MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS For the Three Months Ended March 31, 2004

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying financial statements and the related notes. Our financial statements, and the financial information discussed below, have been prepared in accordance with Philippine generally accepted accounting principles, or Philippine GAAP, which differs in certain significant respects from generally accepted accounting principles in the United States.

The financial information appearing in this report and in the accompanying financial statements is stated in Philippine pesos. All references to "pesos," "Philippine pesos" or "Php" are to the lawful currency of the Philippines; all references to "U.S. dollars," "US$" or "dollars" are to the lawful currency of the United States; all references to "Japanese yen," "JP¥" or "¥" are to the lawful currency of Japan and all references to "Euro" or "€" are to the lawful currency of the European Union. Translations of Philippine peso amounts into U.S. dollars in this report and in the accompanying financial statements were made based on the exchange rate of Php56.216 to US$1.00, the volume weighted average exchange rate at March 31, 2004 quoted through the Philippine Dealing System.

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

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

Financial Highlights

(in millions)	March 31, 2004 (Unaudited)	December 31, 2003(1) (Audited)	Increase (Decrease) Amount	%
Consolidated Balance Sheets				
Total assets	Php301,412	Php297,626	Php3,786	1
Property, plant and equipment – net	243,455	244,427	(972)	–
Total debt	156,960	159,814	(2,854)	(2)
Total stockholders' equity	98,451	93,578	4,873	5
Debt to equity ratio	1.59x	1.71x	–	–

	Three Months Ended March 31,			
			Increase (Decrease)	
	2004	2003(1)	Amount	%
	(Unaudited)			
Consolidated Statements of Income				
Operating revenues	Php27,092	Php22,737	Php4,355	19
Operating expenses	16,619	15,645	974	6
Net operating income	10,473	7,092	3,381	48
EBIT(2)	9,826	6,344	3,482	55
EBITDA(3)	16,346	12,147	4,199	35
Net income	5,240	2,483	2,757	111
Operating margin	39%	31%	–	–
EBITDA margin	60%	53%	–	–
Consolidated Statements of Cash Flows				
Net cash provided by operating activities	Php16,679	Php11,920	Php4,759	40
Net cash used in investing activities	4,687	2,220	2,467	111
Capital expenditures	4,299	1,890	2,409	127
Net cash used in financing activities	7,237	8,038	(801)	(10)

(1) As restated to reflect the change in accounting policy on leases, as described in *Note 3 – Accounting Changes* to the accompanying financial statements.

(2) EBIT is defined as earnings before minority interest in net (income) losses of consolidated subsidiaries, adding back interest expense and related items, taxes and deducting interest income. EBIT should not be considered in isolation or as a substitute for operating income, net income, cash flows from operating activities and other income or cash flow statement data prepared in conformity with generally accepted accounting principles, or as a measure of profitability or liquidity.

(3) EBITDA is defined as earnings before minority interest in net (income) losses of consolidated subsidiaries, adding back interest expense and related items, taxes, depreciation and amortization, deducting interest income and is presented because it is generally accepted as providing useful information regarding a company's ability to service and/or incur debt. EBITDA should not be considered in isolation or as a substitute for operating income, net income, cash flows from operating activities and other income or cash flow statement data prepared in conformity with generally accepted accounting principles, or as a measure of profitability or liquidity.

EBIT and EBITDA, on a consolidated basis for the three months ended March 31, 2004 and 2003, are derived as follows:

	Three Months Ended March 31,			
			Increase (Decrease)	
	2004	2003(b)	Amount	%
	(Unaudited)			
(in millions)				
Earnings before minority interest in net (income) losses of consolidated subsidiaries(a)	Php5,236	Php2,487	Php2,749	111
Add: Interest expenses(a)	2,948	2,956	(8)	–
Provision for income tax(a)	1,854	1,004	850	85
Less: Interest income(a)	212	103	109	106
EBIT	9,826	6,344	3,482	55
Add: Depreciation and amortization(a)	6,520	5,803	717	12
EBITDA	Php16,346	Php12,147	Php4,199	35

(a) See statements of income in the accompanying financial statements.

(b) As restated to reflect the change in accounting policy on leases, as described in *Note 3 – Accounting Changes* to the accompanying financial statements.

Overview

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

- *Wireless* — wireless telecommunications services provided by PLDT's subsidiaries, Smart Communications, Inc., our cellular service provider, and Mabuhay Satellite Corporation, ACeS Philippines Cellular Satellite Corporation, and Telesat, Inc., our satellite and very small aperture terminal, or VSAT, operators;
- *Fixed Line* — fixed line telecommunications services primarily provided through PLDT. We also provide fixed line services through PLDT's subsidiaries PLDT Clark Telecom, Inc., Subic Telecommunications Company, Inc., PLDT-Maratel, Inc. and Bonifacio Communications Corporation, which together account for approximately 1% of our consolidated fixed lines in service, and PLDT Global Corporation; and
- *Information and Communications Technology* — information and communications infrastructure and services for internet applications, internet protocol-based solutions and multimedia content delivery provided by PLDT's subsidiary ePLDT, Inc.; internet access services provided by ePLDT's subsidiary Infocom Technologies, Inc.; and e-commerce, call centers and IT-related services provided by other investees of ePLDT, as described in *Note 9 – Investments* to the accompanying financial statements.

Results of Operations

The table below shows the contribution by each of our business segments to our consolidated operating revenues, operating expenses and net operating income (losses) for the three months ended March 31, 2004 and 2003. Most of our revenues are derived from our operations within the Philippines. Our revenues derived from outside the Philippines consist primarily of revenues from incoming international calls to the Philippines.

	Three Months Ended March 31,					
					Increase (Decrease)	
	2004	**%**(1)	**2003**(2)	**%**(1)	**Amount**	**%**
			(Unaudited)			
(in millions)						
Operating Revenues						
Wireless	Php14,956	55	Php10,940	48	Php4,016	37
Fixed line	11,694	43	11,440	50	254	2
Information and communications technology	442	2	357	2	85	24
	27,092	100	22,737	100	4,355	19
Operating Expenses						
Wireless	8,151	30	7,126	31	1,025	14
Fixed line	8,101	30	8,077	36	24	–
Information and communications technology	367	1	442	2	(75)	(17)
	16,619	61	15,645	69	974	6
Net Operating Income (Losses)						
Wireless	6,805	25	3,814	17	2,991	78
Fixed line	3,593	13	3,363	14	230	7
Information and communications technology	75	1	(85)	–	160	(188)
	Php10,473	39	Php7,092	31	Php3,381	48

(1) Operating expenses and net operating income (losses) are computed as a percentage of operating revenues.
(2) As restated to reflect the change in accounting policy on leases, as described in *Note 3 – Accounting Changes* to the accompanying financial statements.

Consolidated Operating Revenues

Largely driven by the continued strong growth of our wireless business, particularly Smart's cellular business, our consolidated operating revenues for the first quarter of 2004 increased by Php4,355 million, or 19%, to Php27,092 million from Php22,737 million in the same period in 2003. The revenue contribution of our wireless business accounted for 55% of our consolidated operating revenues for the first quarter of 2004, compared to 48% in the same period in 2003. Smart contributed Php14,711 million in revenues for the first quarter of 2004 an increase of 37% over its revenue contribution of Php10,744 million for the same period in 2003.

Wireless

Our wireless business segment offers cellular services as well as satellite, VSAT, and other services.

The following table summarizes our consolidated operating revenues from our wireless business for the three months ended March 31, 2004 and 2003 by service segment:

	Three Months Ended March 31,					
					Increase	
	2004	%	2003	%	Amount	%
			(Unaudited)			
(in millions)						
Wireless services:						
Cellular	Php14,711	98	Php10,744	98	Php3,967	37
Satellite, VSAT and others	245	2	196	2	49	25
Total	Php14,956	100	Php10,940	100	Php4,016	37

Our wireless service revenues increased by Php4,016 million, or 37%, to Php14,956 million in the first quarter of 2004 from Php10,940 million in the same period in 2003 mainly as a result of the continued strong growth in revenues generated from Smart's cellular service. Accordingly, as a percentage of our consolidated operating revenues, wireless service revenues increased to 55% in the first quarter of 2004 from 48% in the same period in 2003.

Cellular Service

Our cellular service revenues consist of:

- revenues derived from actual usage of the network by prepaid subscribers and any unused peso value of expired prepaid cards or electronic air time loads, net of discounts given to dealers;
- monthly service fees from postpaid subscribers, including (1) charges for calls in excess of allocated free local calls, (2) toll charges for national and international long distance calls, (3) charges for text messages of our GSM service customers in excess of allotted free text messages and (4) charges for value-added services, net of related content provider costs;
- revenues generated from incoming calls and messages to our subscribers, net of interconnection expenses; fees from reciprocal traffic from international correspondents; and revenues from inbound international roaming calls for the GSM service;
- service fees charged to Pilipino Telephone Corporation, or Piltel, for using Smart's GSM network for Piltel's *Talk 'N Text* prepaid cellular service; and

- other charges, including those for reconnection and migration.

Proceeds from the sale of handsets and SIM cards are not recorded as part of cellular service revenues. Gains on the sale of handsets are offset against selling and promotion expenses, while losses on the sale of handsets and SIM cards are included as part of selling and promotion expenses.

Our cellular service revenues in the first quarter of 2004 amounted to Php14,711 million, an increase of Php3,967 million, or 37%, from Php10,744 million in the same period in 2003. Cellular service revenues accounted for 98% of our wireless revenues and contributed 54% to our consolidated operating revenues in the first quarter of 2004, compared to 47% in the same period in 2003. This increase was primarily due to the growth in Smart's subscriber base, which increased by 3,795,371, or 51%, from 7,389,807 as of March 31, 2003 to 11,185,178 as of March 31, 2004. The strong subscriber growth offset the decline in blended monthly gross and net ARPU, which dropped by 12% and 8%, respectively.

Smart markets nationwide cellular communications services under the brand names *Smart Buddy, Smart Gold, addict mobile* and *Smart Infinity. Smart Buddy* is a prepaid service while *Smart Gold, addict mobile* and *Smart Infinity* are postpaid services, which are all provided through Smart's digital GSM network. Introduced in April 2003, *addict mobile* offers exclusive multimedia content to subscribers and features personalized means for internet surfing, allowing subscribers to apply their allocated free credits towards their choice of data and value-added services. *Smart Infinity* is a premium postpaid plan, launched in January 2004 that caters to affluent and highly mobile market, offering first class quality services, including a round-the-clock dedicated personal concierge service, international assistance services, premium handset packages and exclusive lifestyle content.

The following table summarizes key measures of our cellular business as of and for the three months ended March 31, 2004 and 2003:

	Three Months Ended March 31,			
			Increase	
	2004	2003	Amount	%
	(Unaudited)			
(in millions)				
Cellular revenues	Php14,711	Php10,744	Php3,967	37
GSM	14,595	10,662	3,933	37
By component	*12,954*	*9,648*	*3,306*	*34*
Voice	6,876	5,656	1,220	22
Data	6,078	3,992	2,086	52
By service type	*12,954*	*9,648*	*3,306*	*34*
Prepaid	11,911	8,686	3,225	37
Postpaid	1,043	962	81	8
GSM-Others(1)	*1,641*	*1,014*	*627*	*62*
Others(2)	116	82	34	41

	As of March 31,			
			Increase	
	2004	2003	Amount	%
	(Unaudited)			
GSM Cellular subscriber base	11,185,178	7,389,807	3,795,371	51
Prepaid	10,919,335	7,176,196	3,743,139	52
Postpaid	265,843	213,611	52,232	24
Systemwide subscriber base(3)	14,356,186	9,368,513	4,987,673	53

	Three Months Ended March 31,			
			Increase (Decrease)	
	2004	2003	Amount	%
	(Unaudited)			
Traffic volumes (in millions)				
Calls (in minutes)	985	842	143	17
Domestic	712	571	141	25
International	273	271	2	1
Inbound	236	237	(1)	–
Outbound	37	34	3	9
Text messages – outbound	8,214	5,114	3,100	61

(1) Refers to other non-subscriber-related revenues, such as facility service fees from Smart's revenue-sharing agreement with Piltel and inbound international roaming fees.

(2) Refers to all other services consisting primarily of revenues from Smart Money Holdings Corporation, public calling offices and *SMARTalk* payphones, and a small number of leased line contracts.

(3) Includes Piltel's *Talk'N Text* subscribers of 3,171,008 and 1,978,706 as of March 31, 2004 and 2003, respectively. *Talk'N Text* is a prepaid GSM service provided by Piltel using Smart's GSM network under a revenue-sharing agreement.

Voice Services

Smart's revenues from voice services, which include all voice traffic and value-added services such as voice mail and international roaming, increased by Php1,220 million, or 22%, to Php6,876 million in the first quarter of 2004 from Php5,656 million in the same period in 2003 mainly due to the increase in subscriber base.

Prior to January 2004, *Smart Buddy* subscribers were charged a rate of Php8.00 per minute for calls made during peak hours and Php4.00 per minute for calls made during off-peak hours regardless of whether the calls were made to subscribers within the Smart network or to other mobile operators' networks. Beginning January 2004, Smart implemented all-day flat air time rates for calls made by its prepaid subscribers. Calls terminating to other Smart and Piltel's *Talk 'N Text* subscribers are charged Php6.50 per minute, while an all-day flat rate of Php7.50 per minute is charged for calls terminating to other cellular network subscribers as well as local and NDD calls.

