to ₱1,821 million and ₱1,646 million as of June 30, 2006 and as of December 31, 2005, respectively. The carrying amounts of the Company's other financial assets approximate their fair values due to the short-term nature of the transactions.

Foreign Currency Swaps and Interest Rate Swaps
In 2004, the Parent Company entered into foreign currency swap agreements with an aggregate notional amount of US$70 million and weighted average swap rate of ₱56.31 to US$1. Under these agreements, the Parent Company effectively swaps the principal amount and interest of these US dollar-denominated loans into Philippine peso-denominated loans with payments up to October 2009.

The Parent Company also entered into US$ interest rate swap agreements with an aggregate notional amount of US$80 million. Under these agreements, the Parent Company effectively swaps these floating rate U.S. dollar-denominated loans into fixed rate loans with semi-annual payment intervals up to October 2009.

In 2005, the Parent Company also entered into Philippine peso interest swap agreements with an aggregate notional amount of ₱3,750 million. Under these agreements, the Parent Company effectively swaps these fixed rate Philippine peso-denominated loans into floating rate loans with semi-annual payment intervals up to July 2012.

## 20. **Basic EPS Computation**

Basic EPS is computed as follows:

| | **June 30, 2006** | June 30, 2006 |
|---|---|---|
| Net income (a) | **₱2,616,742,032** | ₱2,410,710,284 |
| Common shares issued | **9,935,294,157** | 9,935,294,157 |
| Less weighted average number of treasury shares acquired during the year | **18,857,000** | 18,857,000 |
| Weighted average number of common shares outstanding (b) | **9,916,437,157** | 9,916,437,157 |
| Earnings per share (a/b) | **₱0.264** | ₱0.243 |

**SIGNATURES**

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

Registrant: **SM PRIME HOLDINGS, INC.**

PRINCIPAL FINANCIAL/ACCOUNTING OFFICER:

__________________________________
**JEFFREY C. LIM** **Date: ________________**
**VP – Finance & Administration**

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## SM Prime revenue up by 19% in Q2

Financial and Operational Highlights
(in Million Pesos, except for financial ratios)

| | Three months ended June 30 | | | Six months ended June 30 | | |
|---|---|---|---|---|---|---|
| | **2006** | **2005** | **% Change** | **2006** | **2005** | **% Change** |
| Profit & Loss Data | | | | | | |
| Revenues | 3,235 | 2,708 | 19% | 6,088 | 5,193 | 17% |
| Operating Expenses | 1,401 | 1,156 | 21% | 2,547 | 2,240 | 14% |
| Operating Income | 1,833 | 1,552 | 18% | 3,541 | 2,953 | 20% |
| Net Income | 1,279 | 1,174 | 9% | 2,617 | 2,411 | 9% |
| EBITDA | 2,288 | 1,900 | 20% | 4,403 | 3,651 | 21% |

| | June 30 2006 | Dec 31 2005 | % Change |
|---|---|---|---|
| Balance Sheet Data | | | |
| Total Assets | 67,609 | 59,429 | 14% |
| Total Investment Properties | 48,980 | 45,380 | 8% |
| Total Debt | 27,370 | 19,735 | 39% |
| Total Stockholders' Equity | 32,687 | 32,550 | 0% |
| Financial Ratios | | | |
| Investment Properties to Total Assets | 0.72 | 0.76 | |
| Current Ratio | 1.25 : 1 | 1.12 : 1 | |
| Debt to Equity | 46 : 54 | 38 : 62 | |

| | June 30 | |
|---|---|---|
| (annualized) | **2006** | **2005** |
| Return on Equity | 0.16 | 0.15 |
| Debt to EBITDA | 3.11 | 2.70 |
| Operating Income to Revenues | 0.58 | 0.57 |
| Net Income to Revenues | 0.43 | 0.46 |

SM Prime Holdings, Inc., the country's leading shopping mall developer and operator, posts 19% increase in gross revenues in the second quarter 2006 to P3.23 billion from P2.71 billion in the same quarter 2005. Rental revenues remain the largest portion, with a significant growth of 20% amounting to P2.68 billion from same quarter last year of P2.24 billion. This is largely due to rentals from new SM Supermalls opened in 2005 and 2006, namely, SM City San Lazaro, SM Supercenter Valenzuela, SM Supercenter Molino, SM City Sta. Rosa, SM City Clark and the Mall of Asia. The new malls opened with a total gross floor area of 862,215 square meters. Currently, these new malls have an average occupancy level of 95%. Same store rental growth is at 6%.

