MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
For the Nine Months Ended September 30, 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 – Summary of Significant Accounting Policies to the accompanying consolidated financial statements for a list of these subsidiaries, including a description of their respective principal business activities).

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying consolidated 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 consolidated 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 consolidated financial statements were made based on the exchange rate of Php56.276 to US$1.00, the volume weighted average exchange rate at September 30, 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.

Our consolidated financial statements as of and for the nine months ended September 30, 2004 incorporate certain changes in accounting policies which have affected our financial

position and results of operations retrospectively. For further discussion please see Note 2 – Summary of Significant Accounting Policies to the accompanying consolidated financial statements.

Financial Highlights and Key Performance Indicators

(in millions)	September 30, 2004 (Unaudited)	December 31, 2003(1) (As restated)	Increase (Decrease) Amount	%
Consolidated Balance Sheets				
Total assets	Php305,978	Php301,042	Php4,936	2
Property, plant and equipment – net	243,956	247,484	(3,528)	(1)
Total debt	159,125	180,612	(21,487)	(12)
Total equity	82,497	63,405	19,092	30
Debt to equity ratio	1.93x	2.85x	–	–

	Nine Months Ended September 30,			
	2004	2003(1) (Unaudited)	Increase Amount	%
Consolidated Statements of Income				
Operating revenues	Php87,519	Php73,524	Php13,995	19
Operating expenses	52,154	50,079	2,075	4
Net operating income	35,365	23,445	11,920	51
Net income	20,007	593	19,414	3,274
Operating margin	40%	32%	–	–
Consolidated Statements of Cash Flows				
Net cash provided by operating activities	Php54,541	Php37,353	Php17,188	46
Net cash used in investing activities	16,613	12,297	4,316	35
Capital expenditures	16,238	11,232	5,006	45
Net cash used in financing activities	29,704	24,506	5,198	21
Operational Data				
Number of fixed lines in service	2,184,411	2,172,793	11,618	1
Number of cellular subscribers	17,472,516	11,550,792	5,921,724	51
Number of employees	18,708	18,009	699	4

(1) As restated to reflect the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying consolidated 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 Smart Communications, Inc., or Smart and Pilipino Telephone Corporation, or Piltel, our cellular service providers, 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 Clark Telecom, Inc., Subic Telecommunications Company, Inc., PLDT-Maratel, Inc., Piltel 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.; call center services provided by ePLDT's subsidiaries Parlance Systems, Inc. and Vocativ Systems, Inc.; internet access services provided by ePLDT's subsidiary, Infocom Technologies, Inc.; and e-commerce and IT-related services provided by other investees of ePLDT, as discussed in *Note 8 – Investments* to the accompanying consolidated financial statements.

Accounting Changes

On January 1, 2004, we adopted SFAS 17/IAS 17 "Leases" and SFAS 12/IAS 12 "Income Taxes." The Philippine Accounting Standards Council, or ASC, approved the adoption of SFAS 17/IAS 17 and SFAS 12/IAS 12 effective in the Philippines for consolidated financial statements covering periods beginning on or after January 1, 2004.

On July 1, 2004, effective January 1, 2004, we elected to early adopt IAS 27 "Consolidated and Separate Financial Statements", IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement", which will be effective in the Philippines for consolidated financial statements covering periods beginning on or after January 1, 2005. We believe that the adoption of these standards earlier than required will fairly reflect the effects of certain significant and material transactions covered by these standards which we entered into during the third quarter of 2004.

Adoption of the above new standards involved the following changes in accounting policies and have accordingly restated our comparative consolidated financial statements retroactively in accordance with the transitional rules detailed in these standards.

- ***SFAS 12/IAS 12 "Income Taxes"***. SFAS 12/IAS 12 prescribes the accounting treatment for current and noncurrent deferred income taxes. The standard requires the use of the balance sheet liability method in accounting for deferred income taxes. It requires the recognition of a deferred tax liability and, subject to certain conditions, a deferred tax asset, for all temporary differences with certain exceptions. The standard provides for the recognition of a deferred tax asset when it is probable that taxable income will be available against which the deferred tax asset can be used. It also provides for the recognition of a deferred tax liability with respect to asset revaluations.

- ***SFAS 17/IAS 17 "Leases"***. SFAS 17/IAS 17 requires the capitalization of finance leases, which transfer substantially all the risks and benefits incidental to ownership of leased item, at the inception of the lease at the fair value of leased property or, if lower, at the present value of the minimum lease payments. SFAS 17/IAS 17 also requires that a lease where the lessor retains substantially all the risks and benefits of ownership of the asset be classified as operating leases, which should be recognized as an expense in the income statement on a straight-line basis over the lease term.

- ***IAS 27 "Consolidated and Separate Financial Statements"***. IAS 27 supersedes Consolidated Financial Statements and Accounting for Investments in Subsidiaries. Under the revised IAS 27, the exclusion of a subsidiary from consolidation when there are severe long-term restrictions that significantly impair a subsidiary's ability to transfer funds to the parent company under the superseded standard was removed. Consequently, Piltel was required to be included in our consolidated financial statements retrospectively.

- ***IAS 32 "Financial Instruments: Disclosure and Presentation"***. IAS 32 covers the disclosure and presentation of all financial instruments. The Standard requires more comprehensive disclosures about a company's financial instruments, whether recognized or unrecognized in the consolidated financial statements. New disclosure requirements include terms and conditions of financial instruments used, types of risks associated with both recognized and unrecognized financial instruments (price risk, credit risk, liquidity risk, and cash flow risk), fair value information of both recognized and unrecognized financial assets and financial liabilities, and our financial risk management policies and objectives. The Standard also requires financial instruments to be classified as liabilities or equity in accordance with their substance and not their legal form. Consequently, we have designated PLDT's Convertible Preferred Stock Series V, VI and VII as compound instruments consisting of liability and equity components. The total fair value of the Convertible Preferred Stock Series V, VI and VII was determined at issue date, of which the aggregate fair value of the liability component of the Series V, VI and VII Convertible Preferred Stock as of date of issuance is included under the "Preferred Stock Subject to Mandatory Redemption" account in the consolidated balance sheets. The residual amount was assigned as the equity component.

- ***IAS 39, "Financial Instruments: Recognition and Measurement"***. IAS 39 establishes the accounting and reporting standards for recognizing and measuring our financial assets and financial liabilities. The Standard requires a financial asset or financial liability to be recognized initially at fair value. Subsequent to initial recognition, we are to continue to measure financial assets at their fair values, except for loans and receivables and held-to-maturity investments, which are measured at cost or amortized cost using the effective interest rate method. Financial liabilities are subsequently measured at cost or amortized cost, except for liabilities classified as "at fair value through profit and loss" and derivatives, which are measured at fair value.

  IAS 39 also covers the accounting for derivative instruments. The Standard has expanded the definition of a derivative instrument to include derivatives (derivative-like provisions) embedded in non-derivative contracts. Under the standard, every derivative instrument is recorded in the balance sheet as either an asset or liability measured at its fair value. Derivatives that are not designated and do not qualify as hedges are adjusted to fair value through income. If the derivative is designated and qualified as a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in equity until the hedged item is recognized in earnings.

The following is the reconciliation from previously reported net income and earnings per share for the nine months ended September 30, 2003, for the year ended December 31, 2003 and for the six months ended June 30, 2004, including the effect of these restatements on per share amounts:

(in millions)	**September 30, 2003**	**December 31, 2003 (As restated)**	**June 30, 2004**(1)
Net income, as previously reported	Php5,794	Php11,182	Php12,007
IAS 17 – Leases	(3)	(17)	–
IAS 27 – Consolidation and Separate Financial Statements	(1,491)	(3,445)	840
IAS 32 – Financial Instruments: Disclosure and Presentation	(1,240)	(1,775)	(647)
IAS 39 – Financial Instruments: Recognition and Measurement	(2,467)	(2,036)	(973)
Net income, as restated	Php593	Php3,909	Php11,227
Earnings per common share, as previously reported	Php27.62	Php55.74	Php65.62
Earnings per share impact of restated items:			
IAS 17 – Leases	(0.02)	(0.10)	–
IAS 27 – Consolidation and Separate Financial Statements	(8.80)	(20.34)	4.95
IAS 32 – Financial Instruments: Disclosure and Presentation	(7.32)	(10.48)	(3.82)
IAS 39 – Financial Instruments: Recognition and Measurement	(14.56)	(12.02)	(5.74)
Earnings per common share, as restated	(Php3.08)	Php12.80	Php61.01

(1) Presented to provide guidance on the reconciliation of IAS adjustments in respect of our last reporting period prior to IAS adoption.

For a detailed discussion on changes in accounting policies, please see *Note 2 – Summary of Significant Accounting Policies* to the accompanying consolidated 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 nine months ended September 30, 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.

	Nine Months Ended September 30,					
					Increase (Decrease)	
	2004	%(1)	2003(2)	%(1)	Amount	%
			(Unaudited)			
(in millions)						
Operating Revenues						
Wireless	Php50,648	58	Php37,436	51	Php13,212	35
Fixed line	35,319	40	34,830	47	489	1
Information and communications technology	1,552	2	1,258	2	294	23
	87,519	100	73,524	100	13,995	19
Operating Expenses						
Wireless	25,908	30	23,780	32	2,128	9
Fixed line	24,665	28	24,894	34	(229)	(1)
Information and communications technology	1,581	2	1,405	2	176	13
	52,154	60	50,079	68	2,075	4
Net Operating Income (Losses)						
Wireless	24,740	28	13,656	19	11,084	81
Fixed line	10,654	12	9,936	13	718	7
Information and communications technology	(29)	–	(147)	–	118	80
	Php35,365	40	Php23,445	32	Php11,920	51

(1) Operating expenses and net operating income (losses) are computed as a percentage of operating revenues.
(2) As restated to reflect the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying consolidated financial statements.

Consolidated Operating Revenues

Largely driven by the continued strong growth of our wireless business, particularly our cellular business, our consolidated operating revenues for the first nine months of 2004 increased by Php13,995 million, or 19%, to Php87,519 million from Php73,524 million in the same period in 2003. Our wireless business contributed Php50,648 million in revenues for the first nine months of 2004, an increase of Php13,212 million, or 35%, over its revenue contribution of Php37,436 million for the same period in 2003. The revenue contribution of our wireless business accounted for 58% of our consolidated operating revenues for the first nine months of 2004, compared to 51% in the same period in 2003. Our fixed line business, on the other hand, contributed Php35,319 million in revenues in the first nine months of 2004, an increase of Php489 million, or 1%, from Php34,830 million in the same period in 2003. As a percentage of our total consolidated operating revenues, our fixed line business revenue decreased in the first nine months of 2004 to 40% from 47% in the same period in 2003 due to the strong growth of our wireless business.

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 nine months ended September 30, 2004 and 2003 by service segment:

	Nine Months Ended September 30,					
					Increase	
	2004	**%**	**2003**(1)	**%**	**Amount**	**%**
			(Unaudited)			
(in millions)						
Wireless services:						
Cellular						
Smart	Php46,201	91	Php34,502	92	Php11,699	34
Piltel	3,952	8	2,577	7	1,375	53
Subtotal	50,153	99	37,079	99	13,074	35
Satellite, VSAT and others	495	1	357	1	138	39
Total	Php50,648	100	Php37,436	100	Php13,212	35

(1) As restated to reflect the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying consolidated financial statements.

Our wireless service revenues increased by Php13,212 million, or 35%, to Php50,648 million in the first nine months of 2004 from Php37,436 million in the same period in 2003 mainly as a result of the continued strong growth in revenues generated from Smart's and Piltel's cellular services. Accordingly, as a percentage of our consolidated operating revenues, wireless service revenues increased to 58% in the first nine months of 2004 from 51% in the same period in 2003.