Air time rates for postpaid subscribers vary depending on type of postpaid plan selected by subscribers. Beginning January 25, 2004, *Smart Gold* and *addict mobile* launched flat rate-regular plans and consumable plans.

Data Services

Smart's revenues from cellular data services, which include all text messaging-related services as well as value-added services, increased by Php2,086 million, or 52%, to Php6,078 million in the first quarter of 2004 from Php3,992 million in the same period in 2003. Cellular data services accounted for 42% of Smart's GSM cellular revenues in the first quarter of 2004, compared to 37% in the same period in 2003. Text messaging-related services contributed revenues of Php5,549 million in the first quarter of 2004, compared to Php3,730 million in the same period in 2003, and accounted for 91% and 93% of the total cellular data revenues for the first quarter of 2004 and 2003, respectively. The increase in revenues from text messaging-related services resulted mainly from a 61% increase in volume of text messages to 8,214 million outbound messages in the first quarter of 2004 from the 5,114 million outbound messages handled in the same period in 2003. Value-added services contributed revenues of Php529 million in the first quarter of 2004, increasing by Php267 million, or 102%, from Php262 million in the same period in 2003.

The following table shows the breakdown of Smart's cellular data revenues for the three months ended March 31, 2004 and 2003:

	March 31,		Increase (Decrease)	
	2004	2003	Amount	%
	(Unaudited)			
(in millions)				
Text messaging				
Domestic	Php5,146	Php3,323	Php1,823	55
International	403	407	(4)	(1)
	5,549	3,730	1,819	49
Value-added services				
Non-Zed(1)	Php245	Php119	Php126	106
Smart Zed™	98	114	(16)	(14)
Mobile Banking, Roaming SMS, WAP, *Smart Money*	186	29	157	541
	529	262	267	102
Total	Php6,078	Php3,992	Php2,086	52

(1) Value-added services developed by Smart on its own platform.

Facility Services

Smart's revenues from GSM service in the first quarter of 2004 and 2003 included facility service fees totaling Php1,343 million and Php841 million, respectively, representing Smart's 50% share from Piltel's *Talk 'N Text* revenues, net of interconnection fees. As of March 31, 2004, Piltel had 3,171,008 *Talk 'N Text* subscribers compared to 1,978,706 subscribers as of March 31, 2003 using Smart's GSM network pursuant to a facilities service agreement between Smart and Piltel. See *Note 15 – Related Party Transactions* to the accompanying financial statements for a description of this agreement.

Subscriber Base, ARPU and Churn Rates

Of Smart's 11,185,178 GSM subscribers as of March 31, 2004, prepaid subscribers accounted for approximately 98% while postpaid subscribers accounted for the remaining 2%. Smart's prepaid GSM subscriber base grew by 52% to 10,919,335 as of March 31, 2004 from 7,176,196 as of March 31, 2003, whereas Smart's postpaid GSM subscriber base increased by 24% to 265,843 as of March 31, 2004 from 213,611 as of March 31, 2003. Smart's prepaid and postpaid net subscriber activations totaled 1,088,200 and 16,866, respectively, in the first quarter of 2004, or a monthly average addition of 362,733 prepaid and 5,622 postpaid subscribers.

Revenues attributable to Smart's prepaid service amounted to Php11,911 million in the first quarter of 2004, a 37% increase over the Php8,686 million earned in the same period in

2003. Net prepaid revenues in the first quarter of 2004 accounted for 92% of GSM voice and data revenues, compared to 90% in the same period in 2003. Revenues attributable to Smart's postpaid service amounted to Php1,043 million in the first quarter 2004, an 8% increase over the Php962 million earned in the same period in 2003. Net postpaid revenues in the first quarter of 2004 accounted for 8% of GSM voice and data revenues, compared to 10% in the same period in 2003.

The following table summarizes Smart's usage-based monthly ARPUs for the three months ended March 31, 2004 and 2003:

	Three Months Ended March 31,							
	Gross		Increase (Decrease)		Net		Increase (Decrease)	
	2004	2003	Amount	%	2004	2003	Amount	%
	(Unaudited)							
Prepaid	Php463	Php533	Php(70)	(13)	Php383	Php416	Php(33)	(8)
Postpaid	1,762	1,716	46	3	1,351	1,268	83	7
Blended	495	565	(70)	(12)	406	439	(33)	(8)

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

Smart's prepaid service revenues consist mainly of charges for subscribers' actual usage of their prepaid cards. Gross monthly ARPU for Smart's prepaid GSM service in the first quarter of 2004 was Php463, compared to Php533 in the same period in 2003. The decline was attributable mainly to a decrease in the average outbound local voice revenue per subscriber in the first quarter of 2004. On a net basis, ARPU in the first quarter of 2004 decreased by 8% to Php383 from Php416 in the same period in 2003. The lower rate of decrease in net ARPU compared to the decrease in gross ARPU resulted from lower average interconnection expense per subscriber due to an increasing percentage of Smart-to-Smart traffic to total voice traffic, to 61% in the first quarter of 2004 from 55% in the same period in 2003, as well as lower dealer discounts on *Smart Load.* Smart currently expects its prepaid ARPUs to continue to decline now that lower-denomination reloads are available and as it continues its expansion into the lower end of the market.

Monthly ARPU for Smart's postpaid GSM service is calculated in a manner similar to that of prepaid service, except that the revenues consist mainly of monthly service fees and charges on usage in excess of the monthly service fees. Until April 2003, pre-termination fees had been reported as part of usage revenues and included in the calculation of postpaid ARPUs; pre-termination fees of Php196 million were included in the ARPU computation during the first quarter of 2003. ARPU is a measure associated with a subscribers' actual usage of the network on which pre-termination fees would have had no effect. Beginning the second quarter of 2003, pre-termination fees were included, upon collection, under "Others" of "GSM Revenues" and are therefore no longer included for the purpose of calculating ARPUs.

Gross monthly ARPU for postpaid GSM subscribers in the first quarter of 2004 was Php1,762, compared to Php1,716 in the same period in 2003. On a net basis, postpaid ARPU increased by 7% to Php1,351 in the first quarter of 2004 from Php1,268 in the same period in 2003. Smart's GSM monthly gross blended ARPU was Php495 in the first quarter of 2004, compared to Php565 in the same period in 2003. Blended net monthly ARPU decreased by 8% to Php406 in the first quarter of 2004 from Php439 in the same period in 2003.

Smart's 50% share of Piltel's revenues from *Talk 'N Text* under a revenue-sharing agreement between Smart and Piltel is not included in the computations of Smart's ARPUs.

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

A prepaid cellular subscriber is recognized as an active subscriber when that subscriber activates and uses the SIM card in the handset, which already contains Php100 worth of pre-stored air time. Subscribers can then reload by purchasing prepaid call-and-text cards that are sold in denominations of Php300, Php500 and Php1,000 or, by purchasing additional air time "over the air" via *Smart Load* in smaller denominations of Php30, Php60, Php115 and Php200, by receiving loads of Php2, Php5, Php10 and Php15 via *Pasa Load* or through their handsets using *Smart Money*. Reloads have validity periods ranging from one day to two months, depending on the amount reloaded. A prepaid GSM account is disconnected if the subscriber does not reload within four months after the full usage or expiry of the last reload. As a result, a subscriber would not be included in our churn rate calculation for up to 121 days to six months after the subscriber may have stopped using the service to make calls or send messages (although the subscriber may continue to receive calls and messages). These effects may contribute to more rapid growth in calculated churn following periods of rapid subscriber growth.

For Smart's prepaid GSM subscribers, the average monthly churn rate for the first quarter of 2004 was 3.3%, slightly higher than the 3.2% average monthly churn rate in the same period in 2003. In line with the various churn management initiatives implemented to address increased churn rates, in May 2003, Smart introduced *Smart Load*, an "over-the-air" electronic loading facility designed to make reloading of air time credits more convenient for, and accessible to consumers. These "over-the-air" reloads, which have both voice and text functions, are packaged in smaller denominations of Php30, Php60, Php115 and Php200, but have shorter validity periods of three days, six days, 12 days and 30 days, respectively. Starting with just 50,000 outlets when it was launched, *Smart Load's* distribution network now encompasses over 400,000 retail agents, approximately 80% of which are micro businesses. As of March 31, 2004, approximately 85% of *Smart Buddy* subscribers were using *Smart Load* as their reloading mechanism. In the first quarter of 2004, *Smart Load* has accounted for approximately 59% of sales derived from reloads.

On December 24, 2003, Smart introduced *Pasa Load* (literally means "transfer load"), a derivative service of *Smart Load* that allows for Php10 load transfers to other *Smart Buddy* and Piltel *Talk 'N Text* subscribers. On January 25, 2004, denominations of Php2, Php5 and Php15 were added to the *Pasa Load* menu. All *Pasa Load* denominations have a one-day expiry period. We believe that *Smart Load* and *Pasa Load* will encourage subscribers to stay within our cellular network instead of churning and re-subscribing at a later time.

Beginning April 18, 2004, *Pasa Load* was also made available to Smart postpaid subscribers as well with identical denominations to those offered to prepaid subscribers. The denominations have a similar one-day load expiry. The sender will be billed the amount of the load and a Php1.00 transaction fee which will be added on top of the monthly service fee.

The average monthly churn rate for Smart's postpaid GSM subscribers for the first quarter of 2004 was 0.2%, compared to 3.6% in the same period in 2003. Smart's policy is to redirect outgoing calls to an interactive voice response system if the postpaid subscriber's account is either 45 days overdue or the subscriber has exceeded the prescribed credit limit. If the subscriber does not make a payment within 44 days of redirection, the account is disconnected. Within this 44-day period, a series of collection activities are implemented, involving the sending of a collection letter, call-out reminders and collection messages via text messaging.

Satellite, VSAT and Other Services

Our revenues from satellite, VSAT and other services consist mainly of rentals received for the lease of Mabuhay Satellite's transponders and Telesat's VSAT facilities to other companies and charges for ACeS Philippines' satellite phone service. Total revenues from these services for the first quarter of 2004 amounted to Php245 million, an increase of Php49 million, or 25%, from Php196 million in the same period in 2003.

Fixed Line

Our fixed line business provides local exchange service, international and national long distance services, data and other network services, and miscellaneous services. Revenues generated from this business for the first quarter of 2004 totaled Php11,694 million, an increase of Php254 million, or 2%, from Php11,440 million for the same period in 2003. This increase was due to higher revenues generated from our international and national long distance services and data and other network services, partially offset by decreased revenues from local exchange service and miscellaneous services. As a percentage of our consolidated operating revenues, however, fixed line revenues decreased for the first quarter of 2004 to 43% from 50% in the same period in 2003 principally due to the continued strong growth of our wireless business.

The following table summarizes our consolidated operating revenues from our fixed line business for the three months ended March 31, 2004 and 2003 by service segment:

	Three Months Ended March 31,					
					Increase (Decrease)	
	2004	%	2003	%	Amount	%
			(Unaudited)			
(in millions)						
Fixed line services:						
Local exchange	Php5,188	44	Php5,248	46	Php(60)	(1)
International long distance	3,218	28	3,053	27	165	5
National long distance	1,798	15	1,638	14	160	10
Data and other network	1,432	12	1,422	12	10	1
Miscellaneous	58	1	79	1	(21)	(27)
Total	Php11,694	100	Php11,440	100	Php254	2

Local Exchange Service

Our local exchange service revenues consist of:

- flat monthly fees for our postpaid service;

- installation charges and other one-time fees associated with the establishment of customer service;

- fixed charges paid by other telephone companies, charges retained by PLDT for calls terminating to cellular subscribers within the local area, and local access charges paid by cellular operators for calls by cellular subscribers that terminate to our local exchange network;

- revenues from usage of prepaid cards for calls within the local area and any unused peso value of expired prepaid cards;

- call revenues generated from payphones and coin-operated phones; and

- charges for special features, including bundled value-added services such as call waiting, call forwarding, multi-party conference calling, speed calling and caller ID.

The following table summarizes key measures of our local exchange service business segment as of and for the three months ended March 31, 2004 and 2003:

	Three Months Ended March 31,			
			Increase (Decrease)	
	2004	2003	Amount	%
		(Unaudited)		
Consolidated local exchange revenues (in millions)	Php5,188	Php5,248	Php(60)	(1)
Number of fixed lines in service				
PLDT Group	2,150,453	2,111,721	38,732	2
PLDT	2,129,198	2,087,237	41,961	2
Number of PLDT employees	10,127	11,777	(1,650)	(14)
Number of PLDT fixed lines in service per PLDT employee	210	177	33	19

Revenues from our local exchange service for the first quarter of 2004 decreased by Php60 million, or 1%, to Php5,188 million from Php5,248 million for the same period in 2003. The decrease was primarily due to the (1) shifting subscriber preference from postpaid to prepaid services, which generate lower average revenue per subscriber, and (2) decline in installation revenues due to a promotion starting July 2003 which waived installation cost of subscribers in an effort to stimulate subscriber growth, partially offset by adjustments in our monthly local service rates. The percentage contribution of local exchange revenues to our total fixed line revenues also decreased for the first quarter of 2004 to 44% from 46% in for the same period in 2003.

Gross additions to PLDT's fixed lines in service for the first quarter of 2004 totaled 168,976, an increase of 76,347 from the gross additions of 92,629 for the same period in 2003. On a net basis, PLDT's fixed line additions for the first quarter of 2004 increased to 13,527 as against a decrease of 5,302 for the same period in 2003. While fixed line additions totaled 14,080 for PLDT's prepaid fixed line services, PLDT's postpaid fixed lines in service declined by 553 for the first quarter of 2004. As of March 31, 2004, PLDT's postpaid and prepaid fixed line subscribers totaled 1,757,814 and 371,384, respectively, which accounted for approximately 83% and 17%, respectively, of PLDT's total fixed lines in service.

