MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
For the Three Months Ended March 31, 2005

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 unaudited 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 unaudited 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 unaudited 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 unaudited consolidated financial statements were made based on the exchange rate of Php54.747 to US$1.00, the volume weighted average exchange rate at March 31, 2005 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 at 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 audited consolidated financial statements as at and for the year ended December 31, 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 unaudited consolidated financial statements.*

Financial Highlights and Key Performance Indicators

	March 31,	December 31,	Increase (Decrease)	
(in millions)	**2005**	**2004**(1)	**Amount**	**%**
	(Unaudited)	(Audited)		
Consolidated Balance Sheets				
Total assets	Php261,403	Php265,473	(Php4,070)	(2)
Property, plant and equipment	192,921	194,525	(1,604)	(1)
Cash and cash equivalents and short-term investments	31,924	31,194	730	2
Total equity	54,383	48,515	5,868	12
Interest-bearing financial liabilities	151,070	164,489	(13,419)	(8)
Notes payable and long-term debt	136,014	149,088	(13,074)	(9)
Net debt to equity ratio(2)	1.91x	2.43x	–	–

	Three Months Ended March 31,			
			Increase (Decrease)	
	2005	**2004**(1)	**Amount**	**%**
		(Unaudited)		
Consolidated Statements of Income				
Revenues and other income	Php30,251	Php30,823	(Php572)	(2)
Service income	29,361	28,107	1,254	4
Expenses	17,325	23,107	(5,782)	(25)
Income before income tax	12,926	7,716	5,210	68
Net income attributable to equity holders	9,361	5,686	3,675	65
Net income margin	31%	18%	–	–
Consolidated Statements of Cash Flows				
Net cash provided by operating activities	15,250	18,103	(2,853)	(16)
Net cash used in investing activities	2,191	5,363	(3,172)	(59)
Capital expenditures	4,263	4,316	(53)	(1)
Net cash used in financing activities	10,245	7,528	2,717	36
Operational Data				
Number of cellular subscribers	20,252,513	14,356,186	5,896,327	41
Number of fixed lines in service	2,149,489	2,197,879	(48,390)	(2)
Number of employees	18,581	17,346	1,235	7
Php per US$ Exchange Rates				
March 31, 2005	Php54.747			
December 31, 2004	56.341			
March 31, 2004	56.216			
December 31, 2003	55.586			

(1) As restated to reflect the effects of the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying unaudited consolidated financial statements.
(2) Net debt is derived by deducting cash and cash equivalents and short-term investment from long-term debt.

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's subsidiaries PLDT Clark Telecom, Inc., Subic Telecommunications Company, Inc., PLDT-Maratel, Inc., Piltel and Bonifacio Communications Corporation, which together account for approximately 3% 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., Vocativ Systems, Inc. and ePLDT Ventus, Inc.; internet access and gaming services provided by ePLDT's subsidiaries, Infocom Technologies, Inc., Digital Paradise, Inc. and netGames, Inc.; and e-commerce, and IT-related services provided by other investees of ePLDT, as discussed in *Note 9 – Investments in Associates – at equity* to the accompanying unaudited consolidated financial statements.

We registered total revenues and other income of Php30,251 million, a decrease of Php572 million in the first quarter of 2005 as compared to Php30,823 million in the same period in 2004 primarily due to the Php1,816 million decline in our non-service wireless revenues, partially offset by Php1,254 million net increase in our service revenues. Wireless service revenues increased by 11%, while fixed line service revenues decreased by 2% in the first quarter of 2005 compared to the same period in 2004.

Expenses decreased by Php5,782 million, or 25%, to Php17,325 million in the first quarter of 2005 from Php23,107 million in the same period in 2004 largely resulting from decreases in financing costs mostly driven by the appreciation of the peso and lower cost of sales and provisions.

With the expiration of Smart's income tax holiday in May 2004, we recognized a higher provision for income tax of Php3,543 million for the first quarter of 2005 as compared to Php2,036 million in the same period in 2004.