Cinema ticket sales showed a strong performance of 20% increase for the six months ended June 30, 2006 due to more blockbuster films in 2006 compared to the same period in 2005 and the huge success of the 2005 Metro Manila Film Festival which extended up to January 2006. For the first half of 2006, major blockbuster films shown were "X-Men 3," "Mission Impossible 3," "Don't Give Up On Us," "Close To You," and "Chronicles of Narnia." In 2005, major blockbuster films shown for the same period were "Let the Love Begin," "Star Wars: Episode 3," Mr. And Mrs. Smith," "Constantine," and "Batman Begins."

Income from operations enjoyed a favorable growth of 20% from P2.95 billion for the six months ended June 30, 2005 to P3.54 billion in the same period 2006. Operating expenses exhibited a minimal increase of 14% relative to the increase in revenues due to the Company's concerted efforts at maintaining operational efficiency.

Net income for the six months ended June 30, 2006 increased 9% at P2.62 billion from same period 2005 of P2.41 billion. The significant decrease in interest and other income is mainly due to decline in interest and dividend income arising from sale of investments and increase in interest expense resulting from new borrowings. Corporate income tax rates were also increased from 32% to 35% effective November 1, 2005 as required by R.A. No. 9337.

On the balance sheet side, cash and cash equivalents, including investments held for trading increased 174% due to proceeds from new loans net of capital expenditures and principal and interest payments. Receivables likewise increased 16% due to increase in rent income from the new malls and accruals for interest and dividend income.

The increase in prepaid expenses and other current assets of 39% is mainly due to prepaid taxes and other operating expenses which will be subsequently amortized over 2006.

The increase in investment properties of 8% is mainly due to construction activities related to SM Sta. Rosa, SM Clark, Mall of Asia, SM North Edsa Annex 3, SM Pasig and SM Lipa.

Loans payable increased 157% due to additional short-term, peso-denominated and dollar-denominated loans amounting to P2 billion and $53.25 million, respectively, availed during 2006, net of principal payments amounting to $1.6 million. Likewise, long-term debt also increased due to the P3 billion floating rate note facility availed from Metrobank in June 2006.

Accounts payable and accrued expenses increased 7% mainly due to accruals for interest and trade payables related to construction.

The decrease in minority interest of 8% is due to share in net income of FARDC net of dividends declared. Likewise, income tax payable also decreased 59% due to subsequent payment of income tax liabilities.

The Company's performance indicators are measured in terms of the following: (1) Ratio of investment properties to total assets which measures the ratio of property and equipment to total assets; (2) current ratio which measures the ratio of total current assets to total current liabilities; (3) debt to equity which measures the ratio of interest bearing liabilities to stockholders' equity; (4) return on equity (ROE) which measures the ratio of net income to capital provided by stockholders; (5) earnings before interest, income taxes, depreciation and amortization (EBITDA); (6) debt to EBITDA which measures the ratio of EBITDA to total interest-bearing liabilities; (7) operating income to revenues which basically measures the gross profit ratio; and, (8) net income to revenues which measures the ratio of net income to gross revenues. The following discuss in detail the key performance indicators of the Company.

The balance sheet remains robust with total investment properties accounting for 72% of total assets as of June 30, 2006 and 76% as of December 31, 2005. The Company's current ratio improved at 1.25:1 as of June 30, 2006 as compared to 1.12:1 as of December 31, 2005.

Interest-bearing debt to stockholders' equity is steady at 0.46:0.54 and 0.38:0.62 as of June 30, 2006 and December 31, 2005, respectively. As discussed previously, additional loans were availed in 2006 for working capital and capital expansion requirements.