Initially intended as an affordable alternative telephone service for consumers under difficult economic conditions, our prepaid fixed line services now forms an important part of PLDT's overall churn and credit risk exposure management and subscriber retention strategy.

Prepaid phone kits, each containing Php500 worth of pre-stored call credits, are sold for Php1,900 per unit. Prepaid subscribers are charged based on usage at a rate of Php1.00 per minute for local calls and the same rates are applicable to postpaid fixed line subscribers for national and international long distance calls.

A prepaid fixed line subscriber is recognized as an active subscriber when that subscriber activates and uses a prepaid call card. Prepaid fixed line subscribers can reload their accounts by purchasing call cards that are sold in denominations of Php500, Php300 and Php150. Reloads are valid for two months for the Php500 and Php300 card. The lower denominated Php150 card, launched in September 2003, has an account life of 15 days. A prepaid fixed line subscriber is disconnected if that subscriber does not reload within one month for the Php500 card, four months for the Php300 card, and 15 days for the Php150 card after the expiry of the last reload. All sales of prepaid cards, whether through dealers or through PLDT's business offices, are non-refundable.

Pursuant to a currency exchange rate adjustment mechanism authorized by the Philippine National Telecommunications Commission, or the NTC, we adjust our monthly local service rates upward or downward by 1% for every Php0.10 change in the peso-to-dollar exchange rate relative to a base rate of Php11.00 to US$1.00. For the first quarter of 2004 and 2003, we implemented three upward adjustments in our monthly local service rates in both periods. The average peso-to-dollar rate for the first quarter of 2004 was Php55.991 to US$1.00, compared to the average of Php54.074 to US$1.00 for the same period in 2003. This change in the average peso-to-dollar rate translated to a peso depreciation of 4%, which resulted in an average net increase of 3% in our monthly local service rates for the first quarter of 2004.

To attract new fixed line subscribers and retain existing ones, PLDT has introduced various value-added services such as *Hype* in April 2003. *Hype* is a full two-way fixed line text messaging service, which allows subscribers to send and receive text messages to and from landline and mobile phones, and is capable of international text messaging. *Hype* also allows subscribers to join TV network-based and new PLDT-initiated texting services.

The ratio of PLDT fixed lines in service per PLDT employee improved from 177 as of March 31, 2003 to 210 as of March 31, 2004. This improvement resulted from the net decrease in PLDT’s employee headcount. As of March 31, 2004, PLDT’s workforce was reduced by 14% to 10,127 employees from 11,777 employees as of March 31, 2003, mainly on account of PLDT’s manpower reduction program.

International Long Distance Service

Our international long distance revenues, which we generate through our international gateway facilities, consist of:

- inbound call revenues representing settlements from foreign telecommunications carriers for inbound international calls, virtual transit and hubbing service and reverse charged calls such as received collect and home country direct service;

- access charges paid to us by other Philippine telecommunications carriers for terminating inbound international calls to our local exchange network; and

- outbound call revenues representing amounts billed to our customers (other than our cellular customers) for outbound international calls, net of amounts payable to foreign telecommunications carriers for terminating calls in their territories.

The following table shows information about our international fixed line long distance business for the three months ended March 31, 2004 and 2003:

	Three Months Ended March 31,			
			Increase (Decrease)	
	2004	2003	Amount	%
	(Unaudited)			
Consolidated international long distance revenues (in millions)	Php3,218	Php3,053	Php165	5
Inbound	2,601	2,478	123	5
Outbound	617	575	42	7
International call volumes (in million minutes, except call ratio)				
PLDT Group	585	640	(55)	(9)
Inbound	547	595	(48)	(8)
Outbound	38	45	(7)	(16)
Inbound-outbound call ratio	14.4:1	13.2:1	–	–
PLDT	579	576	3	1
Inbound	542	532	10	2
Outbound	37	44	(7)	(16)
Inbound-outbound call ratio	14.6:1	12.1:1	–	–

Our consolidated international long distance revenues increased by Php165 million, or 5%, to Php3,218 million in the first quarter of 2004 from Php3,053 million in the same period in 2003, primarily as a result of an increase of our inbound international long distance revenues principally driven by an increase in average inbound termination rates. Likewise, the percentage contribution of international long distance revenues to our total fixed line revenues slightly increased to 28% in the first quarter of 2004 from 27% in the same period in 2003.

Our revenues from inbound international long distance calls in the first quarter of 2004 increased by Php123 million, or 5%, to Php2,601 million from Php2,478 million in the same period in 2003 primarily due to an increase in PLDT's average inbound termination rates and the positive impact of the depreciation of the average value of the peso relative to the U.S. dollar, partially offset by the effect of lower inbound call volumes.

Our inbound international long distance call volumes in the first quarter of 2004 decreased by 8% to 547 million minutes from 595 million minutes in the same period in 2003, primarily due to increased competition from alternative means of long distance communications, particularly e-mailing, international text messaging and internet telephony and more inbound calls terminating directly to cellular subscribers. In addition, the increase in our average termination rates has also resulted in reduced inbound call volumes, principally those being routed through direct facilities from the U.S. to the Philippines.

After lengthy negotiations commencing in May 2002 with carriers around the world, PLDT increased its average termination rates with carriers that account for a substantial portion of its international inbound traffic terminating on its fixed line network to approximately US$0.12 per minute effective February 1, 2003. Prior to the increase in termination rates, a substantial portion of PLDT's international inbound traffic terminating on its fixed line network was charged an average termination rate of approximately US$0.08 per minute. For further discussion, please see *Note 25 – Other Matters – U.S. Federal Communications Commission, or U.S. FCC, Ruling versus Philippine Telecommunications Companies* to the accompanying financial statements.

The depreciation of the peso contributed to the increase in our inbound international long distance revenues in peso terms since settlement charges for inbound calls are billed in U.S. dollars or in special drawing rights, an established method of settlement among international telecommunications carriers using values based on a basket of foreign currencies, that are translated into pesos at the prevailing exchange rates at the time of billing.

Our revenues from outbound international long distance calls in the first quarter of 2004 increased by Php42 million, or 7%, to Php617 million from Php575 million in the same period in 2004. The growth was primarily due to an increase in net average revenue per minute as a result of a decrease in our average settlement rate for foreign administrations in dollar terms by US$0.04 per minute.

The depreciation of the peso also contributed to the outbound international long distance revenues in peso terms because outbound calls are charged at U.S. dollar rates and billed to our subscribers in pesos at the prevailing exchange rates at the time of billing.

Our outbound international long distance call volumes declined by 16% to 38 million minutes in the first quarter of 2004 from 45 million minutes in the same period in 2003, primarily due to cellular substitution (subscribers opting to use cellular for international outbound calls) and the popularity of alternative means of communications such as e-mailing, international text messaging and internet telephony.

National Long Distance Service

Our national long distance revenues consist of:

- per minute charges for calls made by our fixed line customers outside of the local service areas but within the Philippines, net of interconnection charges payable for calls carried through the backbone network of, and/or terminating to the customer of, another telecommunications carrier; and
- access charges received from other telecommunications carriers for calls carried through our backbone network and/or terminating to our customers.

The following table shows our national long distance revenues and call volumes for the three months ended March 31, 2004 and 2003:

	Three Months Ended March 31,			
			Increase (Decrease)	
	2004	**2003**	**Amount**	**%**
		(Unaudited)		
Consolidated national long distance revenues (in millions)	Php1,798	Php1,638	Php160	10
National long distance call volumes (in million minutes)				
PLDT Group	489	500	(11)	(2)
PLDT	483	492	(9)	(2)

Our national long distance revenues increased by Php160 million, or 10%, to Php1,798 million in the first quarter of 2004 from Php1,638 million in the same period in 2003 as a result of increased national direct dial, or NDD, rates and more beneficial interconnection agreements with cellular operators. Accordingly, the percentage contribution of national long distance revenues to our total fixed line revenues increased to 15% in the first quarter of 2004 from 14% in the same period in 2003.

Effective March 1, 2003, the rate for NDD calls originating from PLDT subscribers and terminating to other local exchange carriers increased to Php5.00 per minute from a flat rate of Php4.50 per minute. In addition, NDD calls originating from and terminating to PLDT was also adjusted to Php5.00 per minute from a flat rate of Php4.50 per minute effective June 8, 2003.

Further, we have entered into more beneficial interconnection agreements with cellular operators. Beginning January 2004, our settlement rate to cellular operators of Php4.50 per minute was reduced to Php4.00 per minute for calls terminating to cellular subscribers. At the same time, the cellular operators' settlement rate for calls terminating to PLDT subscribers increased from Php2.50 per minute to Php3.00 per minute. In 2003, certain local exchange carriers, previously under revenue sharing arrangements, have entered into access charging agreements with PLDT. Under the revenue sharing agreements, charges are generally apportioned 30% for the originating entity, 40% for the backbone owner and another 30% for the terminating entity. Under these access charging agreements, the originating carrier generally pays access charges of (1) Php0.50 per minute for short haul traffic and Php1.25 per minute for long haul traffic to the carrier owning the backbone network; and (2) Php1.00 per minute to the terminating carrier. This change in interconnection charges resulted in a 54% decrease in average revenue per minute for calls originating from and terminating to other local exchange carriers.

Our national long distance call volumes, however, decreased by approximately 2% to 489 million minutes in the first quarter of 2004 from 500 million minutes in the same period in 2003. Cellular substitution and the widespread availability and growing popularity of alternative non-voice means of communications, particularly cellular text messaging and e-mailing, have negatively affected call volumes.

Data and Other Network Services

In the first quarter of 2004, our data and other network services posted a revenue of Php1,432 million, an increase of Php10 million, or 1%, from Php1,422 million in the same period in 2003. The revenue contribution of this service segment to our total fixed line revenues remained relatively flat at 12% in the first quarters of 2004 and 2003.

Data and other network services we currently provide include traditional bandwidth services, broadband/packet-based/internet-based services and other packet-based switching services.

The foregoing services are used for domestic and international communications, broadband data transmission services, internet exchange services, private networking services, switch-based services and international packet-based services.

Traditional bandwidth services accounted for 40% of the total revenues from PLDT's data and other network services in the first quarter of 2004, broadband/IP-based services accounted for 54%, and other services accounted for the remaining 6%, compared to 55%, 39% and 6%, respectively, in the same period in 2003. These percentage changes indicate a continuing shift in data and other network revenues from traditional bandwidth services to broadband/IP-based services. We expect this trend to continue given the growing demand for broadband transmission of voice, data and video due to the continued growth of the internet, e-commerce and other online services.

PLDT offers two residential internet service packages targeting separate markets: *PLDT Vibe* for light to medium internet users and *DSL* broadband for heavy internet users. As of March 31, 2004, the number of PLDT's fixed line subscribers that signed up for *PLDT Vibe* was

288,054, of which 160,711 were postpaid and 127,343 were prepaid subscribers, compared to 96,044 as of March 31, 2003, of which 72,263 were postpaid and 23,781 were prepaid subscribers, while the number of *DSL* subscribers reached 28,172 and 12,869 as of March 31, 2004 and 2003, respectively.

In March 2003, PLDT launched a number of data services, namely: *Continuum, iView* and *Encompass*, all under the *Brains* umbrella. *Brains Continuum* provides customers the ability to recover from service interruptions and offers network diversity, facility and hosting services in partnership with ePLDT. *Brains iView* enables customers to monitor the performance of their network, track bandwidth utilization patterns and identify the source of network problems. *Brains Encompass* provides a broad range of services for the customers' managed networking needs, be it a wide area network or local area network.

During 2003, we also launched a variety of data network products and services to address the needs of large corporations, small and medium-sized enterprises and retail customers. These include: *Resort Solutions*, a network service that provides real-time communication links between the head office and remote offices of vacation resorts; *Shops.work,* a network service that allows the real-time linking of retail stores facilitating sales and inventory monitoring; *Embed,* a wholesale banking solution that enables banks to build a community among clients in a business-to-business or business-to-consumer arrangement; and *High Bandwidth Optical Services* or *HBOS*, a dedicated high-speed point-to-point optical access solution that enables data mirroring, storage area network and local area network connectivity within Metro Manila, which also offers an option for a virtually alternative data center.

Miscellaneous

Miscellaneous revenues are derived mostly from directory advertising and facilities rental. In the first quarter of 2004, these revenues decreased by Php21 million, or 27%, to Php58 million from Php79 million in the same period in 2003. The decline was mainly due to a decrease in royalty fee on account of a change in revenue sharing agreement from collection rate to a fixed/flat rate. Miscellaneous revenues accounted for approximately 1% of our total fixed line revenues in the first quarter of 2004 and 2003.