As a result of the foregoing, our net income attributable to equity holders increased by Php3,675 million, or 65%, to Php9,361 million in the first quarter of 2005 from Php5,686 million in the same period in 2004.

Accounting Changes

The accounting policies adopted are consistent with those of the previous financial period except that we have adopted in year-end 2004 the following new accounting standards effective for financial years beginning January 1, 2005. Our March 31, 2004, unaudited consolidated financial statements herein have been restated to give effect to the provisions of the new standard adopted:

- ***PAS 19, "Employee Benefits".*** PAS 19 requires the use of the projected unit credit method in measuring retirement benefit expense and a change in the manner of computing benefit expense relating to past service cost and actuarial gains and losses. Past service cost is recognized as an expense on a straight-line basis over the average period until the benefits become vested. On the initial adoption of this standard, the effect of the change in accounting policy includes all actuarial gains and losses that arose in earlier periods even if they fall inside the 10% corridor. In subsequent periods, portion of actuarial gains or losses is recognized as income or expense if the cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceeded the greater of: (i) 10% of the present value of the defined benefit obligation at that date (before deducting plan assets); and (ii) 10% of the fair value of any planned assets at that date by dividing the excess determined by the expected average remaining working lives of the employees participating in that plan is recognized immediately as income or expense.

- ***PAS 21, "The Effects of Changes in Foreign Exchange Rates".*** PAS 21 requires the recognition of foreign exchange gains and losses in the period they are incurred. Upon the adoption of PAS 21, we adjusted previously recorded undepreciated capitalized foreign exchange losses, net of exchange losses that qualify as borrowing cost and income tax effect, against beginning retained earnings, to the extent that such capitalized amounts do not meet the conditions for capitalization under the new accounting standard, and restated prior periods' unaudited consolidated financial statements. Further, PAS 21 requires the determination of the functional currency of an entity. Exchange differences from any retranslation are taken directly as a separate component of equity. On disposal of an entity with a functional currency other than the Philippine peso, the deferred cumulative amount recognized in equity relating to that particular foreign operation shall be recognized in the consolidated income statement.

- ***PAS 27, "Consolidated and Separate Financial Statements".*** PAS 27 supersedes SFAS 27/IAS 27, "Consolidated Financial Statements and Accounting for Investments in Subsidiaries". Under PAS 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 unaudited consolidated financial statements retrospectively.

- ***PAS 32, "Financial Instruments: Disclosure and Presentation".*** PAS 32 covers the disclosure and presentation of all financial instruments. This standard requires more comprehensive disclosures about a company's financial instruments, whether recognized or unrecognized in the financial statements. New disclosure requirements include terms and conditions of financial instruments used, types of risks associated with both recognized and unrecognized financial instruments (market risk, 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. This 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 at issuance date is included as a financial liability under *Interest-bearing Financial Liabilities* account in the accompanying unaudited consolidated balance sheets. The residual amount was assigned as the equity component.

- ***PAS 39, "Financial Instruments: Recognition and Measurement".*** PAS 39 establishes the accounting and reporting standards for recognizing and measuring our financial assets and financial liabilities. This 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.

PAS 39 also covers the accounting for derivative instruments. This standard has expanded the definition of a derivative instrument to include derivatives (derivative-like provisions) embedded in non-derivative contracts. Under this 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 qualifies 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.

- ***PAS 40, "Investment Property".*** PAS 40 prescribes the accounting treatment for investment properties which are defined as land and/or building held to generate income or for capital appreciation or both. An investment property is initially recognized at cost. Subsequent to initial recognition, an investment property is either carried at (i) cost, less accumulated depreciation or any accumulated impairment losses, or (ii) fair value, wherein fair value movements are recognized as income or expense. Transfers to or from investment property classification are made only when there is evidence of a change in use.

- ***PFRS 2, "Share-Based Payment".*** PFRS 2 requires an entity to recognize goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognize a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction. In line with our adoption of PFRS 2, we recognized in our consolidated statements of income the costs of employees' and directors' share options and other share-based incentives by using an option-pricing model, further details of which are given in *Note 21 – Employee Benefits* to the accompanying unaudited consolidated financial statements.