Cellular Service

Unless otherwise indicated, the financial data and operating metrics cited in the cellular service section reflect the consolidated results of our cellular subsidiary, Smart and its subsidiary, Piltel.

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; and
- other charges, including those for reconnection and migration.

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

Our cellular service revenues in the first nine months of 2004 amounted to Php50,153 million, an increase of Php13,074 million, or 35%, from Php37,079 million in the same period in 2003. Cellular service revenues accounted for 99% of our wireless revenues and contributed 57% to our consolidated operating revenues in the first nine months of 2004, compared to 50% in the same period in 2003.

As of September 30, 2004, the combined cellular subscribers of Smart and Piltel reached 17,472,516, an increase of 5,921,724, or 51%, over their combined cellular subscriber base of 11,550,792 as of the same period in 2003. Prepaid and postpaid net subscriber activations totaled 1,433,664 and 10,445, respectively, in the third quarter of 2004, or a monthly average addition of 477,888 prepaid and 3,482 postpaid subscribers.

Smart markets nationwide cellular communications services under the brand names *Smart Buddy, Smart Gold, addict mobile, Smart Infinity* and *Smart Kid. Smart Buddy* is a prepaid service while *Smart Gold, addict mobile*, *Smart Infinity* and *Smart Kid* are postpaid services, which are all provided through Smart's digital GSM network. *Smart Gold* was launched in April 1999 and remains Smart's most broadbased postpaid brand. Introduced in April 2003, *addict mobile* is aimed primarily at the 18-35 year olds in the higher and middle income markets. It 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, targeting affluent individuals 35 years and above who are highly mobile locally and internationally. It offers a round-the-clock dedicated personal concierge service, international assistance services, premium handset packages and exclusive lifestyle content. *Smart Kid*, launched in May 2004, is especially designed for children, ages 5 to 12 years old, and is equipped with "Family Finder" which automatically forwards the child's call to pre-assigned numbers on the phone, a location-based finder service to enable them to keep in touch with their family members, as well as educational value-added services content. Prepaid versions of *addict mobile* and *Smart Kid* were subsequently introduced in October 2004.

On August 1, 2004, Smart launched *Smart Padala*, its newest service intended for overseas Filipino workers. *Smart Padala* is the first cash remittance service through text and is faster and cheaper than traditional remittance centers. It is ideally suited for the lower income market where cash remittances have the highest need and appreciation. *Smart Padala* is coursed through the banking services of Banco de Oro, a Philippine financial institution, as well as the various partnerships with internationally-licensed remittance companies (e.g., CBN, Travelex) and domestic encashment centers (e.g., McDonald's, 7-11, Seaoil and Tambunting Pawnshops.) *Smart Padala* is one of the latest innovative services by Smart emanating from its *Smart Money* platform. Launched in October 2000, *Smart Money* is the foundation for Smart's mobile commerce initiatives and makes possible Smart's electronic loading services such as *Smart Load*, *Pasa Load* and *Smart Padala*. Working with Banco de Oro and MasterCard, one of the world's leading payment services providers, *Smart Money* is a reloadable electronic cash card that works with GSM mobile phones, and can be used worldwide as a result of the MasterCard partnership. *Smart Money* has won international recognition, most notably as the Most Innovative GSM Wireless Service for Customers in the 2001 GSM Association annual assembly in Cannes. As of September 30, 2004, there were approximately 600,000 active *Smart Money* cards in use.

Piltel markets its cellular prepaid service under the brand name *Talk 'N Text* and is provided through Smart's GSM network.

The following table summarizes key measures of our cellular business as of and for the nine months ended September 30, 2004 and 2003:

	Nine Months Ended September 30,			
			Increase	
	2004	2003(1)	Amount	%
	(Unaudited)			
(in millions)				
Cellular revenues	Php50,153	Php37,079	Php13,074	35
GSM	49,993	36,942	13,051	35
By component	*48,864*	*36,166*	*12,698*	*35*
Voice	24,786	20,268	4,518	22
Data	24,078	15,898	8,180	51
By service type	*48,864*	*36,166*	*12,698*	*35*
Prepaid	45,845	33,727	12,118	36
Postpaid	3,019	2,439	580	24
GSM-Others(2)	*1,129*	*776*	*353*	*45*
Others(3)	160	137	23	17

	As of September 30,			
			Increase	
	2004	2003	Amount	%
	(Unaudited)			
Cellular subscriber base	17,472,516	11,550,792	5,921,724	51
Prepaid	17,188,537	11,319,034	5,869,503	52
Smart	12,998,664	8,779,170	4,219,494	48
Piltel	4,189,873	2,539,864	1,650,009	65
Postpaid	283,979	231,758	52,221	23

	Nine Months Ended September 30,			
			Increase	
	2004	2003	Amount	%
	(Unaudited)			
Systemwide traffic volumes (in millions)				
Calls (in minutes)	3,708	3,125	583	19
Domestic – outbound	2,640	2,152	488	23
International	1,068	973	95	10
Inbound	944	857	87	10
Outbound	124	116	8	7
Text messages – outbound	30,436	20,231	10,205	50
Smart	25,054	16,969	8,085	48
Piltel	5,382	3,262	2,120	65

(1) *As restated to reflect the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying consolidated financial statements.*
(2) *Refers to other non-subscriber-related revenues, such as inbound international roaming fees.*
(3) *Refers to all other services consisting primarily of revenues from Smart Money Holdings Corporation, public calling offices and payphones, and a small number of leased line contracts.*

Voice Services

Cellular revenues from voice services, which include all voice traffic and voice value-added services such as voice mail and international roaming, increased by Php4,518 million, or 22%, to Php24,786 million in the first nine months of 2004 from Php20,268 million in the same period in 2003 mainly due to the increase in subscriber base.

Prior to January 2004, Smart prepaid 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 our network or to other mobile operators' networks. Beginning January 2004, we implemented all-day flat air time rates for calls made by our prepaid subscribers. *Smart Buddy* subscribers' calls terminating to subscribers within our network 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. *Talk 'N Text* subscribers, on the other hand, are charged Php5.50 for calls made to subscribers within our network, while an all-day flat rate of Php6.50 are 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 the type of postpaid plan selected by subscribers. Beginning January 25, 2004, *Smart Gold*, *Smart Infinity* and *addict mobile* launched flat rate-regular plans and consumable plans.

Data Services

Cellular revenues from data services, which include all text messaging-related services as well as value-added services, increased by Php8,180 million, or 51%, to Php24,078 million in the first nine months of 2004 from Php15,898 million in the same period in 2003. Cellular data services accounted for 48% of GSM cellular revenues in the first nine months of 2004, compared to 43% in the same period in 2003. Text messaging-related services contributed revenues of Php21,779 million in the first nine months of 2004, compared to Php14,733 million in the same period in 2003, and accounted for 90% and 93% of the total cellular data revenues for the first nine months of 2004 and 2003, respectively. The increase in revenues from text messaging-related services resulted mainly from a 50% increase in volume of text messages to 30,436 million outbound messages in the first nine months of 2004 from the 20,231 million outbound messages handled in the same period in 2003. Value-added services contributed revenues of Php2,299 million in the first nine months of 2004, increasing by Php1,134 million, or 97%, from Php1,165 million in the same period in 2003.

The following table shows the breakdown of cellular data revenues for the nine months ended September 30, 2004 and 2003:

	Nine Months Ended September 30,			
			Increase (Decrease)	
	2004	2003(1)	Amount	%
		(Unaudited)		
(in millions)				
Text messaging				
Domestic	Php20,378	Php13,217	Php7,161	54
International	1,401	1,516	(115)	(8)
	21,779	14,733	7,046	48
Value-added services				
Non-Zed(2)	Php1,227	Php507	Php720	142
Smart Zed™	438	482	(44)	(9)
Mobile Banking, Roaming SMS, WAP, *Smart Money*	634	176	458	260
	2,299	1,165	1,134	97
Total	Php24,078	Php15,898	Php8,180	51

(1) As restated to reflect the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying consolidated financial statements.

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

Subscriber Base, ARPU and Churn Rates

Of our 17,472,516 GSM subscribers as of September 30, 2004, prepaid subscribers accounted for approximately 98% while postpaid subscribers accounted for the remaining 2%. Cellular prepaid GSM subscriber base grew by 52% to 17,188,537 as of September 30, 2004 from 11,319,034 as of September 30, 2003, whereas postpaid GSM subscriber base increased by 23% to 283,979 as of September 30, 2004 from 231,758 as of September 30, 2003.

The table below shows our average monthly activations:

	Nine Months ended September 30,					
	2004		2003		Increase (Decrease)	
	Gross	Net	Gross	Net	Gross	Net
Prepaid	877,923	498,924	636,998	321,819	240,925	177,105
Smart	623,227	351,948	461,284	236,681	161,943	115,267
Piltel	254,696	146,976	175,714	85,138	78,982	61,838
Postpaid-Smart	6,440	3,889	13,435	6,123	(6,995)	(2,234)

Revenues attributable to our cellular prepaid service amounted to Php45,845 million in the first nine months of 2004, a 36% increase over the Php33,727 million earned in the same period in 2003. Prepaid service revenues in the first nine months of 2004 and 2003 accounted for 94% and 93%, respectively, of GSM voice and data revenues. Revenues attributable to Smart's postpaid service amounted to Php3,019 million in the first nine months of 2004, a 24% increase over the Php2,439 million earned in the same period in 2003. Postpaid service revenues in the first nine months of 2004 and 2003 accounted for 6% and 7%, respectively, of GSM voice and data revenues.

The following table summarizes our cellular monthly ARPUs for the nine months ended September 30, 2004 and 2003:

	Nine Months Ended September 30,							
	Gross		Increase (Decrease)		Net		(Decrease)	
	2004	2003	Amount	%	2004	2003	Amount	%
	(Unaudited)							
Prepaid								
Smart	Php439	Php517	(Php78)	(15)	Php364	Php415	(Php51)	(12)
Piltel	323	353	(30)	(8)	272	288	(16)	(6)
Prepaid – Blended	413	484	(71)	(15)	343	395	(52)	(13)
Postpaid – Smart	1,733	1,741	(8)	–	1,247	1,312	(65)	(5)
Prepaid and Postpaid Blended	436	508	(72)	(14)	384	439	(55)	(13)

Our quarterly prepaid and postpaid ARPUs over the last seven quarters are as follows:

	Prepaid				Postpaid	
	Smart		Piltel		Smart	
	Gross	Net	Gross	Net	Gross	Net
2004						
First Quarter	Php463	Php383	Php341	Php287	Php1,736	Php1,326
Second Quarter	455	380	341	289	1,683	1,239
Third Quarter	399	329	288	241	1,780	1,176
2003						
First Quarter	533	416	351	273	1,716	1,268
Second Quarter	527	426	362	299	1,751	1,336
Third Quarter	490	404	345	292	1,756	1,332
Fourth Quarter	535	454	359	303	1,800	1,385

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.