Information and Communications Technology

Our information and communications technology business is conducted by ePLDT, a wholly-owned subsidiary of PLDT. ePLDT's principal business is its operation of an internet data center under the brand name *Vitro*™. Granted pioneer status as an internet data center by the Philippine Board of Investments, *Vitro*™ provides co-location services, server hosting, hardware and software maintenance services, website development and maintenance services, webcasting and webhosting, shared applications, data disaster recovery and business continuity services, intrusion detection, and security services such as firewall and managed firewall.

ePLDT is focused on developing its call center business which capitalizes on the availability of English-speaking labor in the Philippines. The call center service business is being undertaken by the following wholly-owned subsidiaries:

- Vocativ Systems, Inc., or Vocativ, which owns and operates a 722-seat call center facility with 883 customer service representatives, or CSRs, exclusively for clients of a global provider of customer relationship management services; and
- Parlance Systems, Inc., or Parlance, which owns and operates a 522-seat call center facility with 619 CSRs, exclusively for one of the largest direct-to-home satellite

service providers in the United States for customer support and billing requirements.

ePLDT has also invested in a number of other e-commerce and internet-related businesses, including a 99.6% interest in Infocom, one of the country's leading internet service providers. Infocom offers consumer prepaid and postpaid internet access, corporate leased lines, dedicated dial-up, multi-user dial-up, broadband internet access thru *DSL* or *NOW* cable internet; web consulting, development and hosting. Please refer to *Note 9 – Investments* to the accompanying financial statements for further discussion on ePLDT's other information and communications technology services.

In the first quarter of 2004, our information and communications technology business generated total revenues of Php442 million, an increase of Php85 million, or 24%, from the Php357 million in the same period in 2003. These revenues accounted for 2% of our consolidated operating revenues for the first quarter of 2004 and 2003. *Vitro*™ and others contributed revenues of Php111 million; ePLDT's call center business contributed revenues of Php241 million; and Infocom contributed revenues of Php90 million representing 25%, 55% and 20%, respectively, of the total revenues from our information and communications technology business in the first quarter of 2004, compared to 21%, 53% and 26% in the same period in 2003. Going forward, we expect revenues from our call center business to continue to contribute significantly to our information and communications technology revenues with the growing demand for call center services.

Consolidated Operating Expenses

Our consolidated operating expenses in the first quarter of 2004 increased by Php974 million, or 6%, to Php16,619 million from Php15,645 million in the same period in 2003. The increase was primarily due to higher non-cash expenses, mainly depreciation and amortization and higher cash expenses in our wireless business, mainly compensation and benefits and other operating costs. As a percentage of our consolidated operating revenues, however, consolidated operating expenses decreased to 61% in the first quarter of 2004 from 69% in the same period in 2003.

Wireless

Consolidated operating expenses associated with our wireless business in the first quarter of 2004 amounted to Php8,151 million, an increase of Php1,025 million, or 14%, from Php7,126 million in the same period in 2003. A significant portion of this increase was attributable to non-cash expenses mainly depreciation and amortization and provision for inventory obsolescence coupled with an increase in certain cash expenses. As a percentage of our wireless operating revenues, operating expenses associated with our wireless business decreased to 54% in the first quarter of 2004 from 65% in the same period in 2003.

The following table summarizes our consolidated wireless-related operating expenses for the three months ended March 31, 2004 and 2003 and the percentage of each expense item to the total:

	Three Months Ended March 31,					
					Increase (Decrerase)	
	2004	%	2003(1)	%	Amount	%
			(Unaudited)			
(in millions)						
Wireless services						
Depreciation and amortization(2)	Php2,985	37	Php2,403	34	Php582	24
Selling and promotions	1,800	22	1,943	27	(143)	(7)
Compensation and benefits	877	11	723	10	154	21
Maintenance	463	6	502	7	(39)	(8)
Rent	454	5	433	6	21	5
Provision for doubtful accounts	387	5	348	5	39	11
Professional and other service fees	192	2	147	2	45	31
Insurance and security services	214	3	175	3	39	22
Taxes and licenses	167	2	144	2	23	16
Provision for inventory obsolescence	128	1	16	–	112	700
Other operating costs	484	6	292	4	192	66
Total	Php8,151	100	Php7,126	100	Php1,025	14

(1) As restated to reflect the change in accounting policy on leases, as described in *Note 3 – Accounting Changes* to the accompanying financial statements.

(2) Includes depreciation of capitalized foreign exchange losses from the revaluation of net dollar liabilities of Php332 million in the first quarter of 2004 and Php252 million in the same period in 2003.

Depreciation and amortization charges increased by Php582 million, or 24%, to Php2,985 million substantially due to an increase in the depreciable asset base owing to continuing network expansion and upgrade and an increase in depreciation charges of capitalized foreign exchange losses from revaluation of net dollar liabilities.

Selling and promotion expenses decreased by Php143 million, or 7%, to Php1,800 million due to lower dealer discounts. Smart's average subscriber acquisition cost, or SAC, for prepaid subscribers in the first quarter of 2004 was Php443, a decrease of 37% from Php703 in the same period in 2003. Discounts to dealers accounted for the highest percentage of prepaid SAC at 40% and 63% in the first quarter of 2004 and 2003, respectively. On the other hand, postpaid SAC in the first quarter of 2004 was Php19,614, an increase of 108% from Php9,443 in the same period in 2003. Handset subsidies accounted for 84% and 87% of postpaid SAC in the first quarter of 2004 and 2003, respectively. Blended SAC declined by 42%, to Php635 in the first quarter of 2004 from Php1,096 in the same period in 2003.

Compensation and benefits increased by Php154 million, or 21%, to Php877 million primarily due to increased salaries, benefits and performance bonuses of Smart's employees. In addition, Smart accrued for an additional share under the enhanced employee retirement fund approved by Smart's Board of Directors in October 2003. Smart's employee headcount increased from 5,252 as of March 31, 2003 to 5,445 as of March 31, 2004.

Maintenance expenses decreased by Php39 million, or 8%, to Php463 million mainly on account of lower repairs and maintenance costs, partially offset by higher site utility expenses due to the continued growth in the number of cell sites and other network facilities.

Rent expenses increased by Php21 million, or 5%, to Php454 million on account of higher transmission links and higher office space rentals for the increased number of wireless centers and space requirements for increased personnel. As of March 31, 2004, Smart had 3,082 GSM cell sites and 4,229 base stations, compared with 2,236 GSM cell sites and 2,953 base stations as of March 31, 2003.

Provision for doubtful accounts increased by Php39 million, or 11%, to Php387 million to cover for possible uncollectible carrier accounts.

Professional and other service fees increased by Php45 million, or 31%, to Php192 million mainly as a result of increased legal, consultancy and bill collection service fees.

Insurance and security services increased by Php39 million, or 22% to Php214 million mainly due to the growth in the number of Smart's cell sites and the increase in the cost of equipment insured as a result of the continued growth and expansion of its GSM network.

Taxes and licenses increased by Php23 million, or 16%, to Php167 million mainly due to an increase in Smart's business-related taxes, NTC supervision and regulation fees and disallowed input taxes.

Provision for inventory obsolescence increased by Php112 million, or 700%, to Php128 million to cover for specifically identified slow and non-moving handsets.

Other operating costs increased by Php192 million, or 66%, to Php484 million mainly due to increases in Smart's various business and operational-related expenses such as facility usage fees, training, travel, supplies, printing, communication and delivery expenses.

Fixed Line

Consolidated operating expenses related to our fixed line business in the first quarter of 2004 totaled Php8,101 million, an increase of Php24 million, compared to Php8,077 million in the same period in 2003. The increase was primarily due to higher non-cash expenses, mainly depreciation and amortization, partially offset by lower cash expenses, particularly compensation and benefits. As a percentage of our total fixed line operating revenues, fixed line-related operating expenses decreased to 69% in the first quarter of 2004, compared to 71% in the same period in 2003.

The following table shows the breakdown of our total consolidated fixed line-related operating expenses for the three months ended March 31, 2004 and 2003 and the percentage of each expense item to the total:

	Three Months Ended March 31,					
					Increase (Decrease)	
	2004	%	2003(1)	%	Amount	%
			(Unaudited)			
(in millions)						
Fixed line services:						
Depreciation and amortization(2)	Php3,468	43	Php3,297	41	Php171	5
Compensation and benefits	1,760	22	1,901	23	(141)	(7)
Maintenance	777	9	710	9	67	9
Provision for doubtful accounts	708	9	776	10	(68)	(9)
Selling and promotions	351	4	294	4	57	19
Professional and other service fees	234	3	256	3	(22)	(9)
Rent	224	3	234	3	(10)	(4)
Insurance and security services	180	2	189	2	(9)	(5)
Taxes and licenses	156	2	124	1	32	26
Other operating costs	243	3	296	4	(53)	(18)
Total	Php8,101	100	Php8,077	100	Php24	–

(1) As restated to reflect the change in accounting policy on leases, as described in *Note 3 – Accounting Changes* to the accompanying financial statements.

(2) Includes depreciation of capitalized foreign exchange losses from the revaluation of net dollar liabilities of Php1,157 million in the first quarter of 2004 and Php1,055 million in the same period in 2003.

Depreciation and amortization charges increased by Php171 million, or 5%, to Php3,468 million mainly due to an increase in depreciation of capitalized foreign exchange losses from the revaluation of our net dollar liabilities, which were incurred in acquiring various telecommunications equipment and higher depreciation of our regular asset base primarily resulting from additional completed projects.

Compensation and benefits decreased by Php141 million, or 7%, to Php1,760 million mainly due to a 14% reduction in headcount due to PLDT's manpower reduction program, partially offset by collective bargaining agreement-related increases in salaries and benefits of PLDT employees. See *Note 17 – Other Expenses – Net* to the accompanying financial statements for further discussion on PLDT's manpower reduction program.

Maintenance expenses increased by Php67 million, or 9%, to Php777 million primarily due to higher maintenance costs of inside plant facility, computer and peripherals and submarine cable in the first quarter of 2004 as compared to the same period in 2003, partially offset by lower maintenance costs on outside plant facilities.

Provision for doubtful accounts decreased by Php68 million, or 9% to Php708 million on account of lower provisions by PLDT for anticipated uncollectible accounts from various specifically identified domestic telecommunications carriers which have been provided for in 2003. PLDT's provision for doubtful accounts in the first quarter of 2004 and 2003 was equivalent to 6% and 6.2% of its operating revenues.

Selling and promotion expenses increased by Php57 million, or 19%, to Php351 million mainly as a result of PLDT's promotional activities in relation to various products and services, partially offset by reduced corporate public relations expenses.

Professional and other service fees decreased by Php22 million, or 9%, to Php234 million as a result of lower advisory fees due to a decrease in number of consultants in line with PLDT's cost management efforts, partially offset by higher collection agency fees on account of higher collection of final accounts and payment of higher legal fees in the first quarter of 2004 for various services.

Rent expenses decreased by Php10 million, or 4%, to Php224 million mainly due to reduced number of leased transponders, partially offset by higher rentals paid by PLDT to suppliers of customer premises equipment as part of its bundled services to corporate customers.

Insurance and security services decreased by Php9 million, or 5%, to Php180 million primarily due to lower amortization for prepaid insurance and a decrease in the number of security guards.

Taxes and licenses increased by Php32 million, or 26%, to Php156 million mainly on account of higher business-related taxes paid in 2004 as compared to 2003.

Other operating costs decreased by Php53 million, or 18%, to Php243 million mainly due to lower contracted employee cost, partially offset by higher office supplies consumption and printing costs.

Information and Communications Technology

Consolidated operating expenses associated with our information and communications technology business in the first quarter of 2004 totaled Php367 million, a decrease of Php75 million, or 17%, from Php442 million in the same period in 2003. The decline was largely due to the sale of our 51% interest in Contact World, a call center business, in June 2003. As a percentage of our information and communications technology operating revenues, operating expenses related to our information and communications technology business decreased to 83% in the first quarter of 2004 from 124% in the same period in 2003. The three largest expense items related to our information and communications technology business in the first quarter of 2004 were compensation and benefits, depreciation and amortization, and maintenance, representing 45%, 18% and 12%, respectively, of our total operating expenses related to this business. For the first quarter of 2003, compensation and benefits, depreciation and amortization and rent registered the largest expenses representing 27%, 23% and 17%, respectively.

Net Operating Income

Our consolidated net operating income in the first quarter of 2004 was Php10,473 million, an increase of Php3,381 million, or 48%, from Php7,092 million in the same period in 2003. Accordingly, our consolidated operating margin (net operating income as a percentage of operating revenues) improved to 39% in the first quarter of 2004 from 31% in the same period in 2003.

Wireless

Our wireless business segment recorded an operating income of Php6,805 million in the first quarter of 2004, an increase of Php2,991 million, or 78%, over Php3,814 million registered in the same period in 2003. Smart's operating income contribution in the first quarter of 2004 increased by Php2,961 million to Php6,804 million from Php3,843 million due primarily to the growth in Smart's subscriber base.

Fixed Line

In the first quarter of 2004, our fixed line business segment contributed a net operating income of Php3,593 million, higher by Php230 million, or 7%, than Php3,363 million in the same period in 2003 as the 2% growth of our fixed line operating revenues covered the slight increase in our fixed line-related expenses. PLDT's net operating income contribution to this business segment in the first quarter of 2004 was Php3,560 million, an increase of Php271 million, or 8%, compared to Php3,289 million in the same period in 2003.

Information and Communications Technology

In the first quarter of 2004, our information and communications technology business segment registered an operating income of Php75 million, compared to an operating loss of Php85 million posted in the same period in 2003. The significant turnaround reflects the contribution of ePLDT's call center business which contributed 55% of information and communications technology business' operating income in the first quarter of 2004.

Interest Expense and Related Items - Net

Interest expense and related items – net decreased by Php8 million, to Php2,948 million in the first quarter of 2004 from Php2,956 million in the same period in 2003 mainly due to the decrease in Smart's and Mabuhay Satellite's interest expenses by Php95 million, and Php19 million, respectively, due to lower debt balances and lower interest rates mainly on foreign currency-denominated loans bearing floating interest rates. These decreases were partially offset by a net increase of Php104 million in PLDT's interest expense resulting from the peso depreciation that increased interest expense on foreign currency-denominated loans in peso terms and a decrease in interest charged to construction as more projects were completed.