- ***PFRS 3, "Business Combinations", PAS 36, "Impairment of Assets" and PAS 38, "Intangible Assets".*** PFRS 3 requires all business combinations within its scope to be accounted for by applying the purchase method. In addition, this standard requires the acquirer to initially measure separately the identifiable assets, liabilities and contingent liabilities at their fair values, at acquisition date, irrespective of the extent of any minority interest.

  PFRS 3 also requires goodwill in a business combination to be recognized by an acquirer as an asset from the acquisition date, initially measured as the excess of the cost of the business combination over the acquirer's interest in the net fair value of the acquiree's identifiable assets and liabilities. Further, the amortization of goodwill acquired in a business combination is prohibited; instead, goodwill is to be tested annually, or more frequently, if events or changes in circumstances indicate that the asset might be impaired.

Moreover, the useful lives of intangible assets are assessed at the individual asset level as having either a finite or indefinite life. Where an intangible asset has a finite life, it will be amortized over its useful life. Amortization periods and methods for intangible assets with finite useful lives are reviewed annually or earlier where an indicator or impairment exists. Intangibles assessed as having indefinite useful lives are not amortized, as there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows to the PLDT Group. However, intangibles with indefinite useful lives are reviewed annually to ensure that their carrying values do not exceed the recoverable amounts regardless of any impairment indicators present.

- ***PFRS 5, "Non-Current Assets Held-for-Sale and Discontinued Operations".*** Under the superseded SFAS 35/IAS 35, "Discontinuing Operations", we would have previously recognized a discontinued operation at the earlier of when (a) we enter into a binding agreement; and (b) the Board of Directors have approved and announced a formal disposal plan. PFRS 5 now requires an operation to be classified as discontinued when the criteria to be classified as held-for-sale have been met or we have disposed of the operation.

Following additional guidelines from PAS 16, "Property, Plant and Equipment", we have recognized the initial settlement of the net present value of legal and constructive obligations associated with the retirement of a tangible long-lived asset that resulted from the acquisition, construction or development and the normal operation of a long-lived asset in the period in which it is incurred. The asset retirement obligations were recognized in the period in which they are incurred if a reasonable estimate of fair values can be made. The related asset retirement costs are capitalized as part of the carrying amount of the corresponding property, plant and equipment which are being depreciated on a straight-line basis over the useful lives of the related assets or the contract periods, whichever is lower.

The following is the reconciliation from net income as previously reported to net income as restated, including the effect of these restatements on per share amounts:

	For the Three Months Ended March 31, 2004
(in millions, except per share amounts)	
Net income, as previously reported	Php5,240
PAS 16 – Property, Plant and Equipment	(15)
PAS 17 – Leases	1
PAS 19 – Employee Benefits	(20)
PAS 21 – The Effects of Changes in Foreign Exchange Rates	42
PAS 27 – Consolidated and Separate Financial Statements	3
PAS 32 – Financial Instruments: Disclosure and Presentation	(478)
PAS 39 – Financial Instruments: Recognition and Measurement	969
PAS 40 – Investment Property	(4)
PFRS 2 – Share-Based Payment	(36)
PFRS 3 – Business Combinations, PAS 36 – Impairment of Assets and PAS 38 – Intangible Assets	(16)
Net income, as restated	Php5,686

	For the Three Months Ended March 31, 2004
(continued)	
Earnings per common share, as previously reported	Php28.32
Earnings per share impact of restated items:	
PAS 16 – Property, Plant and Equipment	(0.09)
PAS 17 – Leases	–
PAS 19 – Employee Benefits	(0.12)
PAS 21 – The Effects of Changes in Foreign Exchange Rates	0.25
PAS 27 – Consolidated and Separate Financial Statements	0.02
PAS 32 – Financial Instruments: Disclosure and Presentation	(2.47)
PAS 39 – Financial Instruments: Recognition and Measurement	5.72
PAS 40 – Investment Property	(0.02)
PFRS 2 – Share-Based Payment	(0.21)
PFRS 3 – Business Combinations, PAS 36 – Impairment of Assets and PAS 38 – Intangible Assets	(0.10)
Earnings per common share, as restated	Php31.30