Prepaid service revenues consist mainly of charges for subscribers' actual usage of their loads. Gross monthly ARPU for *Smart Buddy* subscribers in the first nine months of 2004 was Php439, a decrease of 15%, compared to Php517 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 nine months of 2004. On a net basis, ARPU in the first nine months of 2004 decreased by 12% to Php364 from Php415 in the same period in 2003. The lower rate of decrease in net ARPU compared to the decrease in gross ARPU resulted mainly from a decrease in the average interconnection expense per subscriber on the back of the increasing percentage of Smart-to-Smart traffic to local voice traffic, to 64% in the first nine months of 2004 from 60% in the same period in 2003. In addition, the introduction of *Smart Load* helped mitigate the decline in net ARPU due to a lower dealer discount of 5% applied to over-the-air loading compared to 10% for prepaid cards. 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. Gross monthly ARPU for *Talk 'N Text* subscribers in the first nine months of 2004 was

Php323, a decrease of 8% compared to Php353 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 nine months of 2004. On a net basis, ARPU in the first nine months of 2004 decreased by 6% to Php272 from Php288 in the same period in 2003.

Monthly ARPU for Smart's postpaid GSM services 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.

Gross monthly ARPUs for postpaid GSM subscribers in the first nine months of 2004 decreased to Php1,733 while net monthly ARPUs slightly decreased by 5% compared to the ARPU levels in the same period in 2003. Smart's GSM monthly gross blended ARPU was Php436 in the first nine months of 2004, a decrease of 14% compared to Php508 in the same period in 2003. Monthly net blended ARPU decreased by 13% to Php384 in the first nine months of 2004 from Php439 in the same period in 2003.

Churn, or the rate at which existing subscribers have their service cancelled 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 at the end of a month, all divided by the number of months in the same period.

In the past, a prepaid cellular subscriber was recognized as an active subscriber when that subscriber activated and used the SIM card in the handset, which already contains Php50 of pre-stored air time (reduced from Php100 in April 2004). Subscribers can reload their air time 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 GSM prepaid account is disconnected if the subscriber does not reload within four months after the full usage or expiry of the last reload. Our current policy is to recognize a prepaid subscriber as "active" only when the subscriber activates and uses the SIM card and reloads at least once during the month of initial activation or in the immediate succeeding month. For example, if a customer activated a SIM card in April 2004 but had not reloaded by May 31, 2004, this customer would not be counted as a subscriber. The rationale for this change stems from our observance of the aggressive "SIM-swapping" activities in the market beginning February 2004. "SIM-swapping" refers to the promotional activity wherein subscribers can exchange their current prepaid SIM card for another operator's SIM card at no cost to the subscriber. We believe that these activities have given rise to a situation where certain subscribers may swap their SIM cards between mobile operators upon full usage of the pre-stored air time, which, without the adjustment to subscriber recognition, would have led, based on the approach used in the past, to an overstatement of our prepaid subscriber base.

For *Smart Buddy*, the average monthly churn rate for the first nine months of 2004 was 2.4%, compared to 2.9% for the same period in 2003 while the average monthly churn rate for *Talk 'N Text* subscribers was 3.2% compared to 4.3% for the same period in 2003.

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 600,000 retail agents, approximately 90% of which are micro businesses. As of September 30, 2004, approximately 97% of *Smart Buddy* subscribers and 99% of *Talk 'N Text* subscribers were using *Smart Load* as their reloading mechanism. In the first nine months of 2004, *Smart Load* has accounted for approximately 66% of sales derived from reloads.

On December 24, 2003, Smart introduced *Pasa Load* (literally meaning "transfer load"), a derivative service of *Smart Load* that allowed for Php10 load transfers to other *Smart Buddy* and *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 nine months of 2004 was 1.0%, 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 nine months of 2004 amounted to Php495 million, an increase of Php138 million, or 39%, from Php357 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 nine months of 2004 totaled Php35,319 million, an increase of Php489 million, or 1%, from Php34,830 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 and miscellaneous services. As a percentage of our consolidated operating revenues, however, fixed line revenues decreased for the first nine months of 2004 to 40% from 47% 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 nine months ended September 30, 2004 and 2003 by service segment:

	Nine Months Ended September 30,					
					Increase (Decrease)	
	2004	%	2003(1)	%	Amount	%
			(Unaudited)			
(in millions)						
Fixed line services:						
Local exchange	Php15,752	44	Php15,930	46	(Php178)	(1)
International long distance	9,532	27	9,300	27	232	2
National long distance	5,260	15	4,956	14	304	6
Data and other network	4,549	13	4,381	12	168	4
Miscellaneous	226	1	263	1	(37)	(14)
Total	Php35,319	100	Php34,830	100	Php489	1

(1) As restated to reflect the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying consolidated financial statements.

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; 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 nine months ended September 30, 2004 and 2003:

	Nine Months Ended September 30,			
			Increase (Decrease)	
	2004	2003	Amount	%
		(Unaudited)		
Consolidated local exchange revenues (in millions)	Php15,752	Php15,930	(Php178)	(1)
Number of fixed lines in service:				
PLDT Group	2,184,411	2,172,793	11,618	1
PLDT	2,115,753	2,098,493	17,260	1
Number of PLDT employees	9,704	10,355	(651)	(6)
Number of PLDT fixed lines in service per PLDT employee	218	203	15	7

Revenues from our local exchange service for the first nine months of 2004 decreased by Php178 million, or 1%, to Php15,752 million from Php15,930 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 decreased to 44% for the first nine months of 2004 from 46% in the same period in 2003.

Gross additions to PLDT's fixed lines in service for the first nine months of 2004 totaled 534,093, an increase of 133,579 from the gross additions of 400,514 for the same period in 2003. On a net basis, PLDT's fixed line additions for the first nine months of 2004 were 82 as against a decrease of 5,954 for the same period in 2003. While fixed line additions totaled 27,332 for PLDT's prepaid fixed line services, PLDT's postpaid fixed lines in service declined by 27,250 for the first nine months of 2004. As of September 30, 2004, PLDT's postpaid and prepaid fixed line subscribers totaled 1,731,117 and 384,636, respectively, which accounted for approximately 82% and 18%, 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 form 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 but the rates for prepaid and postpaid fixed line subscribers for national and international long distance calls are the same.

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. During the first nine months of 2004, we implemented five upward and one downward adjustments in our monthly local service rates compared to nine upward and three downward adjustments during the same period in 2003. The average peso-to-dollar rate for the first nine months of 2004 was Php55.970 to US$1.00, compared to the average of Php53.877 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 4% in our monthly local service rates for the first nine months of 2004.

The ratio of PLDT fixed lines in service per PLDT employee improved from 203 as of September 30, 2003 to 218 as of September 30, 2004. This improvement resulted from the net

decrease in PLDT's employee headcount. As of September 30, 2004, PLDT's workforce was reduced by 651 to 9,704 employees from 10,355 employees as of September 30, 2003, mainly on account of PLDT's manpower rightsizing program, or MRP.

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 nine months ended September 30, 2004 and 2003:

	Nine Months Ended September 30,			
			Increase (Decrease)	
	2004	2003	Amount	%
		(Unaudited)		
Consolidated international long distance revenues (in millions)	Php9,532	Php9,300	Php232	2
Inbound	7,915	7,897	18	–
Outbound	1,617	1,403	214	15
International call volumes (in million minutes, except call ratio)				
PLDT Group	1,731	1,722	9	1
Inbound	1,615	1,602	13	1
Outbound	116	120	(4)	(3)
Inbound-outbound call ratio	13.9:1	13.4:1	–	–
PLDT	1,710	1,626	84	5
Inbound	1,596	1,508	88	6
Outbound	114	118	(4)	(3)
Inbound-outbound call ratio	14.0:1	12.8:1	–	–

Our consolidated international long distance revenues increased by Php232 million, or 2%, to Php9,532 million in the first nine months of 2004 from Php9,300 million in the same period in 2003. The percentage contribution of international long distance revenues to our total fixed line revenues remained flat at 27% in the first nine months of 2004 and 2003.

Our revenues from inbound international long distance calls in the first nine months of 2004 increased by Php18 million to Php7,915 million from Php7,897 million in the same period in 2003 primarily due to the positive impact of the depreciation of the average value of the peso relative to the U.S. dollar and an increase in PLDT's average inbound termination rates.

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. The average conversion rate was Php55.970 for the first nine months of 2004 and Php53.877 for the same period in 2003.

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 26 – Other Matters – U.S. Federal Communications Commission, or U.S. FCC, Ruling versus Philippine Telecommunications Companies* to the accompanying consolidated financial statements.

Our inbound international long distance call volumes in the first nine months of 2004 increased by 1% to 1,615 million minutes from 1,602 million minutes in the same period in 2003, largely due to an increase in transit calls.

Our revenues from outbound international long distance calls in the first nine months of 2004 increased by Php214 million, or 15%, to Php1,617 million from Php1,403 million in the same period in 2003. The depreciation of the peso contributed to the increase in 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. Average billing rates were Php55.82 and Php54.94 for the first nine months of 2004 and 2003, respectively.

Our outbound international long distance call volumes declined by 3% to 116 million minutes in the first nine months of 2004 from 120 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 nine months ended September 30, 2004 and 2003:

	Nine Months Ended September 30,			
			Increase (Decrease)	
	2004	2003	Amount	%
	(Unaudited)			
Consolidated national long distance revenues (in millions)	Php5,260	Php4,956	Php304	6
National long distance call volumes (in million minutes)				
PLDT Group	1,406	1,511	(105)	(7)
PLDT	1,360	1,488	(128)	(9)

Our national long distance revenues increased by Php304 million, or 6%, to Php5,260 million in the first nine months of 2004 from Php4,956 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 nine months 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, 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 7% 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 7% to 1,406 million minutes in the first nine months of 2004 from 1,511 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 nine months of 2004, our data and other network services posted a revenue of Php4,549 million, an increase of Php168 million, or 4%, from Php4,381 million in the same period in 2003. The revenue contribution of this service segment to our total fixed line revenues increased to 13% in the first nine months of 2004 from 12% in the same period in 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.

Broadband/IP-based services accounted for 57%, traditional bandwidth services accounted for 37% and other services accounted for the remaining 6% of the total revenues from PLDT's data and other network services in the first nine months of 2004, compared to 43%, 51% 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 September 30, 2004, the number of PLDT's fixed line subscribers for *PLDT Vibe* stood at 342,191, of which 144,655 are exclusive postpaid users, 145,826 are exclusive prepaid users, and 51,710 are both postpaid and prepaid users, compared to 165,774 as of September 30, 2003, of which 101,215 are exclusive postpaid users, 52,199 are exclusive prepaid users, and 12,360 are both postpaid and prepaid users, while the number of *DSL* subscribers reached 41,245 and 18,334 as of September 30, 2004 and 2003, respectively.

In April 2004, PLDT introduced additional enhanced IP-based solutions under an umbrella brand *IP-Plus*, namely, *Quality of Service*, or *QoS*, *IP Security*, or *IP Sec*, and *Voice over Virtual Private Network*, or *VoVPN*. With *QoS*, customers are given priority service for voice, premium and basic, with the highest priority given to voice since it requires error-free transmission. *IP Sec* optimizes the latest encryption technology to ensure utmost confidentiality of vital information. *VoVPN* gives customers toll-grade quality without the cost of toll charges. All these *IP Plus* solutions translate to cost-efficiency, high reliability and increased security and flexibility.

In June 2004, PLDT established an Innovation Laboratory, or *Innolab*, in Cebu, a show and demo room where existing and potential clients as well as students can have a hands-on experience on various PLDT products and services designed for our corporate clientele. It also serves as a venue for testing software applications and computer programs and is expected to be the starting ground for innovative ideas where new products and cost-effective solutions unfold.

Miscellaneous

Miscellaneous revenues are derived mostly from directory advertising and facilities rental. In the first nine months of 2004, these revenues decreased by Php37 million, or 14%, to Php226 million from Php263 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 nine months of 2004 and 2003, respectively.

Information and Communications Technology

Our information and communications technology business is conducted by ePLDT, a wholly-owned subsidiary of PLDT.