Interest Income

Interest income increased by Php109 million, or 106%, to Php212 million in the first quarter of 2004 from Php103 million in the same period in 2003 mainly attributable to Smart's higher average cash balances.

Other Expenses – Net

In the first quarter of 2004, consolidated other expenses – net were Php625 million, a decrease of Php119 million, or 16%, compared to Php744 million in the same period in 2003 principally due to the decrease in manpower reduction cost of Php122 million, or 54%, to Php105 million in the first quarter of 2004 from Php227 million in the same period in 2003. The manpower reduction cost corresponded to 132 and 299 employees affected by PLDT's manpower reduction program in the first quarter of 2004 and 2003, respectively. See *Note 17 – Other Expenses – Net* to the accompanying financial statements for further discussion.

Income Before Income Tax and Minority Interest

Our income before income tax and minority interest in net income (losses) of consolidated subsidiaries in the first quarter of 2004 was Php7,090 million, representing an increase of Php3,599 million, or 103%, from Php3,491 million in the same period in 2003. On a non-consolidated basis, income before income tax and equity share in net income of our subsidiaries increased by Php88 million, or 34%, to Php344 million in the first quarter of 2004 as compared to Php256 million in the same period in 2003.

Our consolidated provision for income tax increased by Php850 million, or 85%, to Php1,854 million in the first quarter of 2004 from Php1,004 million in the same period in 2003. On a non-consolidated basis, our provision for income tax was Php127 million in the first quarter of 2004, an increase of Php61 million, or 92%, from Php66 million in the same period in 2003.

In the first quarter of 2004, our effective corporate tax rates were lower than the 32% statutory corporate tax rate due to differences between our consolidated and non-consolidated income as shown in our financial statements and our taxable income. These differences arose from the following:

- the effect of a three-year income tax holiday granted to Smart by the Philippine Board of Investments in connection with the pioneer status it awarded to Smart's GSM network expansion project;
- income already subjected to final tax or lower tax rate; and
- equity in net income of our associates, which has already been subjected to tax and therefore, as income to PLDT, is no longer subject to income tax.

Smart's three-year income tax holiday, which will expire in May 2004, applies to the incremental income generated from its GSM network expansion. The income tax holiday is computed by applying the exemption rate against the income tax due on GSM operations. The exemption rate is computed by dividing the incremental GSM revenues by eligible GSM revenues (both gross of interconnection revenues) where the incremental GSM revenues are derived by deducting the BOI-prescribed base figure (Smart’s gross GSM revenue in 2000) from the total GSM revenues. After adjusting for non-deductible items and unrealized and realized foreign exchange losses, Smart’s net taxable income is multiplied by the statutory corporate income tax rate of 32% and the exemption rate. The resulting figure is the income tax holiday that will be deducted from the income tax due on GSM revenues with the difference being the income tax due for the period. We expect our consolidated effective tax rate to increase following the expiration of Smart’s tax holiday.

Net Income

As a result of the factors discussed above, our consolidated net income for the first quarter of 2004 was Php5,240 million, representing an increase of Php2,757 million, or 111%, over our restated consolidated net income of Php2,483 million in the same period in 2003. This increase was principally due to Smart’s net income contribution of Php5,152 million for the first quarter of 2004, a significant improvement of Php2,379 million, or 86%, over its net income contribution of Php2,773 million in the same period in 2003 and the non-recurrence of impairment losses of Php387 million recognized by ePLDT in the first quarter of 2003 relating to certain equipment of an investee company. On a non-consolidated basis, PLDT's net income in the first quarter of 2004, before taking into account its equity share in net income of investees, was Php217 million compared to Php190 million in the same period in 2003.

Basic and diluted earnings per share, or EPS, of common shares increased to Php28.32 and Php26.74, respectively, in the first quarter of 2004 from basic and diluted EPS of Php12.15 and Php11.31, respectively, in the same period in 2003, after giving retroactive effect to common share equivalents. See *Note 19 – Earnings Per Common Share* to the accompanying financial statements for further discussion.

Liquidity and Capital Resources

The following table shows our consolidated and non-consolidated cash flows for the three months ended March 31, 2004 and 2003 as well as consolidated and non-consolidated capitalization and other selected financial data as of March 31, 2004 and 2003:

	Consolidated		Non-Consolidated	
	Three Months Ended March 31,		Three Months Ended March 31,	
	2004	2003(1)	2004	2003(1)
	(Unaudited)			
(in millions)				
Cash Flows				
Net cash provided by operating activities	Php16,679	Php11,920	Php8,484	Php5,223
Net cash used in investing activities	4,687	2,220	886	862
Capital expenditures	4,299	1,890	797	706
Net cash used in financing activities	7,237	8,038	4,923	5,640
Net increase (decrease) in cash and cash equivalents	4,777	1,695	2,750	(1,266)

	Consolidated		Non-Consolidated	
	March 31, 2004	December 31, 2003(1)	March 31, 2004	December 31, 2003(1)
	(Unaudited)	(Audited)	(Unaudited)	(Audited)
(in millions)				
Capitalization				
Notes payable	Php2,132	Php2,133	Php1,982	Php1,933
Current portion of long-term debt	25,701	23,742	17,758	15,850
Long-term debt – net of current portion	129,127	133,939	113,262	116,392
Total debt	Php156,960	Php159,814	Php133,002	Php134,175
Stockholders' equity	98,451	93,578	98,451	93,578
	Php255,411	Php253,392	Php231,453	Php227,753
Other Financial Data				
Cash and cash equivalents	Php24,040	Php19,263	Php8,028	Php5,278
Property, plant and equipment – net	243,455	244,427	186,716	188,152
Total assets	301,412	297,626	266,244	261,184
Net debt(2)	132,920	140,551	124,974	128,897

(1) As restated to reflect the change in accounting policy on leases, as described in *Note 3 – Accounting Changes* to the accompanying financial statements.

(2) Total debt less cash and cash equivalents.

As of March 31, 2004, our consolidated cash and cash equivalents totaled Php24,040 million. Principal sources of consolidated cash and cash equivalents in the first quarter of 2004 were cash flows from operations amounting to Php16,679 million and drawings from long-term credit facilities aggregating Php1,143 million. These funds were used principally for capital outlays of Php4,299 million, including capitalized interest of Php152 million; debt principal payments of Php5,633 million; and interest payments of Php2,354 million.

Operating Activities

On a consolidated basis, net cash flows from operating activities in the first quarter of 2004 increased by Php4,759 million, or 40%, to Php16,679 million from Php11,920 million in the same period in 2003.

A growing portion of our consolidated cash flow is generated by our wireless business, which accounted for 55% of our consolidated operating revenues in the first quarter of 2004, compared to 48% in the same period in 2003. Revenues from our fixed line and information and communications technology services accounted for 43% and 2%, respectively, of our consolidated operating revenues in the first quarter of 2004 and 50% and 2%, respectively, for the first quarter of 2003.

PLDT's contribution to our consolidated cash flows from operations in the first quarter of 2004 was Php8,484 million, representing an increase of Php3,261 million, or 62%, from Php5,223 million in the same period in 2003. The increase was due to an improved collection of receivables from international carriers during the first quarter of 2004 and higher level of settlements of current liabilities in the first quarter of 2003.

Our subsidiaries, particularly Smart, made significant contributions to our cash from operations. In the first quarter of 2004, Smart generated cash from operations of Php7,707 million, or 46% of our consolidated cash flows from operations compared to Php5,981 million, or 50% in the same period in 2003. Smart’s strong cash flows reflect the continuing strong performance of its cellular business. However, Smart is subject to loan covenants that restrict its ability to pay dividends, redeem preferred shares, make distributions to PLDT or otherwise provide funds to PLDT or any associate without the consent of its lenders. After receiving approvals from Finnvera and certain lenders for the payment of dividends to PLDT, Smart paid dividends in the amount of Php4,300 million to PLDT in June 2003, representing 70% of Smart’s 2002 net income and paid additional dividends in the amount of Php1,866 million to PLDT in November 2003, equivalent to the remaining 30% of its 2002 net income. Similar waivers are currently being sought for payment of dividends to PLDT equivalent to 70% of Smart’s 2003 net income. We cannot assure you that Smart will be able to obtain such waivers or any other waivers in the future, or what amount, if any, Smart would be permitted or financially able to distribute. We expect that we will have difficulty meeting our debt payment obligations if we do not continue to receive cash dividends from Smart.

As of March 31, 2004, related party liabilities included (1) PLDT’s payables to Smart amounting to Php3,843 million, representing interconnection fees; (2) Smart’s liabilities to Piltel totaling Php1,430 million, relating mostly to prepaid air time reloads for *Talk ‘N Text* subscribers through *Smart Load*, and (3) Piltel’s liabilities to PLDT amounting to Php1,012 million, representing interconnection charges. See “Related Party Transactions” in this report and *Note 15 – Related Party Transactions* to the accompanying financial statements for further discussion.

Investing Activities

On a consolidated basis, net cash used in investing activities in the first quarter of 2004 of Php4,687 million increased by Php2,467 million, or 111%, compared to Php2,220 million in the same period in 2003. This increase was primarily the result of higher aggregate capital spending. On a non-consolidated basis, net cash used in investing activities was Php886 million in the first quarter of 2004 compared to Php862 million in the same period in 2003.

Our consolidated capital expenditures in the first quarter of 2004 totaled Php4,299 million, an increase of Php2,409 million, or 127%, from Php1,890 million in the same period of 2003 primarily due to PLDT’s and Smart’s increased capital spending. Smart's capital spending of Php3,460 million in the first quarter of 2004 was used to further expand and upgrade its GSM and transmission network facilities to increase capacity and coverage in respect of basic and advanced cellular services. PLDT's capital spending of Php797 million was principally used to finance the expansion of its fixed line data and network services. ePLDT and its subsidiaries’ capital spending of Php32 million was used to primarily fund its *Vitro*™, Infocom and call center business operations. The balance represented other subsidiaries’ capital spending. Consolidated capital expenditures in the first quarter of 2003 amounted to Php1,890 million, of which Php706 million, Php1,119 million, Php10 million and Php38 million were attributable to PLDT, Smart, ePLDT and PLDT Global, respectively.

Under the terms of Piltel's debt restructuring plan, PLDT issued a Letter of Support for the benefit of Piltel and its creditors under which PLDT has agreed to cover any funding shortfalls of Piltel up to a maximum amount of US$150 million. Under the Letter of Support, PLDT provided to Piltel Php2,317 million (US$48 million) in 2000, Php2,039 million (US$41 million) in 2001, and Php571 million (US$11 million) in 2002. There was no drawdown under the Letter of Support in 2003 nor in the first quarter of 2004. Drawings under the PLDT Letter of Support are converted into U.S. dollars at the prevailing exchange rates at the time of drawdown. As of March 31, 2004, the remaining undrawn balance under the Letter of Support was US$50 million (approximately Php2,822 million). If, among other things, Piltel's financial and operating performance were to deteriorate or any amounts were required to be paid to Piltel's unrestructured creditors in cash to settle their claims (aggregate principal of US$1 million as of December 31, 2003), additional drawings under the Letter of Support would likely be required to provide all or a portion of the funds needed by Piltel. We cannot assure that additional amounts will not have to be drawn under the Letter of Support nor can we predict when the remaining undrawn balance under the Letter of Support will be exhausted. See *Note 9 – Investments* to the accompanying financial statements for further discussion.

Financing Activities

On a consolidated basis, we used net cash of Php7,237 million for financing activities in the first quarter of 2004, compared to Php8,038 million in the same period in 2003. On a non-consolidated basis, net cash used in financing activities in the first quarter of 2004 was Php4,923 million, compared to Php5,640 million in the same period in 2003. The net cash used in financing activities in the first quarter of 2004 was mainly attributable to debt repayments by PLDT in line with its ongoing debt reduction program.

Debt Financing

Additions to our consolidated long-term debt in the first quarter of 2004 totaled Php1,143 million, all of which came from PLDT's drawings, primarily from loan facilities extended and/or guaranteed by various export credit agencies and refinancing facilities used to repay maturing debts. Payments in respect of principal and interest amounted to Php5,633 million and Php2,354 million, respectively, in the first quarter of 2004.

Our consolidated indebtedness as of March 31, 2004 was Php156,960 million, representing a decrease of Php2,854 million, or 2%, compared to Php159,814 million as of December 31, 2003. This decrease was mainly due to the reductions of Php1,173 million and Php1,373 million in PLDT's and Smart's indebtedness, respectively. PLDT's indebtedness decreased by 1% to Php133,002 million as of March 31, 2004 from Php134,175 million as of December 31, 2003, due to PLDT's debt repayments in line with PLDT's efforts to reduce overall indebtedness. Smart's indebtedness as of March 31, 2004 was Php19,213 million, a decrease of 7% from Php20,586 million as of December 31, 2003.

As of March 31, 2004, PLDT had undrawn committed dollar-denominated long-term credit facilities in the aggregate amount of US$101 million, inclusive of the remaining US$30 million undrawn portion of the US$149 million KfW refinancing facility, US$8 million undrawn portion of the US$12 million term loan facility extended by DEG-Deutsche Investitions-und Entwicklungsgesellschaft mbH, or DEG, under an agreement dated May 29, 2003 and the undrawn JP¥5,615 million syndicated term loan facility supported by Nippon Export and

Investment Insurance of Japan under an agreement dated June 11, 2003. Smart also had undrawn committed dollar-denominated long-term credit facilities as of March 31, 2004 in the aggregate amount of US$40 million under the US$100 million NEXI loan facility signed by Smart in November 2002 which was drawn on April 5, 2004. In addition, Smart still has available facilities under its €50 million Framework Agreement with HypoVereinsbank up to a maximum aggregate amount of €44 million.