We fully adopted PAS 16 in 2005, which requires us to determine the depreciation charge separately for each significant part of an item of property, plant and equipment. Consequently, we changed the estimated useful lives of certain components of our property, plant and equipment and we recognized the effect of the change in accounting estimate prospectively, in accordance with *PAS 8, "Accounting Policies, Changes in Accounting Estimates and Errors".* Our full adoption of this standard reduced our consolidated net income by Php347 million (Php236 million after tax effect) for the three months ended March 31, 2005.

For a detailed discussion regarding changes in accounting policies, please refer to *Note 2 – Summary of Significant Accounting Policies* to the accompanying unaudited consolidated financial statements.

Results of Operations

The table below shows the contribution by each of our business segments to our revenues and other income, expenses and net income (losses) for the three months ended March 31, 2005 and 2004. Most of our revenues are derived from our operations within the Philippines.

	Wireless	Fixed Line	ICT	Inter-segment Transactions	Total
(in millions)					
For the three months ended March 31, 2005 (Unaudited)					
Revenues and other income	Php18,726	Php11,858	Php751	(Php1,084)	Php30,251
Service	17,948	11,805	652	(1,044)	29,361
Non-service	759	–	66	(10)	815
Other income	19	53	33	(30)	75
Expenses	9,077	8,611	721	(1,084)	17,325
Income before tax	9,649	3,247	30	–	12,926
Net income attributable to equity holders	6,952	2,370	39	–	9,361
For the three months ended March 31, 2004(1) (Unaudited)					
Revenues and other income	18,834	12,106	474	(591)	30,823
Service	16,115	12,085	435	(528)	28,107
Non-service	2,615	–	36	(20)	2,631
Other income	104	21	3	(43)	85
Expenses	12,710	10,553	435	(591)	23,107
Income before tax	6,124	1,553	39	–	7,716
Net income attributable to equity holders	4,617	1,029	40	–	5,686

	Wireless Amount	%	Fixed Line Amount	%	ICT Amount	%	Inter-segment Transactions Amount	Total Amount	%
Increase (Decrease)									
Revenues and other income	(Php108)	(1)	(Php248)	(2)	Php277	58	(Php493)	(Php572)	(2)
Service	1,833	11	(280)	(2)	217	50	(516)	1,254	4
Non-service	(1,856)	(71)	–	–	30	83	10	(1,816)	(69)
Other income	(85)	(82)	32	152	30	1000	13	(10)	(12)
Expenses	(3,633)	(29)	(1,942)	(18)	286	66	(493)	(5,782)	(25)
Income before tax	3,525	58	1,694	109	(9)	(23)	–	5,210	68
Net income attributable to equity holders	2,335	51	1,341	130	(1)	(3)	–	3,675	65

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

Wireless

Revenues and Other Income

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

The following table summarizes our service and non-service revenues and other income from our wireless business for the three months ended March 31, 2005 and 2004 by service segment:

	Three Months Ended March 31,					
					Increase (Decrease)	
	2005	%	2004(1)	%	Amount	%
			(Unaudited)			
(in millions)						
Wireless services:						
Service Revenues						
Cellular	Php17,406	93	Php15,679	83	Php1,727	11
Satellite, VSAT and others	542	3	436	2	106	24
	17,948	96	16,115	85	1,833	11
Non-service Revenues						
Sale of handsets and SIM-packs	759	4	2,615	14	(1,856)	(71)
Other Income	19	–	104	1	(85)	(82)
Total Wireless Revenues and Other Income	Php18,726	100	Php18,834	100	(Php108)	(1)

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

Service Revenues

Our wireless service revenues increased by Php1,833 million, or 11%, to Php17,948 million in the first quarter of 2005 compared to Php16,115 million in the same period in 2004, mainly as a result of the continued growth of Smart's and Piltel's subscriber base. Accordingly, as a percentage of our total consolidated service revenues, cellular service revenues increased to 57% in the first quarter of 2005 from 55% in the same period in 2004.