In the first nine months of 2004, our information and communications technology business generated total revenues of Php1,552 million, an increase of Php294 million, or 23%, from Php1,258 million in the same period in 2003. These revenues accounted for 2% of our consolidated operating revenues for the first nine months of 2004 and 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.

The following table summarizes our consolidated operating revenues from information and communications technology business for the nine months ended September 30, 2004 and 2003 by service segment:

	Nine Months Ended September 30,					
					Increase (Decrease)	
	2004	%	2003	%	Amount	%
Call center	Php855	55	Php677	54	Php178	26
Internet business	352	23	299	24	53	18
Vitro™ data center	310	20	248	20	62	25
Others	35	2	34	2	1	3
	Php1,552	100	Php1,258	100	Php294	23

Call Center

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

- Vocativ Systems, Inc., or Vocativ, which owns and operates a 824-seat call center facility with 730 customer service representatives, or CSRs, exclusively for clients of a global provider of customer relationship management services. Vocativ is currently expanding its capacity by 369 seats which will become operational by the fourth quarter of 2004; and
- Parlance Systems, Inc., or Parlance, which owns and operates a 675-seat call center facility with 994 CSRs, exclusively for one of the largest direct-to-home satellite service providers in the United States for customer support and billing requirements. Parlance is further expanding its capacity by 274 seats to accommodate anticipated increased call volumes from its existing client.

Call center revenues consist of:

- inbound calls for customer care, product inquiries, sales and technical support based on active minutes;
- outbound calls for sales and collections based on active minutes; and
- service income for e-mail handling, web chat, web co-browsing, data entry and

business process outsourcing based on transaction volume

Operating revenues related to our call center business in the first nine months of 2004 increased to Php855 million, or 26%, compared to Php677 million in the same period in 2003 due to combined effects of the following:

- Vocativ's upward price adjustment for voice and voice over internet protocol, or VoIP, and an increase in programs being handled; and

- upward price adjustment of Parlance for its inbound and outbound projects, coupled with an increase in the number of registered minutes.

Call center revenues accounted for 55% and 54% of our information and communications technology revenues for the first three quarters of 2004 and 2003, respectively.

Internet business

ePLDT has also invested in a number of other e-commerce and internet-related businesses, which include:

- 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; and

- 67.79% interest in Digital Paradise, Inc., or DigiPar, an internet café business which assumed the assets and brand of *Netopia*. *Netopia* is now one of the largest and fastest growing internet café chains in the country with over 100 branches and over 4,000 work stations. DigiPar offers high-speed internet services, including internet advertising, gaming and printing.

Internet Service revenues consist of:

- revenues derived from actual usage of internet access network by prepaid subscribers and any unused peso value of expired prepaid cards or electronic internet time loads, net of discounts given to dealers;
- monthly service fees from postpaid corporate and consumer subscribers, including (1) charges for internet usage in excess of allocated free plan internet hours; (2) one-time installation and activation fees; and (3) fees for value added services such as additional mailbox accounts;

- monthly service fees on value added services, including e-mail and web hosting services;
- one-time fees generated from resellership of internet-related solutions such as security solutions and domain registration; and

- share in revenues of text, voice and internet messages for cellular, landline and internet-based content and applications

Operating revenues from our internet business for the nine months ended September 30, 2004 increased by Php53 million, or 18%, to Php352 million from Php299 million in the same period in 2003 primarily due to the consolidation of DigiPar coupled with an increase in Infocom's postpaid subscriber base.

Vitro™ data center

ePLDT operates an internet data center under the brand name *Vitro*™. Granted pioneer status as an internet data center by the Philippine Board of Investments, or BOI, *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.

Vitro™ revenues consist of:

- monthly service fees derived from co-location services, server hosting, hardware and software maintenance services, website development and maintenance services, web hosting, data recovery security services and other value added services;
- installation charges and other one-time fees associated with the set-up;
- monthly service fees or one-time fees generated from professional services of Vitro's certified professionals; and
- one-time fees generated from resellership of software licenses and hardware equipment.

In the first nine months of 2004, *Vitro*™ contributed revenues of Php310 million, an increase of Php62 million, or 25%, from Php248 million in the same period in 2003, primarily due to an increase in product sales (i.e. Cisco equipment and Microsoft licenses), co-location revenues, server hosting and other services. *Vitro*™ revenues accounted for 20% of total revenues from information and communications technology business in the first nine months of 2004 and 2003.

Others

Revenues from other businesses related to our information and communications technology segment in the first nine months of 2004 increased by Php1 million, or 3%, to Php35 million from Php34 million in the same period in 2003 largely due to professional services rendered coupled with an increase in number of certificates sold.

Please refer to *Note 8 – Investments* to the accompanying consolidated financial statements for further discussion on ePLDT's other information and communications technology services.

Consolidated Operating Expenses

Our consolidated operating expenses in the first nine months of 2004 increased by Php2,075 million, or 4%, to Php52,154 million from Php50,079 million in the same period in

2003. The increase was primarily due to higher non-cash expenses, mainly depreciation and amortization, associated with our wireless business. As a percentage of our consolidated operating revenues, however, consolidated operating expenses decreased to 60% in the first nine months of 2004 from 68% in the same period in 2003.

Wireless

Consolidated operating expenses associated with our wireless business in the first nine months of 2004 amounted to Php25,908 million, an increase of Php2,128 million, or 9%, from Php23,780 million in the same period in 2003. A significant portion of this increase was attributable to non-cash expenses mainly depreciation and amortization coupled with an increase in certain cash expenses particularly maintenance, professional and other service fees, and compensation and benefits. As a percentage of our wireless operating revenues, operating expenses associated with our wireless business decreased to 51% in the first nine months of 2004 from 64% in the same period in 2003.

Cellular business expenses accounted for 97% and 96%, while satellite, VSAT and other business expenses accounted for 3% and 4% of our wireless business operating expenses for the first nine months of 2004 and 2003, respectively.

The following table summarizes our consolidated wireless-related operating expenses for the nine months ended September 30, 2004 and 2003 and the percentage of each expense item to the total:

	Nine Months Ended September 30,					
					Increase (Decrease)	
	2004	%	2003(1)	%	Amount	%
			(Unaudited)			
(in millions)						
Wireless services						
Depreciation and amortization(2)	Php9,451	37	Php7,687	32	Php1,764	23
Selling and promotions	6,781	26	7,596	32	(815)	(11)
Compensation and benefits	2,692	10	2,404	10	288	12
Maintenance	1,749	7	1,356	6	393	29
Rent	1,442	5	1,411	6	31	2
Professional and other service fees	775	3	400	2	375	94
Insurance and security services	691	3	546	2	145	27
Taxes and licenses	663	3	733	3	(70)	(10)
Provision for inventory obsolescence	329	1	97	–	232	239
Provision for doubtful accounts	95	–	501	2	(406)	(81)
Other operating expenses	1,240	5	1,049	5	191	18
Total	Php25,908	100	Php23,780	100	Php2,128	9

(1) As restated to reflect the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying consolidated financial statements.

(2) Includes depreciation of capitalized foreign exchange losses from the revaluation of net dollar liabilities of Php1,139 million in the first nine months of 2004 and Php858 million in the same period in 2003.

Depreciation and amortization charges increased by Php1,764 million, or 23%, to Php9,451 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 the revaluation of net dollar liabilities.

Selling and promotion expenses decreased by Php815 million, or 11%, to Php6,781 million due to lower dealer discounts and advertising and promotions. Cellular average subscriber acquisition cost, or SAC, for prepaid subscribers in the first nine months of 2004 was Php470, a decrease of 34% from Php715 in the same period in 2003. On the other hand, SAC for postpaid subscribers increased by 78% as a result of heightened competition in the postpaid segment, where higher handset subsidies were utilized to attract new subscriptions, as well as to retain the existing subscriber base. Blended SAC, however, decreased by 33% as prepaid subscribers account for 99% of our subscriber activations.

	For the nine months ended September 30,								
	2004			2003			Increase (Decrease)		
	Prepaid	Postpaid	Blended	Prepaid	Postpaid	Blended	Prepaid	Postpaid	Blended
Dealer discounts	Php115	Php401	Php117	Php335	Php750	Php343	(Php220)	(Php349)	(Php226)
Handset subsidies	185	17,587	313	162	10,556	364	23	7,031	(51)
Advertising and promotions	170	5,243	209	218	1,735	247	(48)	3,508	(38)
Total SAC	Php470	Php23,231	Php639	Php715	Php13,041	Php954	(Php245)	Php10,190	(Php315)

Compensation and benefits increased by Php288 million, or 12%, to Php2,692 million primarily due to increased headcount and 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 by 9% to 5,801 as of September 30, 2004 from 5,335 as of September 30, 2003.

Maintenance expenses increased by Php393 million, or 29%, to Php1,749 million mainly on account of higher repairs and maintenance costs, and higher site utility expenses due to the continued growth in the number of cell sites and other network facilities.

Rent expenses increased by Php31 million, or 2%, to Php1,442 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 September 30, 2004, we had 3,741 GSM cell sites and 5,006 base stations, compared with 2,575 GSM cell sites and 3,497 base stations as of September 30, 2003.

Professional and other service fees increased by Php375 million, or 94%, to Php775 million mainly as a result of increased legal, consultancy and bill collection service fees.

Insurance and security services increased by Php145 million, or 27%, to Php691 million mainly due to the increase in our number of cell sites and in the amount of network equipment insured as a result of the continued growth and expansion of our GSM network.

Taxes and licenses decreased by Php70 million, or 10%, to Php663 million mainly due to a decrease in Smart's business-related taxes partly offset by higher NTC supervision and regulation fees and disallowed input tax expense.

Provision for inventory obsolescence increased by Php232 million, or 239%, to Php329 million to cover for specifically identified slow moving handsets relating to ACeS Philippines.

Provision for doubtful accounts decreased by Php406 million, or 81%, to Php95 million due mainly to the reversal of provision for carrier accounts following subsequent collections from such carrier accounts.

Other operating expenses increased by Php191 million, or 18%, to Php1,240 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 nine months of 2004 totaled Php24,665 million, a decrease of Php229 million, compared to Php24,894 million in the same period in 2003. The decrease was primarily due to PLDT's cost-containment initiatives, partially offset by higher non-cash expenses, mainly depreciation and amortization. As a percentage of our total fixed line operating revenues, fixed line-related operating expenses decreased to 70% in the first nine months 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 nine months ended September 30, 2004 and 2003 and the percentage of each expense item to the total:

	Nine Months Ended September 30,					
					Increase (Decrease)	
	2004	**%**	**2003**(1)	**%**	**Amount**	**%**
			(Unaudited)			
(in millions)						
Fixed line services:						
Depreciation and amortization(2)	Php10,764	44	Php10,208	41	Php556	5
Compensation and benefits	5,200	21	5,400	22	(200)	(4)
Maintenance	2,331	9	2,387	10	(56)	(2)
Provision for doubtful accounts	2,105	9	2,575	10	(470)	(18)
Selling and promotions	964	4	990	4	(26)	(3)
Professional and other service fees	873	4	774	3	99	13
Rent	594	2	588	3	6	1
Insurance and security services	535	2	577	2	(42)	(7)
Taxes and licenses	468	2	489	2	(21)	(4)
Provision for inventory obsolescence	–	–	86	–	(86)	(100)
Other operating expenses	831	3	820	3	11	1
Total	Php24,665	100	Php24,894	100	(Php229)	(1)

(1) As restated to reflect the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying consolidated financial statements.