After giving effect to the anticipated application of existing refinancing facilities, the scheduled maturities of our outstanding long-term debt as of March 31, 2004 are as follows:

Maturity	Consolidated	Non-consolidated
	(in millions) (Unaudited)	
2004(1)	Php19,535	Php13,519
2005	30,579	22,524
2006	28,957	21,877
2007	28,263	25,611
2008	4,640	4,635
2009 and onwards	42,854	42,854

(1) April 1, 2004 through December 31, 2004.

Approximately Php111,974 million principal amount of our consolidated outstanding long-term debt as of March 31, 2004 is scheduled to mature over the period from 2004 to 2008. Of this amount, approximately Php88,166 million is attributable to PLDT, Php19,213 million to Smart, and the remainder to Mabuhay Satellite, PLDT-Maratel and ePLDT.

Covenants

Our debt instruments contain restrictive covenants, including covenants that prohibit us from paying common dividends, and require us to comply with specified financial ratios and other financial tests, calculated in conformity with accounting principles generally accepted in the Philippines, at relevant measurement dates, principally at the end of each quarterly period.

The financial tests under our debt instruments, as amended, include maintaining a positive tangible net worth and compliance with the following ratios:

- interest coverage ratio, calculated on a non-consolidated basis and excluding PLDT's equity share in net earnings or losses of investees, of not less than 180% or 200%;
- total debt to EBITDA on a non-consolidated basis of not more than 5.0:1 from March 2004 to June 2004, not more than 4.5:1 from September 2004 to December 2004 and not more than 4.0:1 from March 2005 and thereafter;
- long-term indebtedness to appraised value of equity/tangible net worth on a non-consolidated basis ranging from not more than 1.1:1 to not more than 3.0:1;
- current ratio on a non-consolidated basis, ranging from not less than 0.9:1 to not less than 1.2:1;
- debt service coverage ratio on a non-consolidated basis of at least 1.1:1; and
- debt to free cash flow ratio on a non-consolidated basis of not more than 5.5:1 from March 31, 2004 to June 30, 2004, not more than 5.0:1 from September 30, 2004 to June 30, 2005, not more than 4.5:1 from September 30, 2005 to June 30, 2006, and

not more than 4.0:1 from September 30, 2006 onwards.

In addition, some of PLDT's debt instruments contain covenants requiring PLDT to comply with specified financial tests on a consolidated basis. These include:

- long-term debt to appraised value of equity/tangible net worth of not more than 2.33:1;
- total debt to EBITDA of not more than 4.5:1 in 2004 and not more than 4.0:1 in 2005 and thereafter;
- current ratio of not less than 0.75:1 to 0.9:1; and
- interest coverage ratio of not less than 200%.

The principal factors that can negatively affect our ability to comply with these financial ratios and other financial tests are depreciation of the peso relative to the U.S. dollar, poor operating performance of PLDT and its consolidated subsidiaries, impairment or similar charges in respect of investments or other assets that may be recognized by PLDT and its consolidated subsidiaries and increases in our interest expenses. Interest expense may increase as a result of various factors including issuance of new debt, the refinancing of lower cost indebtedness by higher cost indebtedness, depreciation of the peso, the lowering of PLDT's credit ratings or the credit ratings of the Philippines, increase in reference interest rates, and general market conditions. Since approximately 96% of PLDT's total debt is denominated in foreign currencies, principally in U.S. dollars, many of these financial ratios and other tests are negatively affected by any weakening of the peso. As of March 31, 2004, the peso depreciated by 1% to Php56.216 to US$1.00, from Php55.586 to US$1.00 as of December 31, 2003. The peso has been subjected to significant fluctuations. In 2003, the peso depreciated to Php55.075 to US$1.00 on March 12, 2003 then recovered to a high of Php52.021 to US$1.00 on May 8, 2003 only to depreciate again to a low of Php55.767 to US$1.00 on November 27, 2003. In the first quarter of 2004, the peso appreciated to a high of Php55.142 on January 6, 2004 but depreciated to a low of Php56.429 on March 22, 2004.

PLDT's ability to maintain compliance with financial covenant requirements measured on a non-consolidated basis is principally affected by the performance of PLDT's fixed line business. PLDT cannot be assured of the benefit of net revenues and cash flows generated by Smart and PLDT's other investees in assisting in complying with non-consolidated covenants.

We have maintained compliance with all of our financial ratios and covenants as measured under our loan agreements. 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. Under some of our loan agreements, certain of our financial ratios have become more restrictive at the end of the second and fourth quarters of 2003 and at the end of the first quarter of 2004 and will continue to become more restrictive in increments thereafter, which will make it more difficult for PLDT to maintain compliance with this ratio in the future. Inability to comply with our financial ratios and covenants or raise new financing could result in a declaration of default and acceleration of some or all of our indebtedness. The terms of some of our debt instruments have no minimum amount for cross-default.

Please see *Note 12 – Long-term Debt* for a detailed discussion of our covenants.

Financing Requirements

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

We continue to pursue various initiatives and financing transactions with the objective of further improving the balance between our cash flows and debt service requirements and reducing our overall indebtedness. In addition, PLDT has reduced its capital expenditures and investments, suspended dividend payments to common shareholders and increased its application of available cash to reduce its indebtedness. Further, we expect to benefit from increasing revenue and cash flow contributions from our subsidiaries, particularly Smart. Smart is currently seeking to obtain waivers from certain lenders for the payment of dividends to PLDT equivalent to 70% of its 2003 net income. See "— Operating Activities" for further details.

Credit Ratings

Our credit ratings may significantly affect the terms of our prospective financings, particularly financing costs. None of our existing indebtedness contains provisions under which credit rating downgrades would trigger a default, changes in applicable interest rates or other similar terms and conditions.

On April 8, 2004, Fitch Ratings upgraded PLDT's long-term foreign currency and local currency ratings to "BB" from "BB-" (BB minus) while the rating of PLDT's convertible preferred stock was similarly upgraded to "B+" (B plus) from "B". The rating action follows a sustained period of improvement in PLDT's operating and financial profile mainly due to the growth of Smart. The stable outlook also reflects Fitch's view that neither the existing competitive landscape nor the planned resumption of common share dividends by PLDT would materially disrupt our deleveraging efforts.

On March 23, 2004, Standard and Poor's Ratings Group affirmed its "BB" rating and stable outlook on PLDT.

On January 27, 2004, PLDT's foreign currency senior unsecured debt rating was upgraded by Moody's Investors Service to "Ba2" from a recent "Ba3" as of July 29, 2003 and preferred stock rating moved up to "B1" from "B2." The rating reflects continued improvements in the operating performance of Smart and the expectation of on-going free cash flow to help repay debt maturities in the coming years. The negative outlook on PLDT's rating is constrained, reflecting Moody's decision to downgrade the Philippine Government's long-term foreign currency bond rating to "Ba2" with a negative outlook also on January 27, 2004.

On December 10, 2003, PhilRatings affirmed its rating of "PRS1" for PLDT's Php2 Billion One-Year Peso Notes which registration was rendered effective by the Philippine Securities and Exchange Commission on April 9, 2003. PRS1 is the highest rating possible on PhilRatings' scale for short-term securities and is based on the issuer's "strongest capability for timely payment of debt on both principal and interest."

Off-Balance Sheet Arrangement

On October 10, 2002, PLDT entered into a Receivables Purchase Deed, or RPD, with a foreign institution, or the Purchaser, under which PLDT agreed (1) to sell its receivables from certain eligible foreign carriers for an advance payment of US$50 million, with a balance of US$35 million as of March 31, 2004, and (2) to service, administer and collect the receivables on behalf of the Purchaser. Under the RPD, the Purchaser will have no recourse to PLDT should an eligible carrier fail or refuse to settle the assigned/purchased receivables, except if PLDT commits a breach on its representations and warranties. For the three months ended March 31, 2004 and 2003, receivables sold under the RPD amounted to US$3 million (Php167 million) and US$3 million (Php165 million), respectively.

Equity Financing

Through our subscriber investment plan, or SIP, which provides postpaid fixed line subscribers the opportunity to buy shares of our 10% cumulative convertible preferred shares as part of the upfront payments collected from subscribers, PLDT was able to raise Php3 million in the first quarter of 2004 and Php40 million in the same period in 2003. As approved by the NTC, the SIP was made optional in 2003 from being compulsory in earlier years.

Cash dividend payments in the first quarter of 2004 amounted to Php393 million, compared to Php368 million in the same period in 2003, all of which were paid solely to preferred shareholders of PLDT. The most recent cash dividend paid by PLDT to its common shareholders was in March 2001, no dividends were paid to common shareholders in 2003 and in the first quarter of 2004.

High and low sales prices for PLDT's common shares on the Philippine Stock Exchange, or PSE, and Amercian Depositary Shares, or ADSs, on the New York Stock Exchange, or NYSE, for the first quarter of 2004 and 2003 were as follows:

	PSE		**NYSE**	
	High	**Low**	**High**	**Low**
2004	Php1,050.00	Php810.00	US$18.60	US$14.38
January	1,050.00	860.00	18.60	14.90
February	980.00	810.00	18.00	14.38
March	970.00	885.00	17.43	15.38
2003	337.50	265.00	6.18	4.85
January	337.50	265.00	6.18	4.85
February	312.50	277.50	5.60	5.12
March	315.00	285.00	5.81	5.11

Contractual Obligations and Commercial Commitments

Contractual Obligations

The following table discloses our contractual obligations outstanding as of March 31, 2004:

	Payments Due by Period				
	Total	Within 1 year	2–3 years	4–5 years	After 5 years
			(Unaudited)		
(in millions)					
Long-term debt obligations	Php154,828	Php25,701	Php67,535	Php18,903	Php42,689
Long-term lease obligations:					
Operating Lease	5,391	1,374	2,249	1,029	739
Capital Lease	1,162	401	594	167	–
Unconditional purchase obligations(1)	12,730	3,986	2,279	2,249	4,216
Other long-term obligations	22,315	–	–	13,881	8,434
Total contractual obligations	Php196,426	Php31,462	Php72,657	Php36,229	Php56,078

(1) The amounts disclosed in the table above are based on the original Air Time Purchase Agreement with ACeS International Limited, or AIL. In 2003, a Standstill Agreement was executed to cover, among other matters, the amended minimum and supplemental air time payment provisions for the year 2003.

Long-term Debt Obligations

For a discussion of our long-term debt obligations, see *Note 12 – Long-term Debt* to the accompanying financial statements.

Long-term Operating Lease Obligations

Transponder Lease Agreement. On December 28, 1995, PLDT and Mabuhay Satellite entered into a Transponder Lease Agreement, which was amended on May 10, 2000. This agreement has a term of ten years commencing on December 18, 1997, unless earlier terminated in accordance with the terms thereof. The annual basic rent for the transponders was US$13 million as of the first quarter of 2004, of which PLDT's aggregate remaining obligation under this agreement was approximately Php2,656 million.

Domestic Fiber Optic Network Submerged Plant Agreement. On July 4, 2000, PLDT entered into an agreement with NTT World Engineering Marine Corporation for submarine cable repair and related services for the maintenance of PLDT's domestic fiber optic network submerged plant for a period of five years up to July 4, 2005. Under this agreement, PLDT is required to pay NTT World Engineering Marine Corporation a fixed annual standing charge of US$2 million, excluding cost for the use of a remotely-operated submersible vehicle at US$5,000 for every day of use and repair cost computed at US$19,000 per day of actual repair. As of March 31, 2004, the aggregate remaining obligation under this agreement was approximately Php157 million.

Digital Passage Service Contracts. PLDT has existing Digital Passage Service Contracts with foreign telecommunication administrations for several dedicated circuits to various destinations for ten to 25 years expiring at various dates. As of March 31, 2004, the aggregate remaining obligation under these contracts amounted to approximately Php39 million.

License Agreement with Mobius Management Systems (Australia) Pty Ltd., or Mobius. PLDT entered into a license agreement with Mobius pursuant to which Mobius has granted PLDT a non-exclusive, non-assignable and non-transferable license for the use of computer software components. Under this agreement, Mobius is also required to provide maintenance services for a period of one year at no additional maintenance charge. PLDT may purchase maintenance services upon expiration of the first year for a fee of 15% of the current published license fee. As of March 31, 2004, the aggregate obligation under this agreement was approximately Php60 million.

Other Long-term Operating Lease Obligations. We have various long-term lease contracts for periods ranging from two to ten years covering certain offices, warehouses, cell sites and telecommunication equipment locations. In particular, Smart has lease obligations aggregating Php2,410 million in respect of office and cell site rentals with over 2,000 lessors nationwide.

Long-term Capital Lease Obligations

Municipal Telephone Projects. In 1993, PLDT entered into two lease agreements with the Philippine Department of Transportation and Communications, or DOTC, covering telecommunications facilities established under the Municipal Telephone Act. Under these agreements, PLDT was granted the exclusive right to perform telecommunications management services, to expand services, and to promote the use of the DOTC-contracted facilities in certain covered areas for a period of 15 years. Title to the properties shall be transferred to PLDT upon expiration of the lease term. As of March 31, 2004, the aggregate remaining obligation under this agreement was approximately Php820 million. In case of cancellation, PLDT is liable to pay Php100 million under each of the two contracts as liquidated damages.