Cellular Service

Our cellular service revenues consist of:

- revenues derived from actual usage of the network by prepaid subscribers and any unused peso value of expired prepaid cards or electronic air time loads, net of discounts given to dealers;
- monthly service fees from postpaid subscribers, including (1) charges for calls in excess of allocated free local calls, (2) toll charges for national and international long distance calls, (3) charges for text messages of our 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 service; and
- other charges, including those for reconnection and migration.

Our cellular service revenues in the first quarter of 2005 amounted to Php17,406 million, an increase of Php1,727 million, or 11%, from Php15,679 million in the same period in 2004.

Cellular service revenues accounted for 97% of wireless service revenues in the first quarters of 2005 and 2004.

As at March 31, 2005, Smart and Piltel cellular subscribers reached 20,252,513, an increase of 5,896,327, or 41%, over combined cellular subscriber base of 14,356,186 as at March 31, 2004. Prepaid subscribers accounted for 99% and 98% of our total subscriber base as at March 31, 2005 and 2004, respectively. Prepaid net subscriber activations totaled 1,050,638 in the first quarter of 2005, or a monthly average addition of 350,213 subscribers. Postpaid subscribers totaled 268,137 subscribers, reflecting a net reduction of 6,357, or a monthly average reduction of 2,119 subscribers in the first quarter of 2005.

Smart markets nationwide cellular communications services under the brand names *Smart Buddy, Smart Gold, addict mobile, Smart Infinity* and *Smart Kid. Smart Buddy, addict mobile prepaid,* or *amp,* and *Smart Kid prepaid* are prepaid services while *Smart Gold, addict mobile*, *Smart Infinity* and *Smart Kid* are postpaid services, which are all provided through Smart's digital network.

Piltel markets its cellular prepaid service under the brand name *Talk 'N Text* and is provided through Smart's network. On December 22, 2004, the Board of Directors of Smart and Piltel approved the amendment of Piltel's and Smart's revenue sharing arrangement of 50-50 for the *Talk 'N Text* service to 80-20 in favor of Piltel.

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 700,000 retail agents, approximately 90% of which are micro businesses. As at March 31, 2005, approximately 82% of *Smart Buddy* subscribers and 87% of *Talk 'N Text* subscribers were using *Smart Load* as their reloading mechanism. In the first quarter of 2005, *Smart Load* accounted for approximately 71% of sales derived from reloads.

In December 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* encourage subscribers to stay within our cellular network instead of churning and re-subscribing at a later time. *Pasa Load* was also made available to Smart postpaid subscribers beginning April 18, 2004 with identical denominations to those offered to prepaid subscribers. The denominations have a similar one-day load expiry. The sender is billed the amount of the load and a Php1.00 transaction fee which is added on top of the monthly service fee.

On August 1, 2004, Smart launched *Smart Padala*, a service intended for overseas Filipino workers. *Smart Padala* is the first cash remittance service through text and is faster and cheaper than traditional remittance arrangements. It is ideally suited for the lower income market where cash remittances have the highest need and appreciation. *Smart Padala* is coursed through Banco de Oro, a Philippine financial institution, as well as partnerships with several internationally-licensed remittance companies (e.g., CBN, Travelex) and domestic encashment centers (e.g., McDonald's, 7-Eleven, Sea Oil and Tambunting Pawnshops.) *Smart Padala* is one of the many innovative initiatives from our *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 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, France. As at March 31, 2005, there were approximately 2,000,000 active *Smart Money* cards in use.