(2) Includes depreciation of capitalized foreign exchange losses from the revaluation of net dollar liabilities of Php3,483 million in the first nine months of 2004 and Php3,203 million in the same period in 2003.

Depreciation and amortization charges increased by Php556 million, or 5%, to Php10,764 million mainly due to higher depreciation of our regular asset base primarily resulting from additional completed projects and 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.

Compensation and benefits decreased by Php200 million, or 4%, to Php5,200 million mainly due to a 6% reduction in headcount due to PLDT's MRP, partially offset by collective bargaining agreement-related increases in salaries and benefits of PLDT employees. See *Note 18*

– Other Income (Expenses) – Net to the accompanying consolidated financial statements for further discussion on PLDT's MRP.

Maintenance expenses decreased by Php56 million, or 2%, to Php2,331 million primarily owing to lower maintenance costs of the domestic fiber optic network due to more remedial works done in 2003 than in 2004, partially offset by the expiration of warranties for certain plant facilities and higher maintenance costs of computer and peripherals in relation to charges for software support agreements for certain systems in the first nine months of 2004 as compared to the same period in 2003.

Provision for doubtful accounts decreased by Php470 million, or 18%, to Php2,105 million on account of lower provisions by PLDT for anticipated uncollectible accounts from various specifically identified domestic telecommunications carriers which were provided for in 2003. PLDT's provision for doubtful accounts in the first nine months of 2004 and 2003 was equivalent to 6% of its operating revenues.

Selling and promotion expenses decreased by Php26 million, or 3%, to Php964 million mainly as a result of reduced corporate public relations expenses, partially offset by an increase in PLDT's promotional activities in relation to various products and services.

Professional and other service fees increased by Php99 million, or 13%, to Php873 million as a result of higher legal fees in the first nine months of 2004 for various services, partially offset by a decrease in number of consultants in line with PLDT's cost management efforts, coupled with a decrease in collection agency fees on account of lower final accounts subject for collection.

Rent expenses increased by Php6 million to Php594 million due to 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 Php42 million, or 7%, to Php535 million primarily due to a decrease in the number of contracted security guards.

Taxes and licenses decreased by Php21 million, or 4%, to Php468 million mainly on account of lower business-related taxes paid in 2004 as compared to 2003.

Other operating expenses increased by Php11 million, or 1%, to Php831 million mainly due to higher contracted cost for technical and helpdesk resources and related computer and network maintenance and in-house systems development, partially offset by lower office supplies consumption and printing costs resulting from PLDT's continuing cost-cutting activities.

Information and Communications Technology

Consolidated operating expenses associated with our information and communications technology business totaled Php1,581 million in the first nine months of 2004, an increase of Php176 million, or 13%, from Php1,405 million in the same period in 2003. As a percentage of our information and communications technology operating revenues, operating expenses related to our information and communications technology business decreased to 102% in the first nine months of 2004 from 112% in the same period in 2003.

The following table shows the breakdown of our total consolidated information and communications technology-related operating expenses for the nine months ended September 30, 2004 and 2003 and the percentage of each expense item to the total:

	Nine Months Ended September 30,					
					Increase (Decrease)	
	2004	%	2003(1)	%	Amount	%
			(Unaudited)			
(in millions)						
Information and communications technology services:						
Compensation and benefits	Php591	37	Php394	28	Php197	50
Rent	243	16	245	17	(2)	(1)
Depreciation and amortization	231	15	247	17	(16)	(6)
Maintenance	218	14	207	15	11	5
Selling and promotions	206	13	160	11	46	29
Professional and other service fees	33	2	52	4	(19)	(37)
Taxes and licenses	17	1	16	1	1	6
Insurance and security services	5	–	8	1	(3)	(38)
Provision for doubtful accounts	5	–	14	1	(9)	(64)
Provision for inventory obsolescence	–	–	11	1	(11)	(100)
Other operating expenses	32	2	51	4	(19)	(37)
Total	Php1,581	100	Php1,405	100	Php176	13

(1) As restated to reflect the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying consolidated financial statements.

Compensation and benefits increased by Php197 million, or 50%, to Php591 million mainly due to the consolidation of DigiPar which resulted in an increase in headcount coupled with an increase in salaries, bonuses and various incentives of employees.

Rent expense decreased by Php2 million, or 1%, to Php243 million due to the migration of international lease provider from PLDT Global to Arcstar which reduced fixed monthly rates for leased circuits.

Depreciation and amortization charges decreased by Php16 million, or 6%, to Php231 million primarily due to a reduction in depreciable asset base of certain subsidiaries and the divestment of Contact World in 2003.

Maintenance expenses increased by Php11 million, or 5%, to Php218 million primarily due to a change in maintenance agreement for higher annual maintenance in respect of our subsidiary's digital certificate business.

Selling and promotion expenses increased by Php46 million, or 29%, to Php206 million mainly as a result of increased advertising and promotions expense due to the consolidation of DigiPar.

Professional and other service fees decreased by Php19 million, or 37%, to Php33 million primarily due to lower training and shuttling expenses relating to our call center representatives.

Provision for doubtful accounts decreased by Php9 million, or 64%, primarily due to Infocom's reversal of its provisions from bundled internet services which accounts have been subsequently collected.

Provision for inventory obsolescence decreased by Php11 million due to inventories already provided for in 2003.

Other operating expenses decreased by Php19 million, or 37%, to Php32 million in line with our over-all cost-containment initiatives.

Net Operating Income

Our consolidated net operating income in the first nine months of 2004 was Php35,365 million, an increase of Php11,920 million, or 51%, from Php23,445 million in the same period in 2003. Accordingly, our consolidated operating margin (net operating income as a percentage of operating revenues) improved to 40% in the first nine months of 2004 from 32% in the same period in 2003.

Wireless

Our wireless business segment recorded an operating income of Php24,740 million in the first nine months of 2004, an increase of Php11,084 million, or 81%, over Php13,656 million registered in the same period in 2003. Operating income contributed by our cellular business in the first nine months of 2004 increased by Php10,897 million to Php25,136 million from Php14,238 million due primarily to the growth in our cellular subscriber base.

Fixed Line

In the first nine months of 2004, our fixed line business segment contributed a net operating income of Php10,654 million, higher by Php718 million, or 7%, than Php9,936 million in the same period in 2003 mainly as a result of higher fixed line operating revenues coupled with lower fixed line-related expenses.

Information and Communications Technology

In the first nine months of 2004, our information and communications technology business segment registered an operating loss of Php29 million, an improvement of Php118 million, or 80%, compared to an operating loss of Php147 million posted in the same period in 2003. This improvement reflects the contribution of ePLDT's call center business which contributed Php256 million and Php71 million in operating income for 2004 and 2003, respectively.

Interest Expense and Related Items - Net

Interest expense and related items – net increased by Php152 million, or 1%, to Php10,819 million in the first nine months of 2004 from Php10,667 million in the same period in 2003.

The following table shows the breakdown of our interest expense and related items accounts:

	Nine Months Ended September 30,			
			Change	
(in millions)	2004	2003	Amount	%
Loans and related items	Php9,191	Php9,701	(Php510)	(5)
Capitalized interest	(471)	(745)	(274)	(37)
Accretion on preferred stock subject to mandatory redemption	1,146	954	192	20
Amortization of debt discount	644	464	180	39
Dividends on preferred stock subject to mandatory redemption	210	196	14	7
Capital lease	99	97	2	2
	Php10,819	Php10,667	Php152	1

Interest expense on loans and related items decreased by Php510 million to Php9,191 million largely due to debt amortizations during the first nine months of 2004. Capitalized interest decreased by 37% to Php471 million as more projects were completed in the first nine months of 2004 compared with the same period in 2003.

In relation to our early adoption of IAS 32 and 39, we recognized the following as part of interest expense and related items account: (1) accretion of the difference between the face value and carrying value of PLDT's Convertible Preferred Stock Series V, VI and VII subject to mandatory redemption using the effective interest method up to redemption or until the shares are converted into common shares; (2) amortization of debt discount arising from debt discounts recognized as Smart's newly issued debt (in relation to the debt exchange transaction for Piltel's debt) and Piltel's restructured debt were recorded at fair values. In addition, in compliance with IAS 17, we recognized interest expense on our capital lease liabilities; and (3) dividends related to PLDT's Convertible Preferred Stock Series V, VI and VII preferred stock subject to mandatory redemption designated as financial liabilities. For further discussion, please see *Note 2 - Summary of Significant Accounting Policies* to the accompanying consolidated financial statements.

Equity Share in Net Losses of Investees Including Provision for Impairment in Value of Investments

Equity share in net losses of investees including provision for impairment in value of investments decreased by Php690 million, or 43% to Php927 million in the first three quarters of 2004 due to ACeS Philippines' provision for impairment in value of its investment in AIL of Php1,614 million in 2003. During 2004, ePLDT recognized a provision for impairment in its investment in an investee of Php616 million.

Interest Income

Interest income increased by Php401 million, or 109%, to Php769 million in the first nine months of 2004 from Php368 million in the same period in 2003 mainly attributable to higher average cash balances.

Other Income (Expenses) – Net

	Nine Months Ended September 30,			
			Change	
(in millions)	2004	2003	Amount	%
Gain on debt exchange transaction	Php4,419	Php–	Php4,419	100
Gain (loss) on derivative transactions – net	435	(1,706)	2,141	125
Foreign exchange losses – net	(645)	(2,886)	2,241	78
Hedge cost	(851)	(808)	(43)	(5)
Manpower rightsizing cost	(736)	(1,955)	1,219	62
Financing charges	(650)	(643)	(7)	(1)
Asset impairment	(395)	(1,344)	949	71
Others – net	(661)	(1,448)	787	54
	Php916	(Php10,790)	Php11,706	108

Gain on the debt exchange transaction in 2004 amounting to Php4,419 million arose from the exchange of 69.4% of Piltel's total outstanding restructured debt by Smart from Piltel's creditors. The gain represents the difference between the fair value of Piltel's debt cancelled and/or exchanged to Smart's debt amounting to Php12,893 million (net of debt discount of Php3,359 million) and Smart's consideration for the debt exchange including cash of Php84 million (US$1.5 million) and fair value of newly issued debt amounting to Php8,390 million (net of debt discount of Php7,464 million). For further discussion, please see Other Information.

In relation to our early adoption of IAS 32 and 39, we recognized the following in our profit and loss accounts: (1) gain (loss) on derivative transactions representing the mark-to-market gain or loss in relation to the derivative instruments not designated as hedges; and (2) foreign exchange losses - net pertaining to the foreign exchange revaluation of the carrying values of financial liabilities and hedged items prior to designation and documentation as hedged instruments in July 2004. For further discussion, please see *Note 2 – Summary of Significant Accounting Policies* to the accompanying consolidated financial statements.

Manpower rightsizing cost decreased by Php1,219 million, or 62%, to Php736 million corresponding to 258 and 1,681 employees affected by PLDT's manpower rightsizing program in the first three quarters of 2004 and 2003, respectively. For further discussion, please see *Note 18 – Other Income (Expenses) - Net* to the accompanying consolidated financial statements.

Financing charges increased by Php7 million, or 1%, to Php650 million for the first nine months of 2004 as compared to the same period in 2003. Financing charges include amortization of debt issuance costs and commitment fees related to the undrawn portion of our loan facilities.

Asset impairment provisions decreased by Php949 million, or 71%, to Php395 million largely due to impairment losses in 2003 amounting to Php964 million and Php380 million recognized by ACeS Philippines and ePLDT, respectively, in respect of certain equipment related to their investee companies. In 2004, asset impairment charges were recognized for certain international facility equipment of PLDT Global and SubicTel in relation to our strategic direction to functionally integrate our international fixed line businesses. In 2003, impairment losses were recognized by ACeS Philippines and ePLDT in respect of certain equipment related to their investee companies.