Other Long-term Capital Lease Obligations. The PLDT Group has various long-term lease contracts for a period of three years covering various office equipment. In particular, Smart has capital lease obligations aggregating Php337 million in respect of office equipment.

Unconditional Purchase Obligations

Air Time Purchase Agreement with ACeS International Limited. PLDT is a party to a Founder NSP, or National Service Provider, Air Time Purchase Agreement with AIL, which was amended in December 1998, under which PLDT is granted the exclusive right to sell ACeS services in the Philippines. In exchange, the Air Time Purchase Agreement states that PLDT has to purchase from AIL a minimum of US$5 million worth of air time annually over ten years commencing on the date of commercial operations of the Garuda I satellite. In the event AIL's aggregate billing revenue is less than US$45 million in any given year, the Air Time Purchase Agreement also states that PLDT has to make supplemental air time purchase payments not to exceed US$15 million per year during the ten-year term.

As of March 31, 2004, PLDT's aggregate remaining minimum obligation under the original Air Time Purchase Agreement was approximately Php12,079 million. See *Note 15 – Related Party Transactions* and *Note 21 – Provisions and Continge*ncies for further details relating to the Air Time Purchase Agreement with AIL.

International Affiliate Agreement with VeriSign, Inc., or VeriSign. On September 15, 2000, ePLDT entered into an agreement with VeriSign for the non-exclusive, non-transferable right and license to use the VeriSign software, brand and Certification Practice Statement for the purpose of approving, issuing, suspending or revoking digital certificates for users of the internet or similar open systems in the Philippines for a period of seven years. Under this agreement, ePLDT is required to pay VeriSign a certain percentage of the revenue derived from the services subject to minimum annual royalty payments aggregating to US$11 million, which was subsequently reduced to US$1 million, for the seven-year contract period. In addition, ePLDT was required to pay an annual support fee totaling US$0.5 million during the first year and

US$0.3 million in each year thereafter.

Effective July 1, 2003, VeriSign has agreed to amend the agreement and issued Addendum 6 to write-off all past due invoices and payments owed to VeriSign, which were invoiced or scheduled to be invoiced under the agreement prior to this Addendum 6. All royalty payments and annual support fees due through June 2003 will be part of the write-off in the amount of US$0.8 million. For contract year 4 (September 2003-August 2004), the annual support fee will be reduced from US$0.3 million to US$ 40,000 and for contract years 5-7 (September 2004-August 2007) from US$0.3 million to US$0.16 million. In addition, VeriSign agreed to reduce the affiliate revenue sharing rates from 50% of suggested retail price to 25% of suggested retail price for both enterprise and internet products for 12 months starting July 2003 and negotiable thereafter. As of March 31, 2004, ePLDT's aggregate remaining minimum obligation under this agreement was approximately Php27 million pertaining to annual support fee.

License Purchase Agreement with I-Contact Solutions Pte. Ltd. On April 2, 2003, iPlus Intelligent Network Inc., or iPlus, a wholly-owned subsidiary of ePLDT and the Philippines' pioneer in IP-based IT response center, entered into an Application Services Provider, or ASP, and Reseller Contract with I-Contact Solutions Pte. Ltd., or I-Contact, of Singapore. Under the agreement, iPlus will purchase licenses of the CosmoCall Universe™ IP-based contact center solution. CosmoCall Universe supports multi-channel customer interactions including telephone, web chat, web voice, web video, web collaboration, email and voicemail in one high capacity, high availability, multi-tenant platform. CosmoCall Universe is a complete, unified contact center suite that includes ACD, IVR, CTI, predictive dialing, multimedia recording and a complement of powerful management applications. The aggregate value of these licenses is US$2.1 million and these will be delivered quarterly over a two-year period. Further to the agreement, I-Contact will appoint iPlus as the exclusive reseller and ASP for the Philippine market and will provide iPlus with all the necessary support in terms of sales, marketing, and technical services. As of March 31, 2004, iPlus' aggregate remaining obligation under this agreement was approximately Php84 million.

Other Unconditional Purchase Obligations. PLDT has various purchase contracts for periods ranging from two to three years covering the use of fraud management system and satellite hub and remote VSAT network systems.

Other Long-term Obligations

Mandatory Conversion and Purchase of Shares. As of March 31, 2004, PLDT had issued a total of 3 million series V convertible preferred shares, 5 million series VI convertible preferred shares and 4 million series VII convertible preferred shares in exchange for a total of 58 million series K class I convertible preferred shares of Piltel pursuant to the debt restructuring of Piltel.

Each share of series V, VI and VII convertible preferred shares is convertible at any time at the option of the holder into one PLDT common share. On the date immediately following the seventh anniversary of the issue date of the series V and series VI convertible preferred shares and on the eighth anniversary of the issue date of the series VII convertible preferred shares, the remaining outstanding shares under these series will be mandatorily converted to PLDT common shares. Under a put option exercisable for 30 days, holders of common shares received on mandatory conversion will be able to require PLDT to purchase such PLDT common shares for Php1,700 or US$36.132 or JP¥4,071.89 per share, depending on the series.

As of March 31, 2004, 145,320 series V convertible preferred shares and 531,251 series VI convertible preferred shares had been converted into PLDT common shares. The aggregate value of the put option based on outstanding shares as of March 31, 2004 was Php22,315 million, of which Php13,881 million is payable on June 4, 2008 and Php8,434 million on June 4, 2009 if all of the outstanding series V, VI and VII convertible preferred shares were mandatorily converted and all the underlying common shares were put to PLDT. The market value of the underlying common shares was Php10,541 million, based on the market price of PLDT's common share of Php950 per share as of March 31, 2004.

Commercial Commitments

As of March 31, 2004, our outstanding commercial commitments, in the form of letters of credit, amounted to Php4,405 million. These commitments will expire within one year.

In October 1998, Smart entered into a Frame Supply Contract with Nokia Telecommunications OY for the supply of hardware, software and documentation for its GSM cellular network. In the same month, Smart and Nokia (Philippines), Inc., or Nokia, signed a Frame Services Contract that covers the design, planning, installation, commissioning, integration, acceptance testing, training and handling over of the GSM network. In August 2001, Smart issued a Master Purchase Order, or MPO, in the amount of US$200 million in favor of Nokia Networks OY for the purchase of additional equipment to expand its GSM cellular network. The US$200 million MPO was completed in November 2003. On May 30, 2003, Smart entered into a Technical Support Services Order, or TSSO, with Nokia in the amount of US$8 million. This TSSO has been fully served as of December 31, 2003.

In January 2004, Smart signed a new MPO in favor of Nokia amounting to US$117 million (Phase 7 under the Frame Supply Contract between Smart and Nokia). Smart is, however, under no legal obligation to incur these expenditures.

As of March 31, 2004, Smart had no guarantee obligations, standby repurchase obligations or other commercial commitments.

Quantitative and Qualitative Disclosures about Market Risks

Our operations are exposed to various risks, including liquidity risk, foreign exchange risk and interest rate risk. The importance of managing these risks has significantly increased in light of considerable change and continuing volatility in the Philippine and international financial markets. With a view to managing these risks, we have incorporated financial risk management functions in our organization, particularly in our treasury operations.

Liquidity Risk Management

We seek to manage our liquidity profile to be able to finance our capital expenditures and service our maturing debts. To cover our financing requirements, we intend to use internally generated funds and proceeds from debt and equity issues and sales of certain assets.

As part of our liquidity risk management program, we regularly evaluate our projected and actual cash flow information and continuously assess conditions in the financial markets for opportunities to pursue fund-raising initiatives. These initiatives may include bank loans, export credit agency-guaranteed facilities, and debt capital and equity market issues.

Foreign Exchange Risk Management

As of March 31, 2004, the Philippine peso had depreciated against the U.S. dollar to Php56.216 to US$1.00 from Php53.604 to US$1.00 as of March 31, 2003, which in turn represented a depreciation against the U.S. dollar from Php51.096 to US$1.00 at March 31, 2002. In the first quarter of 2004, PLDT capitalized net foreign exchange losses of Php1,217 million, as compared to Php910 million in the same period in 2003. Of these capitalized net foreign exchange losses, Php1,287 million in the first quarter of 2004 and Php819 million in the same period in 2003, were attributable to foreign currency-denominated liabilities used to finance our capital investments and were therefore recorded as additions to the carrying value of the related property accounts.

The following table shows our consolidated and non-consolidated foreign currency-denominated monetary assets and liabilities and their peso equivalents as of March 31, 2004 and as of December 31, 2003:

	March 31, 2004(1)		December 31, 2003(2)	
	U.S. dollars	Pesos	U.S. dollars	Pesos
	(Unaudited)	(in millions)	(Audited)	
Consolidated				
Assets				
Cash and cash equivalents	US$205	Php11,276	US$146	Php8,098
Receivables-net	178	9,476	195	10,855
	383	20,752	341	18,953
Liabilities				
Notes payable	–	–	3	150
Accounts payable	66	2,490	60	3,322
Accrued expenses and other current liabilities	85	4,669	25	1,342
Long-term debt	2,749	150,888	2,819	153,542
Deferred credits and other noncurrent liabilities	206	11,584	209	11,613
	3,106	169,631	3,116	169,969
Net foreign currency-denominated liabilities	US$2,723	Php148,879	US$2,775	Php151,016
Non-Consolidated				
Assets				
Cash and cash equivalents	US$118	Php6,631	US$54	Php3,014
Receivables-net	120	6,750	134	7,463
	238	13,381	188	10,477
Liabilities				
Accounts payable	8	464	16	874
Accrued expenses and other current liabilities	65	3,655	7	386
Long-term debt	2,337	127,707	2,373	128,757
Deferred credits and other noncurrent liabilities	206	11,584	209	11,613
	2,616	143,410	2,605	141,630
Net foreign currency-denominated liabilities	US$2,378	Php130,029	US$2,417	Php131,153

(1) The exchange rate used was Php56.216 to US$1.00.
(2) The exchange rate used was Php55.586 to US$1.00.

While a certain percentage of our revenues is either linked to or denominated in U.S. dollars, substantially all of our indebtedness, a substantial portion of our capital expenditures and a portion of our operating expenses are denominated in foreign currencies, mostly in U.S. dollars.

As of March 31, 2004, approximately 96% of both our total consolidated and non-consolidated debts were denominated in foreign currencies. Of our foreign currency-denominated debts, 7% and 8% are in Japanese yen, on a consolidated and non-consolidated basis, respectively, and the balance in U.S. dollars. Thus, a weakening of the peso against the U.S. dollar or Japanese yen will increase both the principal amount of our unhedged foreign currency-denominated debts (representing 61% and 56% of our consolidated and non-consolidated debts, respectively), and interest expense on our debt in peso terms. In addition, many of our financial ratios and other financial tests will be negatively affected. If, among other things, the value of the peso against the U.S. dollar drops from its current level, we may be unable to maintain compliance with these ratios, which could result in acceleration of some or all of our indebtedness. For further information on our loan covenants, see "Liquidity and Capital Resources — Financing Activities — Covenants" above and *Note 12 – Long-term Debt* to the accompanying financial statements.

To manage our foreign exchange risks, stabilize cash flows, and improve investment and cash flow planning, we enter into forward foreign exchange contracts, foreign currency swap contracts, currency options and other hedging products aimed at reducing and/or managing the adverse impact of changes in foreign exchange rates on our operating results and cash flows. However, these hedges do not cover all of our exposure to foreign exchange risks, and hedges to cover all of our exposure are not currently nor readily available.

Specifically, we use forward foreign exchange contracts, foreign currency swap contracts and currency option contracts to manage the foreign exchange risk associated with our foreign currency-denominated loans. As of March 31, 2004, PLDT's outstanding forward foreign exchange contracts, principal-only long-term cross-currency swap contracts and currency option contracts amounted to US$105 million, US$725 million and US$137 million, respectively.

Smart's outstanding forward foreign exchange contracts amounted to US$112 million as of March 31, 2004. Also, Smart had a long-term cross-currency swap contract which matured on April 30, 2003. The final exchange has been made and the contract has been terminated.

For further discussions of these contracts, see *Note 12 – Long-term Debt* to the accompanying financial statements.

Interest Rate Risk Management

From time to time and on a limited basis, we enter into interest rate swap agreements in order to manage our exposure to interest rate fluctuations.

We make use of hedging instruments and structures solely for reducing or eliminating financial risks associated with our liabilities and not for trading or speculative purposes.

Effect of Peso Depreciation

In the first quarter of 2004 and 2003, our operating revenues, which have been received in U.S. dollars or in respect of which we have been able to adjust our service fees to reflect changes in the peso-to-dollar exchange rate exceeded our U.S. dollar-linked operating expenses. As a result, the depreciation of the peso against the dollar over this period had a positive net impact on our operating profit. However, since substantially all of our indebtedness is denominated in U.S. dollars, such depreciation has also increased our interest expense in peso terms and increased the peso amounts of our U.S. dollar-denominated indebtedness. PLDT has capitalized its foreign exchange losses in respect of its U.S. dollar-denominated indebtedness, and net income in future periods is expected to be negatively affected as a result of higher depreciation expense resulting from such capitalization. Our cash flows are negatively affected by the higher peso cost of repaying U.S. dollar-denominated debts, and our ability to comply with financial covenants and ratios is negatively affected by the increase in the amount of our debts and our interest expenses in peso terms.