In order to test the apparent market demand for fixed rate or "bucket" plans for voice and text services, Smart launched from March 11 to April 10, 2005 the *Smart 258 Unlimited Call* and *Text* promo wherein all Smart and *Talk 'N Text* prepaid subscribers had the option to avail of unlimited on-network (Smart-to-Smart) voice calls or unlimited on-network (Smart-to-Smart) texts. The *Smart 258 Unlimited Call* promo covered on-network (Smart-to-Smart) voice calls for Php115 with a validity of 10 days with a maximum duration of five minutes per call. To initiate a *Smart 258 Unlimited Call*, a subscriber sends a text of the called party's mobile identification number to a designated number. Both parties then received a call back to set-up the call. Off-network calls, all text messaging (on-net and off-net) and value-added service downloads were not part of this promo and were charged at prevailing rates. On the other hand, *Smart 258 Unlimited Text* covered on-network (Smart-to-Smart) texts messages for Php60 with a validity of six days. Off-network text messages, all voice calls (on-net and off-net) and value-added service downloads were not part of this promo and were charged at prevailing rates. Under this *Smart 258* promo, subscribers could only avail of one option at a time (i.e. *Unlimited Call* or *Unlimited Text* only).

On April 21,2005, Smart announced that it would reinstitute the *Smart 258 Unlimited Call* and *Text* promos for another 30 days with the following modifications:

- the *Smart 258 Unlimited Call* Php115 load will be valid for seven days with a maximum call duration of three minutes;
- the *Smart 258 Unlimited Text* Php60 load will be valid for four days; and
- subscribers can now avail of *Smart 258 Unlimited Call* and *Text* simultaneously.

The following table summarizes key measures of our cellular business as at and for the three months ended March 31, 2005 and 2004:

	Three Months Ended March 31,			
			Increase (Decrease)	
	2005	2004	Amount	%
		(Unaudited)		
(in millions)				
Cellular service revenues	Php17,406	Php15,679	Php1,727	11
Mobile	17,295	15,641	1,654	11
By component	*16,810*	*15,263*	*1,547*	*10*
Voice	8,422	7,874	548	7
Data	8,388	7,389	999	14
By service type	*16,810*	*15,263*	*1,547*	*10*
Prepaid	15,791	14,220	1,571	11
Postpaid	1,019	1,043	(24)	(2)
Others(1)	*485*	*378*	*107*	*28*
Satellite-based PCOs	111	38	*73*	*192*

(1) Refers to other non-subscriber-related revenues consisting primarily of inbound international roaming fees, revenues from Smart Money Holdings Corporation and a small number of leased line contracts.

	As at March 31,			
			Increase	
	2005	2004	Amount	%
		(Unaudited)		
Cellular subscriber base	20,252,513	14,356,186	5,896,327	41
Prepaid	19,984,376	14,090,343	5,894,033	42
Smart	15,242,173	10,919,335	4,322,838	40
Piltel	4,742,203	3,171,008	1,571,195	50
Postpaid	268,137	265,843	2,294	1

	Three Months Ended March 31,			
			Increase	
	2005	2004	Amount	%
		(Unaudited)		
Systemwide traffic volumes (in millions)				
Calls (in minutes)	1,307	1,177	130	11
Domestic	945	857	88	10
International	362	320	42	13
Inbound	319	279	40	14
Outbound	43	41	2	5
Text messages	10,561	9,900	661	7
Smart	8,600	8,214	386	5
Piltel	1,961	1,686	275	16

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 Php548 million, or 7%, to Php8,422 million in the first quarter of 2005 from Php7,874 million in the same period in 2004 mainly due to an increase in subscriber base which compensated for a 23% drop in the average voice usage per subscriber from 22 minutes per month in the first quarter of 2004 to 17 minutes per month in the same period in 2005.

Prior to January 2004, our 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 is charged for calls terminating to other cellular network subscribers as well as local and NDD calls. The percentage of on-net voice traffic as a proportion of total voice traffic was approximately 64% for the first quarters of 2005 and 2004.

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 Php999 million, or 14%, to Php8,388 million in the first quarter of 2005 from Php7,389 million in the same period in 2004. Cellular data services accounted for 48% of mobile cellular revenues in the first quarter of 2005, compared to 47% in the same period in 2004.