Income Before Income Tax

Our income before income tax in the first nine months of 2004 was Php25,304 million, representing an increase of Php24,565 million from Php739 million in the same period in 2003, mainly attributable to a higher operating revenues generated in the first nine months of 2004 coupled with a substantial decline in other expenses - net during the same period.

Our consolidated provision for income tax increased by Php5,268 million to Php5,332 million in the first nine months of 2004 from Php64 million in the same period in 2003.

In the first nine months 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 BOI in connection with the pioneer status it awarded to Smart's GSM network expansion project, which expired in May 2004;
- 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 expired in May 2004, applied to the incremental income generated from its GSM network expansion. The income tax holiday was computed by applying the exemption rate against the income tax derived from GSM operations. The exemption rate was computed by dividing the incremental GSM revenues by eligible GSM revenues (both gross of interconnection revenues) where the incremental GSM revenues were 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 was multiplied by the statutory corporate income tax rate of 32% and the exemption rate. The resulting figure was the income tax holiday that was deducted from the income tax due on GSM revenues with the difference being the income tax due for the period.

Net Income

As a result of the factors discussed above, our consolidated net income for the first nine months of 2004 was Php20,007 million, representing an increase of Php19,414 million over our restated consolidated net income of Php593 million in the same period in 2003. This increase was principally due to our wireless business net operating income contribution of Php24,740 million for the first nine months of 2004, a significant improvement of Php11,084 million, or 81%, over its net operating income contribution of Php13,656 million in the same period in 2003 and a substantial decline in other expenses – net of Php11,706 million largely due to the Php4,419 million gain recognized from the Piltel debt exchange transaction.

Basic and diluted earnings per common share, or EPS, increased to Php111.22 and Php104.89, respectively, in the first nine months of 2004 as against basic and diluted loss per common share of Php3.08 in the same period in 2003, after giving retroactive effect to common share equivalents. See *Note 20 – Earnings Per Common Share* to the accompanying consolidated financial statements for further discussion.

Liquidity and Capital Resources

The following table shows our consolidated cash flows for the nine months ended September 30, 2004 and 2003 as well as consolidated capitalization and other selected financial data as of September 30, 2004 and December 31, 2003:

	Nine Months Ended September 30,	
	2004	**2003**(1)
	(Unaudited)	
(in millions)		
Cash Flows		
Net cash provided by operating activities	Php54,541	Php37,353
Net cash used in investing activities	16,613	12,297
Capital expenditures	16,238	11,232
Net cash used in financing activities	29,704	24,506
Net increase in cash and cash equivalents	8,144	562

	September 30, 2004	December 31, 2003(1)
	(Unaudited)	(As restated)
(in millions)		
Capitalization		
Notes payable	Php18	Php2,133
Current portion of long-term debt	31,508	23,810
Long-term debt – net of current portion	127,599	154,669
Total debt	159,125	180,612
Preferred stock subject to mandatory redemption	13,863	12,735
Total equity	82,497	63,405
	Php255,485	Php256,745
Other Financial Data		
Cash and cash equivalents	Php27,516	Php19,372
Property, plant and equipment – net	243,956	247,484
Total assets	305,978	301,042
Net debt(2)	131,609	161,240

(1) As restated to reflect the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying consolidated financial statements.

(2) Total debt less cash and cash equivalents.

As of September 30, 2004, our consolidated cash and cash equivalents totaled Php27,516 million. Principal sources of consolidated cash and cash equivalents in the first nine months of 2004 were cash flows from operations amounting to Php54,541 million and drawings from long-term credit facilities aggregating Php5,707 million. These funds were used principally for capital outlays of Php16,238 million, total debt principal payments of Php25,405 million; and interest payments of Php8,881 million.

Operating Activities

Our consolidated net cash flows from operating activities in the first nine months of 2004 increased by Php17,188 million, or 46%, to Php54,541 million from Php37,353 million in the same period in 2003.

A growing portion of our cash flow is generated by our wireless business, which accounted for 58% of our consolidated operating revenues in the first nine months of 2004, compared to 51% in the same period in 2003. Revenues from our fixed line and information and

communications technology services accounted for 40% and 2%, respectively, of our consolidated operating revenues in the first nine months of 2004 and 47% and 2%, respectively, for the first nine months of 2003.

Wireless' operating cash flows accounted for 56% of our consolidated cash flows from operations owing to the sustained growth of our cellular subscriber base and service usage. Our fixed line business contributed 43% to our consolidated operating cash flows in the first three quarters of 2004 with improved collection efficiency and lower cash expenses in line with our cost-containment efforts. We believe that our continuing strong cash flows on a consolidated basis will allow us to defray our current liabilities despite our current ratio being less than 1:1 as of September 30, 2004.

Our subsidiaries, particularly Smart, made significant contributions to our cash from operations. In the first nine months of 2004, Smart generated cash from operations of Php29,912 million, or 55% of our consolidated cash flows from operations, representing an increase of Php11,270 million, or 60%, compared to Php18,642 million, or 50%, of our consolidated operating cash flows in the same period in 2003. Smart's significant 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. On May 26, 2004, after having obtained the relevant waivers from Finnvera and certain of its lenders, Smart paid a dividend of Php11,280 million to PLDT, equivalent to 70% of Smart's 2003 net income. After receiving similar approvals from Finnvera and certain lenders, Smart has paid dividends in the amount of Php4,300 million to PLDT in June 2003, representing 70% of Smart's 2002 net income and in the amount of Php1,866 million to PLDT in November 2003, equivalent to the remaining 30% of its 2002 net income. Similar waivers have already been obtained by Smart to pay a dividend representing the 30% balance of Smart's 2003 net income equivalent to Php4,820 million in the fourth quarter of 2004.

Investing Activities

Net cash used in investing activities in the first nine months of 2004 of Php16,613 million increased by Php4,316 million, or 35%, compared to Php12,297 million in the same period in 2003. This increase was primarily the result of higher aggregate capital spending.

Our consolidated capital expenditures in the first nine months of 2004 totaled Php16,238 million, an increase of Php5,006 million, or 45%, from Php11,232 million in the same period of 2003 primarily due to Smart's increased capital spending. Smart's capital spending of Php12,792 million in the first nine months 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 Php3,175 million was principally used to finance the expansion of its fixed line data and network services. ePLDT and its subsidiaries' capital spending of Php205 million was used to primarily fund its *Vitro*™, Infocom and call center business operations. Consolidated capital expenditures in the first nine months of 2003 amounted to Php11,232 million, of which Php4,098 million, Php6,916 million, Php71 million and Php108 million were attributable to PLDT, Smart, ePLDT and PLDT Global, respectively. The balance represented other subsidiaries' capital spending.

During the first nine months of 2004, we made certain strategic investments aggregating Php999 million to strengthen our position in the wireless and information and communications technology segments. Of the Php999 million investment, Php656 million represented Smart's

partial investment in a wireless broadband and data service company, and Php231 million pertained to ePLDT's investment in convertible debt securities of a company engaged in the systems integration of internet and mobile telephone gaming project.

Financing Activities

On a consolidated basis, we used net cash of Php29,704 million for financing activities in the first nine months of 2004, compared to Php24,506 million in the same period in 2003. The net cash used in financing activities in the first nine months of 2004 was mainly attributable to debt repayments by PLDT in line with its ongoing debt reduction program.

Debt Financing

Additions to our consolidated total debt in the first nine months of 2004 totaled Php5,707 million, of which Php3,405 million came from PLDT's drawings, primarily from long-term loan facilities used to finance capital expenditures and refinancing facilities used to repay maturing debts. Payments in respect of principal and interest of our total debt amounted to Php25,405 million and Php8,881 million, respectively, in the first nine months of 2004, of which Php18,344 million and Php7,488 million were attributable to PLDT, respectively.

The following table shows our consolidated long-term debt as of September 30, 2004 and December 31, 2003:

	September 30, 2004	December 31, 2003	Increase (Decrease)	
			Amount	%
(in millions)	**(Unaudited)**	**(As restated)**		
PLDT	Php123,736	Php135,403	(Php11,667)	(9)
Smart	25,834	20,586	5,248	25
Piltel	5,155	17,637	(12,482)	(71)
Mabuhay Satellite	4,059	4,723	(664)	(14)
ePLDT	160	105	55	52
Vocativ	149	–	149	100
Maratel	14	25	(11)	(44)
	Php159,107	Php178,479	(Php19,372)	(11)

Our consolidated long-term debt decreased by Php19,372 million, or 11%, to Php159,107 million as of September 30, 2004 largely due to debt repayments in line with PLDT’s efforts to reduce overall debt level. Smart’s indebtedness increased by 25% to Php25,834 million at the end of the third quarter of 2004 on account of the debt exchange transaction with Piltel’s creditors in July 2004 where Smart issued new debt of US$283.3 million booked at fair value of Php8,390 million, net of debt discount amounting to Php7,464 million; Smart’s unamortized discount amounted to Php7,369 million as of September 30, 2004. Conversely, Piltel’s debt balance owed to third parties as of September 30, 2004 was reduced to Php5,155 million, net of unamortized discount of Php2,073 million. Mabuhay Satellite’s debt level decreased by 14% to Php4,059 million owing to debt amortizations during the year. Other subsidiaries’ indebtedness increased by Php193 million primarily from Vocativ’s full availment of a 5-year Php149 million term loan facility.

As of September 30, 2004, PLDT had undrawn committed dollar-denominated long-term credit facilities for capital expenditures in the aggregate amount of US$39 million, inclusive of the remaining JP¥4,055 million undrawn portion of the JP¥5,615 million syndicated term loan facility supported by Nippon Export and Investment Insurance of Japan under an agreement dated

June 11, 2003. PLDT waived further disbursements from the US$149 million Kreditanstalt für Wiederaufbau refinancing facility effective September 1, 2004, thus, cancelling the undrawn portion of US$9 million. The US$4 million undrawn portion of the US$12 million term loan facility extended by DEG-Deutsche Investitions-und Entwicklungsgesellschaft mbH under an agreement dated May 29, 2003 was also cancelled pursuant to a request by PLDT to DEG effective September 26, 2004. On September 13, 2004, Smart signed a US$104 million 5-year term loan facility supported by Finnish Export Credit Plc as the Lender of Record with ABN AMRO Bank, Banque National de Paribas, Calyon, DBS Bank and Sumitomo Mitsui Banking Corporation as the Lead Arrangers. The full amount of the facility will be drawn in November 2004. The loan will be payable over five years in ten equal installments starting May 2005 with final repayment in November 2009. As of September 30, 2004, Smart still had available facilities under its €50 million Framework Agreement with Bayerische Hypo-und Vereinsbank Aktiengesellschaft up to a maximum aggregate amount of €44 million.

The scheduled maturities of our consolidated outstanding long-term debt at nominal values as of September 30, 2004 are as follows:

Year	US$ Loans(2)		JP¥ Loans(3)		Peso Loans	Total
			(in millions)			
2004(1)	US$79	Php4,448	JP¥2,014	Php1,031	Php669	Php6,148
2005	470	26,455	6,818	3,489	880	30,824
2006	442	24,888	6,816	3,488	852	29,228
2007	483	27,139	3,178	1,626	78	28,843
2008	78	4,407	1,589	813	67	5,287
2009 and onwards	1,191	67,026	–	–	1,270	68,296

(1) October 1, 2004 through December 31, 2004.
(2) The exchange rate used was Php56.276 to US$1.00.
(3) The exchange rate used was Php0.5117 to JP¥1.00.