In terms of profitability, ROE remains steady at 16% and 15% as of June 30, 2006 and December 31, 2005, respectively.

EBITDA increased 21% to P4.40 billion for the first half of 2006 from P3.65 billion in the same period 2005. Debt to EBITDA slightly increased at 3.11:1 and 2.70:1 as of June 30, 2006 and 2005, respectively.

Operating income to revenues is almost steady at 58% for the period ended June 30, 2006 compared to 57% in the same period 2005. On the other hand, net income to revenues slightly decreased at 43% compared to 46% for the periods ended June 30, 2006 and 2005, respectively.

The Company has no known direct or contingent financial obligation that is material to the Company, including any default or acceleration of an obligation. There were no contingent liabilities or assets in the Company's balance sheet. The Company has no off-balance sheet transactions, arrangements, obligations during the reporting year as of balance sheet date.

There are no known trends, events, material changes, seasonal aspects or uncertainties that are expected to affect the company's continuing operations.

SM Prime currently has 25 Supermalls strategically located nationwide with a total gross floor area of 3.4 million square meters.

Last May 21, 2006, the Company opened the Mall of Asia to a huge crowd of close to a million. Located on a 60 hectare property overlooking Manila Bay, the 386,000 square meter complex consists of four buildings linked by elevated walkways - Main Mall, the North Parking Building, the South Parking Building, and the Entertainment Center Building. Other malls scheduled to open in 2006 are SM Supercenter Pasig and SM City Lipa. Total gross floor area will increase to 3.6 million square meters by end 2006.

**SM PRIME HOLDINGS, INC.**
**AGING OF RENT RECEIVABLE**
**AS OF JUNE 30, 2006**

| | BALANCE | CURRENT | 1 - 3 MONTHS |
|---|---|---|---|
| SM MEGAMALL | 222,962,562 | 154,580,930 | 68,381,631 |
| SM NORTH EDSA | 152,694,162 | 123,224,733 | 29,469,429 |
| SM SOUTHMALL | 93,499,321 | 79,533,167 | 13,966,154 |
| SM FAIRVIEW | 98,900,740 | 83,713,680 | 15,187,060 |
| SM BACOOR | 74,530,833 | 61,000,477 | 13,530,356 |
| SM MANILA | 77,850,217 | 62,486,088 | 15,364,129 |
| SM CEBU | 74,463,763 | 52,472,300 | 21,991,463 |
| SM PAMPANGA | 58,162,255 | 49,911,065 | 8,251,190 |
| SM BICUTAN | 33,845,989 | 32,228,087 | 1,617,902 |
| SM STA MESA | 55,887,209 | 50,942,287 | 4,944,922 |
| SM ILOILO | 49,696,674 | 43,605,094 | 6,091,580 |
| SM DASMARINAS | 48,096,132 | 44,703,990 | 3,392,142 |
| SM MARILAO | 39,582,518 | 38,517,076 | 1,065,442 |
| SM DAVAO | 42,167,053 | 37,441,679 | 4,725,374 |
| SM BATANGAS | 36,210,734 | 34,451,700 | 1,759,034 |
| SM BAGUIO | 41,732,310 | 39,467,829 | 2,264,481 |
| SM SUCAT | 43,292,134 | 40,290,682 | 3,001,452 |
| SM LUCENA | 30,385,076 | 27,857,842 | 2,527,234 |
| SM SAN LAZARO | 63,545,526 | 56,416,410 | 7,129,116 |
| SM CAGAYAN DE ORO | 24,282,197 | 19,516,888 | 4,765,309 |
| SM VALENZUELA | 24,521,325 | 22,049,531 | 2,471,794 |
| SM MOLINO | 29,360,382 | 22,008,748 | 7,351,634 |
| SM STA ROSA | 37,074,538 | 25,312,512 | 11,762,026 |
| SM CLARK | 42,234,267 | 38,735,629 | 3,498,638 |
| SM MALL OF ASIA | 291,573,549 | 276,110,952 | 15,462,597 |
| | 1,786,551,466 | 1,516,579,375 | 269,972,090 |