Impact of Inflation and Changing Prices

Inflation can be a significant factor in the Philippine economy, and we are continually seeking ways to minimize its impact. In recent periods, while decreases in the relative value of the peso have had a significant effect on us, we do not believe inflation has had a material impact on our operations. The average inflation rate in the Philippines in the first quarter of 2004 was 3.5%, the same level as in the same period in 2003.

OTHER INFORMATION

Smart's Proposed Exchange Offer to Piltel Creditors

On March 23, 2004, Smart sent out invitations to the creditors of Piltel, subject to certain terms and conditions, to offer to sell their indebtedness to Smart in exchange for: (a) cash (in U.S. Dollars or Pesos); and/or (b) U.S. dollar-denominated loan obligations of Smart; and/or (c) in consideration of delivery of U.S. dollar-denominated bonds guaranteed by the Republic of the Philippines. The options available to Piltel creditors are as follows:

- Cash settlement, at a maximum exchange price of US$0.40 for each US$ equivalent of Piltel debt exchanged, Smart has allocated US$20 million to apply towards the cash offer;
- US$ Smart debt maturing in December 2007 at the rate of US$0.525 for each US$ equivalent of Piltel debt exchanged, with interest at US$ LIBOR plus 1% per annum, payable quarterly;
- US$ Smart debt maturing in December 2008 at the rate of US$0.575 for each US$ equivalent of Piltel debt exchanged, with interest at US$ LIBOR plus 1% per annum, payable quarterly;
- US$ Smart 10-year debt maturing in June 2014, at par by reference to the US$ equivalent of Piltel debt exchanged, with fixed interest at 2.25% per annum, payable quarterly,
- For Yen Trade creditor, US$ Smart 10-year debt maturing in June 2014, at par by reference to the US$ equivalent of Piltel debt exchanged, with fixed interest at 2.25% per annum, payable quarterly and with an option to elect, by not less than 15 months' prior notice, for an early repayment at a discount either on December 2007 at 52.5% of the relevant debt amount or on December 2008 at 57.5% of the relevant debt amount; and
- 12-year US$ RoP-guaranteed bonds, at par, with a 2% coupon per annum, payable semi-annually (this option is not available to Piltel bondholders).

Piltel creditors were initially given four weeks from the date the letters of invitation were issued to respond to Smart's offer. Smart will only proceed with the debt transaction if the following conditions are met:

- At least 75% in aggregate of existing Piltel debt by value offered by the creditors is exchanged for one or more of the menu of options;
- Minimum acceptance thresholds for each facility are met, as follows:
  - 100% by principal amount of Yen Trade Facility;

- 67% by principal amount of the Peso and US$ Facility Agreements;
- US$65 million face value of the bonds (Conversion Notes);
- 67% by principal amount of the US$ Trade Facilities; and
- 50.01% by principal amount of the Term Notes Facility Agreement.

- Certain waivers/amendments relating to Piltel's existing indebtedness are obtained, including the termination of the PLDT Letter of Support.

Smart is in the process of securing the necessary consent and waivers from its financial creditors and guarantors of its debt to enable it to accept offers that may be made to it as a result of the letters of invitation it has issued. Further, Smart intends to request consents from its financial creditors and guarantors of its debts, subject to the debt exchange transaction described above being successfully completed, to allow it to acquire PLDT's interests in Piltel consisting of 767 million common shares (representing 45.3% of Piltel's outstanding common shares) and 59 million Series K convertible preferred shares (convertible into Piltel common shares at a ratio of 170:1). The consideration for the share transfer will be determined at a later date. Should Smart acquire PLDT's interests in Piltel, it is not Smart's intention to enter into a legal statutory merger with Piltel nor does it intend to use Piltel as a backdoor listing vehicle.

On April 24, 2004, Smart extended the deadline for Piltel creditors to make an offer to sell their Piltel debt for 10 days until April 30, 2004. On May 3, 2004, Smart granted one further extension of the deadline to accept offers from creditors of Piltel to sell their Piltel debt. Accordingly, the deadline for Piltel creditors to make an offer to sell their Piltel debt has been extended to May 31, 2004. As of April 30, 2004, Smart had received offers in respect of more than 50% of the aggregate value of the Piltel debt. This level was, however, still below the thresholds (both in aggregate and in respect of certain individual facilities) set by Smart. All other material terms of the invitations issued by Smart on March 23, 2004 remain unchanged.

U.S. Federal Communications Commission, or U.S. FCC, Ruling versus Philippine Telecommunications Companies

In compliance with orders of the National Telecommunications Commission, or NTC, effective February 2003, PLDT stopped terminating traffic sent directly by each of AT&T and MCI, because PLDT's bilateral agreements with AT&T and MCI lapsed in December 2002, without either agreeing with PLDT on any provisional arrangement or final agreement on new termination rates. Upon petitions of AT&T and MCI, on March 10, 2003, the International Bureau of the U.S. FCC issued an Order directing all facilities-based carriers subject to U.S. FCC jurisdiction to suspend payments for termination services to Philippine carriers, including PLDT, Smart and Subic Telecom, until such time as the U.S. FCC issues a Public Notice that AT&T's and MCI's circuits on the U.S.–Philippine route are fully restored. The Order also removed the Philippines from the list of U.S.–international routes approved for the provision of International Simple Resale, or ISR. In response to the International Bureau's Order, the NTC issued a Memorandum Order dated March 12, 2003, directing all affected Philippine carriers "(1) not to accept terminating traffic via direct circuits from U.S. facilities-based carriers who do not pay Philippine carriers for services rendered; and (2) to take all measures necessary to collect payments for services rendered in order to preserve the viability, efficiency, sustained growth and development and continued competitiveness of the Philippine telecommunications industry."

On October 17, 2003, based on negotiations between the NTC and the U.S. FCC to resolve the issue regarding termination rates, the NTC, in the expectation that the U.S. FCC would fully lift its March 10, 2003 Order, lifted its March 12, 2003 Order and directed all

Philippine carriers to immediately accept terminating traffic via direct circuits from U.S. facilities-based carriers at mutually acceptable final or interim termination rates and other terms and conditions agreed upon by the parties.

On November 17, 2003, after Smart reached interim agreements with each of AT&T and MCI on September 30 and November 12, 2003, respectively, the U.S. FCC lifted its March 10, 2003 Order with respect to Smart and ordered the U.S. carriers to resume making payments to Smart.

On January 15, 2004, after PLDT reached interim agreements with each of MCI and AT&T and reopened its circuits with these carriers on November 12, 2003 and January 9, 2004, respectively, the U.S. FCC lifted its March 10, 2003 Order also with respect to PLDT and ordered the U.S. carriers to resume making payments to PLDT.

However, the U.S. FCC has yet to restore the Philippines to the list of U.S.-international routes approved for the provision of ISR. In a recently announced order, the U.S. FCC has omitted the Philippines from the list of countries exempted from the U.S. FCC's International Settlements Policy.

Investigation by U.S. Department of Justice

In January 2004, PLDT and a PLDT employee received a grand jury subpoena, and an employee of Smart received a grand jury subpoena seeking documents and testimony in connection with a criminal investigation being conducted by the U.S. Department of Justice with respect to alleged antitrust violations relating to the provision of international termination services in the Philippines. The U.S. Department of Justice has also requested testimony and documents from Smart in connection with this investigation. Moreover, in March 2004, PLDT (U.S.) Ltd., a subsidiary of PLDT Global, also received a grand jury subpoena seeking documents in connection with this investigation. At this time, PLDT cannot predict the outcome of this investigation.

Related Party Transactions

In the ordinary course of business, companies belonging to the PLDT Group are engaged in arm's-length intercompany transactions. We believe that the terms of these transactions are comparable with those available from unrelated parties.

- *Telecommunications services provided within the PLDT Group* — interconnection agreements among/between PLDT, Smart, Piltel, Clark Telecom, Subic Telecom, PLDT-Maratel and PLDT Global under terms similar with those agreed with other telecommunications providers outside the PLDT Group.

- *Transponder Lease Agreement between PLDT and Mabuhay Satellite* — an agreement pursuant to which Mabuhay Satellite leases to PLDT C-band transponders on board the Agila II satellite. Total fees under this agreement totaled Php149 million and Php194 million for the three months ended March 31, 2004 and 2003, respectively. PLDT's outstanding obligations under this agreement amounted to Php26 million as of December 31, 2003 and no outstanding obligations as of March 31, 2004.

- *Facilities Management Agreement between PLDT and Piltel* — an agreement under which PLDT undertakes the management, operation and maintenance of Piltel's regional telecommunications facilities as well as Executive Order No. 109, network operations and services, including E.O. 109 fixed line build-out installations, public calling offices, payphone facilities, and the systems required to support these services. Management fees under this agreement totaled Php17 million and Php21 million for the three months ended March 31, 2004 and 2003, respectively. PLDT's outstanding receivables under this agreement amounted to Php346 million and Php329 million as of March 31, 2004 and December 31, 2003, respectively.

- *Facilities Management Agreement between Subic Telecom and Piltel* — an agreement under which Subic Telecom manages the regional telephone network, customer operations, network operations and payphones of Piltel in Subic and Olongapo City. Management fees under this agreement totaled Php5 million for the three months ended March 31, 2004 and 2003, respectively. Subic Telecom's outstanding receivables under this agreement amounted to Php16 million and Php11 million as of March 31, 2004 and December 31, 2003, respectively.

- *Agreements between Smart and Piltel* — agreements relating to the integration of Smart's and Piltel's operations under which Smart undertakes to manage Piltel's facilities, customer services, administrative support and management services and billing services. In addition, Smart also entered into a facilities service agreement with Piltel under which Piltel accesses Smart's existing GSM network and facilities to enable Piltel to offer prepaid cellular service using GSM technology in exchange for approximately 50% of Piltel's revenues, net of interconnection expenses. Total fees under these service agreements totaled Php217 million and Php168 million for the three months ended March 31, 2004 and 2003, respectively. Smart's outstanding receivables under these agreements amounted to Php123 million and Php906 million as of March 31, 2004 and December 31, 2003, respectively.

- *Air Time Purchase Agreement between PLDT and AIL and Related Agreements* — an agreement under which PLDT has been granted the exclusive right to sell ACeS services in the Philippines. In March 2003, PLDT, together with the founder shareholders, entered into a Standstill Agreement in respect of the Air Time Purchase Agreement. On February 10, 2004, notwithstanding the ongoing negotiations, AIL advised PLDT of the termination of the Standstill Agreement and the reinstatement of the terms of the original Air Time Purchase Agreement following the lapse of the November 15, 2003 deadline for the negotiation of a revised Air Time Purchase Agreement. See *Note 20 – Contractual Obligations and Commercial Commitments* to the accompanying financial statements for further discussion.

- *Agreements between Smart and ACeS Philippines* — agreements under which Smart (1) provides ACeS Global Mobile Personal Communications by Satellite, or GMPCS, services, in the Philippines under a revenue-sharing agreement, (2) undertakes the management, maintenance and operations of GMPCS, and (3) provides certain administrative support and services in certain aspects of ACeS Philippines' business operations. Fees under these agreements, net of ACeS' share, totaled Php20 million and Php16 million for the three months ended March 31, 2004 and 2003, respectively. Under these agreements, Smart had no outstanding obligation as of March 31, 2004 and December 31, 2003.

In addition, transactions to which PLDT or its subsidiary is a party, in which a director or key officer or owner of more than 10% of the common shares of PLDT, or any member of the immediate family of a director or key officer or owner of more than 10% of the common shares of PLDT had a direct or indirect material interest as of March 31, 2004 and December 31, 2003 and for the three months ended March 31, 2004 and 2003 are as follows:

- *Agreements with NTT Communications and/or its Affiliates* — agreements under which (1) NTT Communications provides advisory services for various business areas of PLDT; (2) NTT World Engineering Marine Corporation provides maintenance services to PLDT's domestic fiber optic network; (3) PLDT is licensed to market managed data and other services using NTT Communications' Arcstar brand; and (4) PLDT and NTT Communications agreed to cooperative arrangements for international telecommunication services. Fees under these agreements totaled Php70 million and Php85 million for the three months ended March 31, 2004 and 2003, respectively. PLDT's outstanding obligations under these agreements amounted to Php28 million and Php40 million as of March 31, 2004 and December 31, 2003, respectively.

- *Agreements between Smart and Asia Link B.V.* — agreements under which Asia Link undertakes to provide technical support services for the operations and maintenance of Smart's CMTS. Fees under these agreements totaled Php107 million and Php67 million for the three months ended March 31, 2004 and 2003, respectively. Under these agreements, Smart had outstanding payables of Php117 million as of March 31, 2004 and Php228 million as of December 31, 2003. Asia Link is a subsidiary of First Pacific.

- *Agreements relating to insurance companies* — Gotuaco del Rosario and Associates, or Gotuaco, acts as the broker for certain insurance companies to cover certain insurable properties of the PLDT Group. Insurance premiums are remitted to Gotuaco and the broker's fees are settled between Gotuaco and the insurance companies. In addition, PLDT has signed an insurance policy with Malayan Insurance Co. Inc., or Malayan, wherein premiums are paid directly to Malayan. Premium payments to Gotuaco and Malayan covering the twelve-month period ending July 31, 2004 totaled Php321 million. Two directors of PLDT have a direct/indirect interest in or serve as director/officer of Gotuaco and Malayan.

For a more detailed discussion of the related party transactions enumerated above, see *Note 15 – Related Party Transactions* to the accompanying financial statements.