Approximately Php100,330 million principal amount of our consolidated outstanding long-term debt as of September 30, 2004 is scheduled to mature over the period from 2004 to 2008. Of this amount, approximately Php77,681 million is attributable to PLDT, Php17,437 million to Smart, and the remainder to Mabuhay Satellite, 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 PLDT's 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 4.5:1 from September 30, 2004 to December 31, 2004 and not more than 4.0:1 from March 31, 2005 and thereafter;
- long-term indebtedness to appraised value of equity/tangible net worth on a non-

consolidated basis ranging from not more than 1.5:1 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 1.1:1;
- 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 5.0:1 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 calculated in conformity with accounting principles generally accepted in the Philippines except that accounts relating to Piltel are to be accounted for on the basis of equity accounting. These include:

- total debt to EBITDA of not more than 4.5:1 in 2004 and not more than 4.0:1 in 2005 and thereafter;
- long-term debt to appraised value of equity/tangible net worth of not more than 2.33:1 to not more than 3.0:1.

We have complied with all of our maintenance ratios as required under our loan covenants and other debt instruments. In addition, we are required to comply with the following ratios for the incurrence of capital expenditures in excess of US$10 million and incurrence of indebtedness:

- long-term indebtedness to appraised value of equity/tangible net worth on a non-consolidated basis of not more than 1.1:1 and on a consolidated basis of not more than 2.33:1; and
- current ratio on a non-consolidated basis of not less than 1.2:1 and on a consolidated basis of not less than 0.9:1; and
- interest coverage ratio on a non-consolidated and consolidated basis 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 long-lived assets that may be recognized by PLDT and its consolidated subsidiaries and increases in our interest expenses. Since approximately 98% 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 September 30, 2004, the peso depreciated by 1% to Php56.276 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. During the first nine months 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 its 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. Further, 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 will continue to become more restrictive as the loans near maturity. Inability to comply with our financial ratios and covenants 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.

Smart's debt instruments contain certain restrictive covenants, including covenants that prohibit Smart from paying dividends, redeem preferred stock, make distributions to PLDT or otherwise provide funds to PLDT or any affiliate without the consent of its lenders. Also, Smart's debt instruments contain certain restrictive covenants that require Smart to comply with specified financial ratios and other financial tests at semi-annual measurement dates. The financial tests under Smart's loan agreements include compliance with a debt-to-equity ratio of not more than 1.50:1 and a debt service coverage ratio of not less than 1.50:1. Smart has maintained compliance with all of its financial covenants.

In addition, some of these loan agreements restrict Smart's ability to enter into transactions with affiliates except on arm's-length terms and for valuable consideration.

As of September 30, 2004, Piltel is not in compliance with the terms of convertible bonds with principal amount of US$0.7 million (approximately US$0.9 million redemption price at the option of the holders). Piltel may not be able to restructure or otherwise pay the claims of its unrestructured debt. However, default on and acceleration of Piltel's unrestructured indebtedness does not create a cross-default under Piltel's restructured indebtedness or any indebtedness of PLDT or Smart.

The Credit and Omnibus Agreements of Mabuhay Satellite impose negative covenants which, among others, restrict material changes in Mabuhay Satellite's nature of business and ownership structure, any lien upon or with respect to any of its assets or to any right to receive income, acquisition of capital stock, declaration and payment of dividends, merger, consolidation and sale with another entity and incurring or guaranteeing additional long-term debt beyond prescribed amounts.

ePLDT's loan agreements impose negative and special covenants which, among other things, restrict ePLDT in regard to payment of cash dividends or any other income of any capital distribution to PLDT, voluntary suspension of its entire business operations for a period of 60 consecutive days of dissolution of its legal existence, and creation of any encumbrances on the shares and property pledged.

One of ePLDT's loan agreements requires it to comply with specified financial ratios and other financial tests at quarterly measurement dates. The financial tests under the agreement include, among others, compliance with a current ratio of not less than 1:1, an interest coverage ratio of not less than 1.5:1, debt to equity ratio of not more than 1.50:1, and a debt service coverage ratio of not less than 1.1:1. The agreement also contains customary and other default provisions that permit the lender to accelerate amounts due under the loan or terminate their commitments to extend additional funds under the loan. As of September 30, 2004, ePLDT has complied with all of its financial covenants.

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 managed its capital expenditures, reduced its investments, suspended dividend payments to common shareholders and increased its application of available cash to reduce its indebtedness. Further, we are benefiting from increasing revenue and cash flow contributions from our subsidiaries, particularly Smart. Smart, however, will be required to obtain further waivers from Finnvera and certain lenders to pay additional dividends in future periods. 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 June 24, 2004 and March 23, 2004, Standard and Poor's Ratings Group affirmed its "BB" rating and stable outlook on PLDT.

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, Moody's affirmed PLDT's "Ba2" senior unsecured debt rating with a negative outlook and its "B1" preferred rating with a stable outlook. 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.

Off-Balance Sheet Arrangement

On October 10, 2002, PLDT entered into a Receivables Purchase Deed, or RPD, with a foreign financial 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, of which US$30 million remains outstanding as of September 30, 2004, and (2) to service, administer and collect the receivables on behalf of the Purchaser. Under the RPD, the Purchaser has 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 nine months ended September 30, 2004 and 2003, receivables sold under the RPD amounted to US$8 million (Php464 million) and US$8 million (Php444 million), respectively. Loss on sale of receivables under the RPD amounted to US$1 million (Php55 million) and US$1 million (Php66 million) for the nine months ended September 30, 2004 and 2003, 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 Php5 million in the first nine months of 2004 and Php47 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. In addition, PLDT raised Php226 million from the exercise by certain officers and executives of their stock option plan in 2004.

Cash dividend payments in the first nine months of 2004 amounted to Php1,040 million, compared to Php1,085 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 April 2001 (dividends declared in March 2001); since then, no dividends have been paid to common shareholders.

Contractual Obligations and Commercial Commitments

Contractual Obligations

The following table discloses our contractual obligations outstanding as of September 30, 2004:

	Payments Due by Period				
	Total	Within 1 year	2–3 years	4–5 years	After 5 years
			(Unaudited)		
(in millions)					
Long-term debt	Php168,626	Php31,510	Php60,480	Php20,112	Php56,524
Long-term lease obligations:					
Operating Lease	3,231	750	1,028	633	820
Capital Lease	1,800	586	642	121	451
Unconditional purchase obligations(1)	12,550	4,372	2,260	2,260	3,658
Other long-term obligations	22,020	–	–	14,015	8,005
Total contractual cash obligations	Php208,227	Php37,218	Php64,410	Php37,141	Php69,458

(1) The amounts disclosed in the table above are based on the original Air Time Purchase Agreement with AIL.

Long-term Debt

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

Long-term Operating Lease Obligations

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 September 30, 2004, PLDT's aggregate remaining obligation under this agreement was approximately Php98 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 September 30, 2004, PLDT's aggregate remaining obligation under these contracts amounted to approximately Php33 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 September 30, 2004, PLDT's aggregate remaining obligation under this agreement was approximately Php50 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, telecommunication equipment locations and various office equipment. In particular, Smart has lease obligations aggregating Php2,898 million as of September 30, 2004 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 in Bohol and Batangas 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 September 30, 2004, PLDT's aggregate remaining obligation under this agreement was approximately Php914 million. In case of cancellation, PLDT is liable to pay Php100 million under each of the two contracts as liquidated damages.

On June 1, 2004, PLDT served the DOTC a notice of termination of the lease agreement in respect of the telecommunications system in Bohol which state of deterioration, obsolescence and disrepair have made it impossible for PLDT to continue managing, operating, and maintaining the system. Since 2002, PLDT has been advising the DOTC of the need to review the viability of the system as it has infused more than Php200 million for upgrades and maintenance to keep the system operable. Further, the enactment of R.A. 7925, which negated the DOTC's warranty to grant PLDT the exclusive right to provide telecommunication services in the areas stipulated, prevented PLDT from achieving the originally projected profitability thereby rendering it impossible for PLDT to continue fulfilling its obligation under the lease agreement. Although several discussions have been held since then to seek a mutually acceptable agreement,

no amenable arrangement has been reached. On June 30, 2004, the DOTC advised PLDT that the request for termination of the lease agreement in Bohol has been referred to the Department of Justice, or DOJ, as government agencies are required to refer all interpretation of contracts and agreements to the DOJ secretary as attorney-general of the national government. As of the date of this report, the DOJ has not yet responded to the DOTC's referral. As of September 30, 2004, the net book value of the telecommunications system in Bohol, including PLDT's additional capital expenditure relating to the telecommunications system, and corresponding capital lease obligation amounted to Php67 million and Php778 million, respectively.

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 and Piltel has capital lease obligations aggregating Php883 million as of September 30, 2004 in respect of office equipment and facilities.

Unconditional Purchase Obligations

Air Time Purchase Agreement with AIL. PLDT is a party to a Founder NSP, or National Service Provider, Air Time Purchase Agreement with AIL in March 1997, 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 September 30, 2004, PLDT's aggregate remaining minimum obligation under the original Air Time Purchase Agreement was approximately Php11,986 million. See *Note 16 – Related Party Transactions* and *Note 22 – Provisions and Contingencies* to the accompanying consolidated financial statements 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.

Effective July 1, 2004, VeriSign has agreed to amend the Agreement and issued Addendum 8 as extension of Addendum 6. Annual support fee for year 5 (September 2004 to August 2005) will remain at US$40,000 and affiliate revenue sharing rates will remain at 25%. As of September 30, 2004, ePLDT's aggregate remaining minimum obligation under this agreement was approximately Php18 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, e-mail 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 other powerful management applications. The aggregate value of these licenses is US$2.1 million and these licenses 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. Effective March 30, 2004, I-Contact has agreed to amend the Contract and waived all financial obligations and committed seats requirement over the two-year period. iPlus will pay all its remaining obligations pertaining only to the 300 seats delivered by I-Contact. As of September 30, 2004, iPlus has paid all its obligations to I-Contact.

Other Unconditional Purchase Obligations. The PLDT group 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 September 30, 2004, PLDT had issued a total of 3 million shares of Series V Convertible Preferred Stock, 5 million shares of Series VI Convertible Preferred Stock and 4 million shares of Series VII Convertible Preferred Stock in exchange for a total of 59 million shares of Series K, Class I Convertible Preferred Stock of Piltel pursuant to the debt restructuring plan of Piltel.

Each share of Series V, VI and VII Convertible Preferred Stock 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 Stocks and on the eighth anniversary of the issue date of the Series VII Convertible Preferred Stock, the remaining outstanding shares under these series will be mandatorily converted to shares of PLDT's common stock. 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 per share, US$36.132 per share, and JP¥4,071.89 per share for Series V, VI and VII, respectively.

As of September 30, 2004, 175,320 shares of Series V Convertible Preferred Stock and 531,251 shares of Series VI Convertible Preferred Stock had been converted to PLDT's common shares. The aggregate value of the put option based on outstanding shares as of September 30,

2004 was Php22,020 million, of which Php14,015 million is payable on June 4, 2008 and Php8,005 million on June 4, 2009, if all of the outstanding shares of Series V, VI and VII Convertible Preferred Stocks were mandatorily converted and all the underlying shares of common stock were put to PLDT. The market value of the underlying shares of common stock was Php15,557 million, based on the market price of PLDT's common stock of Php1,395 per share as of September 30, 2004.

Please refer to *Note 14 – Preferred Stock Subject to Mandatory Redemption* to the accompanying consolidated financial statements for further discussion.

Commercial Commitments

As of September 30, 2004, our outstanding commercial commitments, in the form of letters of credit, amounted to Php1,569 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 Master Purchase Order, or MPO, in the amount of US$200 million in favor of Nokia for the purchase of additional equipment to expand Smart's GSM network. The US$200 million MPO was completed in November 2003. On May 30, 2003, Smart entered into a Technical Support Services Agreement, or TSSA, with Nokia in the amount of US$8 million. This TSSA 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. On June 23, 2004, Smart signed a TSSA with Nokia in the amount of US$10 million which is valid until December 31, 2004.

As of September 30, 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 September 30, 2004, the Philippine peso had depreciated against the U.S. dollar to Php56.276 to US$1.00 from Php54.877 to US$1.00 as of September 30, 2003, which in turn represented a depreciation against the U.S. dollar from Php52.410 to US$1.00 at September 30, 2002. In the first nine months of 2004, our consolidated capitalized net foreign exchange losses of Php1,037 million, as compared to Php3,708 million in the same period in 2003. Of these capitalized net foreign exchange losses, Php952 million in the first nine months of 2004 and Php3,605 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 foreign currency-denominated monetary assets and liabilities and their peso equivalents as of September 30, 2004 and as of December 31, 2003:

	September 30, 2004(1)		December 31, 2003(2)	
	U.S. dollars	Pesos	U.S. dollars	Pesos
	(Unaudited)	(in millions)	(As restated)	
Assets				
Cash and cash equivalents	US$296	Php16,647	US$146	Php8,105
Receivables-net	159	8,960	195	10,855
Prepayments and other current assets	80	4,489	29	1,615
	535	30,096	370	20,575
Liabilities				
Accounts payable	57	3,195	60	3,322
Accrued expenses and other current liabilities	65	3,581	25	1,363
Notes payable	–	–	3	150
Long-term debt	2,761	155,362	3,078	167,913
Deferred credits and other noncurrent liabilities	229	12,867	256	14,205
Preferred stock subject to mandatory redemption	205	11,542	190	10,549
	3,317	186,547	3,612	197,502
Net foreign currency-denominated liabilities	US$2,782	Php156,451	US$3,242	Php176,927

(1) The exchange rate used was Php56.276 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 September 30, 2004, approximately 98% of our total consolidated debts were denominated in foreign currencies. Of our foreign currency-denominated debts, 7% are in Japanese yen on a consolidated basis 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 67% of our consolidated foreign-currency debts), 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 substantially 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 consolidated 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.

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 September 30, 2004, PLDT's outstanding forward foreign exchange contracts, principal-only long-term cross-currency swap contracts/options and currency option contracts amounted to US$79 million and JP¥811 million; US$725 million; and US$79 million and JP¥875 million, respectively. Smart's outstanding forward foreign exchange contracts amounted to US$66 million as of September 30, 2004.

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

Interest Rate Risk Management

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 nine months 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. We have capitalized foreign exchange losses in respect of 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 nine months of 2004 was 6.9%, compared to 2.9% in the same period in 2003.

OTHER INFORMATION

Long-Term Incentive Plan

On August 3, 2004, PLDT's board of directors approved the establishment of a long-term incentive plan, or LTIP, for eligible key executives and advisors of PLDT and its subsidiaries and affiliates. The LTIP is a four-year cash plan covering the period January 1, 2004 to December 31, 2007. The awards payment at the end of the four-year period (without interim payments) is contingent upon the achievement of the approved target increase in PLDT's common share price by the end of the plan period and the cumulative consolidated net income target for the plan period. The target increase in the PLDT base share price, which is the average of the closing prices of PLDT shares ten trading days before or after December 31, 2003, is approximately 15% per annum compounded for the plan period.

Launch of *1528 Smart* in Hong Kong

PLDT, by way of a partnership among Smart, PLDT Global and CSL of Hong Kong as its operator partner, now offers a mobile reseller service in Hong Kong. Launched on September 1, 2004, *1528 Smart* is a prepaid GSM mobile phone service designed and packaged to cater to the Filipino expatriate community in Hong Kong. It offers the lowest text and IDD rates to the Philippines, compared to other Hong Kong operators, as well as value-added services offered by Smart including *Smart Load, Pasa Load* and *Smart Padala.*

Acquisition of Meridian Telekoms, Inc.

On September 2, 2004, Smart acquired a 40% stake in Meridian Telekoms, Inc., a company primarily engaged in providing wireless broadband and data services to small and medium-scale enterprises in the Philippines. Meridian operates under a legislative franchise (Republic Act 8337) and has provisional authorities to operate issued by the National Telecommunications Commission. The acquisition will strengthen Smart's position in the wireless data segment and is in line with Smart's overall strategy of providing the widest range of innovative wireless services. Subject to securing various regulatory and other approvals, Smart intends to increase its stake in Meridian Telekoms, Inc. to 100% before the end of 2005.

Piltel Debt Exchange Transaction

On July 2, 2004, Smart closed the Piltel debt exchange transaction. Approximately US$289 million, or 69.4%, in the aggregate of the outstanding restructured Piltel debt were exchanged by Piltel creditors to Smart debt. Smart paid cash of US$1.5 million (Php84 million) and issued new debt of US$283.3 million at fair value of Php8,390 million, net of debt discount amounting to Php7,464 million. The breakdown of the total amount of Smart debt issued to participating Piltel creditors are as follows:

- 2007 Facility for US$0.2 million payable in full in December 2007;
- 2008 Facility for US$2.9 million payable in full in December 2008; and
- 2014 Facility for US$280.1 million payable in full in June 2014.

Interest for the above facilities are payable every quarter at a floating rate of three months US$ LIBOR + 1.00% for the 2007 and 2008 facilities, and a fixed rate of 2.25% per annum for

the 2014 facility. Furthermore, a portion of the 2014 facility amounting to US$144 million has a variable yield option whereby the creditor has an option to elect for an early repayment at a discount either in December 2007 at 52.5% of the relevant debt amount or in December 2008 at 57.5% of the relevant debt amount.

Further, on July 2, 2004, to integrate our wireless holdings, Smart entered into a Sale and Purchase Agreement with PLDT to acquire the latter's 59.3 million shares of Piltel Series K, Class I Convertible Preferred Stock for Php2,066 million. The payment was settled through an offset of amounts owed to Smart by PLDT arising primarily from interconnection charges.

On July 9, 2004, Smart converted a total of 4.8 million shares of Piltel Series K, Class I Convertible Preferred Stock into 820.3 million shares of Piltel common stock, equivalent to 32.7% of the total outstanding shares of common stock of Piltel after such conversion. Such initial conversion resulted in diluting PLDT's ownership in Piltel from 57.6%to 30.5%. Smart intends to convert its remaining 54.5 million shares of Piltel Series K, Class I Convertible Preferred Stock into 9,260 million shares of common stock from the increase in authorized capital stock of Piltel. On September 3, 2004, at a special stockholders' meeting, Piltel's stockholders approved an increase in Piltel's authorized capital stock from 2,700 million shares of common stock to 11,800 million shares of common stock. The approved increase will enable Piltel to accommodate the full conversion of the Series K, Class I Convertible Preferred Stock. Such conversion is expected to take place once all the necessary regulatory approvals have been obtained and is likely to be completed before the end of the year. Once all the outstanding shares of Piltel Series K, Class I Convertible Preferred Stock are fully converted, Smart will hold a total of 10,080 million shares of common stock of Piltel, equivalent to 85.6% of the resulting total outstanding shares of common stock after such conversion. In aggregate therefore, upon completion of the conversion, ownership of Piltel by PLDT and Smart will be 92.1%.

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

Effective as of February 1, 2003, PLDT stopped terminating traffic sent directly by each of AT&T and MCI, because PLDT's termination rate 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. In separate orders dated February 7 and 26, 2003, the National Telecommunications Commission, or NTC, confirmed that "absent any provisional or interim agreement" with U.S. carriers, there would be no provision of termination services between the parties "who are thereby encouraged to seek other routes or options to terminate traffic to the Philippines." Upon petitions of AT&T and MCI, on March 10, 2003, the International Bureau of the U.S. FCC issued an Order which directed 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 were 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 the 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 International Bureau of 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 International Bureau of 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.

On May 13, 2004, the U.S. FCC partially dismissed and partially denied applications by Philippine carriers, including PLDT, and certain U.S. carriers for review of the March 10, 2003 Order of the International Bureau of the U.S. FCC. In particular, the U.S. FCC affirmed the March 10, 2003 Order's finding that "Philippine carriers engaged in collective action to "whipsaw" AT&T and MCI." The U.S. FCC stated, however, that the findings of the March 10, 2003 Order were not findings under the U.S. anti-trust laws and that the U.S. DOJ is independently "investigating the possibility of anticompetitive practices among Philippine carriers under its authority pursuant to U.S. anti-trust laws." The U.S. FCC also upheld the March 10, 2003 Order in respect of the suspension of payments for termination services to the Philippine carriers pending restoration of the circuits. In addition, the U.S. FCC denied a request to modify the March 10, 2003 Order of the International Bureau of the U.S. FCC to restore the Philippines to the list of U.S.-international routes approved for the provision of ISR. The U.S. FCC stated that it was dismissing this request as moot because of the U.S. FCC's recently adopted International Settlements Policy Reform which eliminated International Settlements Policy, or ISP.

Although not included in the initial list of countries exempted from the U.S. FCC's ISP, the U.S. FCC identified the U.S.-Philippines route as eligible for being removed from the ISP in accordance with its newly established procedures for doing so. Under this procedure, the U.S. FCC asked for public comment on the removal of the Philippines from the ISP. In comments filed in June and July, 2004, removal was supported by several Philippine and U.S. carriers, including AT&T and MCI, and was opposed by one U.S. carrier, International Access, Inc.

On July 6, 2004, PLDT filed with the U.S. FCC a Petition for Reconsideration of the Commission's May 13, 2004 Order on the grounds that the Order should have vacated as moot the International Bureau's March 10, 2003 Order.

Investigation by U.S. Department of Justice

In January 2004, PLDT received a grand jury subpoena seeking documents and a PLDT employee was subpoenaed to testify before the grand jury 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. Further, in March 2004, PLDT (U.S.) Ltd., a subsidiary of PLDT Global, received a grand jury subpoena seeking documents, in response to which PLDT (U.S.) Ltd. produced documents. In addition, in March 2004, a PLDT (U.S.) Ltd. employee received a subpoena to testify before the grand jury in connection with this investigation. This employee has not yet been asked to appear before the grand jury. At this time, the PLDT Group cannot predict the outcome of this investigation.

Related Party Transactions

In the ordinary course of business, companies related to but are outside of the consolidated 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.

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 September 30, 2004 and December 31, 2003 and for the nine months ended September 30, 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. Total fees under these agreements totaled Php251 million and Php218 million for the nine months ended September 30, 2004 and 2003, respectively. PLDT's outstanding obligations under these agreements amounted to Php36 million and Php40 million as of September 30, 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 cellular business. Total fees under these agreements totaled Php324 million and Php223 million for the nine months ended September 30, 2004 and 2003, respectively. Under these agreements, Smart had outstanding payables of Php192 million and Php228 million as of September 30, 2004 and December 31, 2003, respectively. Asia Link is a subsidiary of the First Pacific Group.

- *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. Total payments to Gotuaco covering the 12-month period ending December 31, 2004 amounted to Php11 million. A director of PLDT have a direct/indirect interest in or serve as director/officer of Gotuaco.

For a more detailed discussion of the related party transactions enumerated above, see *Note 16 – Related Party Transactions* to the accompanying consolidated financial statements.