The following table shows the breakdown of cellular data revenues for the three months ended March 31, 2005 and 2004:

	Three Months Ended March 31,			
			Increase (Decrease)	
	2005	**2004**	**Amount**	**%**
		(Unaudited)		
(in millions)				
Text messaging				
Domestic	Php6,689	Php6,210	Php479	8
International	452	468	(16)	(3)
	7,141	6,678	463	7
Value-added services				
Non-Zed(1)	Php680	Php343	Php337	98
Smart Zed™	172	143	29	20
Smart Money	21	6	15	250
Mobile Banking, Roaming SMS and WAP	374	219	155	71
	1,247	711	536	75
Total	Php8,388	Php7,389	Php999	14

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

Text messaging-related services contributed revenues of Php7,141 million in the first quarter of 2005, an increase of 7%, compared to Php6,678 million in the same period in 2004, and accounted for 85% and 90% of the total cellular data revenues for the first quarters of 2005 and 2004, respectively. The increase in revenues from text messaging-related services resulted mainly from a 7% increase in the volume of text messages to 10,561 million outbound messages in the first quarter of 2005 from 9,900 million outbound messages handled in the same period in 2004. Value-added services contributed revenues of Php1,247 million in the first quarter of 2005, increasing by Php536 million, or 75%, from Php711 million in the same period in 2004 as a result of a significant increase in ringtone/caller ringtunes download activity as well as increased usage emanating from *Smart Padala*.

Subscriber Base, ARPU and Churn Rates

Of our 20,252,513 subscribers as at March 31, 2005, prepaid subscribers accounted for approximately 99% while postpaid subscribers accounted for the remaining 1%. Cellular prepaid subscriber base grew by 42% to 19,984,376 as at March 31, 2005 from 14,090,343 as at March 31, 2004, whereas postpaid subscriber base increased by 1% to 268,137 as at March 31, 2005 from 265,843 as at March 31, 2004.

Our net subscriber activation and reduction for the first quarters of 2005 and 2004 are as follows:

	For the Three Months Ended March 31,		**Decrease**	
	2005	**2004**	**Amount**	**%**
Prepaid				
Smart	920,885	1,088,200	(167,315)	(15)
Piltel	129,753	303,923	(174,170)	(57)
Postpaid	(6,357)	16,866	(23,223)	(138)
Total	1,044,281	1,408,989	(364,708)	(26)

Revenues attributable to our cellular prepaid service amounted to Php15,791 million in the first quarter of 2005, an 11% increase over the Php14,220 million earned in the same period in 2004. Prepaid service revenues in the first quarters of 2005 and 2004 accounted for 94% and 93%, respectively, of voice and data revenues. Revenues attributable to Smart's postpaid service amounted to Php1,019 million in the first quarter of 2005, a 2% decrease over the Php1,043 million earned in the same period in 2004. Postpaid service revenues in the first quarters of 2005 and 2004 accounted for 6% and 7%, respectively, of voice and data revenues.

Our quarterly prepaid and postpaid ARPUs for the first quarter of 2005 and the four quarters of 2004 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	287	241	1,780	1,176
Fourth Quarter	395	328	275	220	1,763	1,402
2005						
First Quarter	Php356	Php289	Php269	Php220	Php1,767	Php1,257

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-provider 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-provider 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 quarter of 2005 was Php356, a decrease of 23%, compared to Php463 in the same period in 2004. The decline was attributable mainly to a decrease in the average text messaging revenue per subscriber as well as lower average outbound local voice revenue per subscriber in the first quarter of 2005. On a net basis, ARPU in the first quarter of 2005 decreased by 25% to Php289 from Php383 in the same period in 2004. Smart expects its prepaid ARPUs to decline as it continues to expand into the lower income bracket of the market. Gross monthly ARPU for *Talk 'N Text* subscribers in the first quarter of 2005 was Php269, a decrease of 21% compared to Php341 in the same period in 2004. The decline was similarly attributable to a decrease in the average text messaging revenue per subscriber as well as lower average outbound local voice revenue per subscriber in the first quarter of 2005. On a net basis, ARPU in the first quarter of 2005 decreased by 23% to Php220 from Php287 in the same period in 2004.

Monthly ARPU for Smart's postpaid 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 ARPU for postpaid subscribers increased by 2% to Php1,767 while net monthly ARPU decreased by 5% to Php1,257, in the first quarter of 2005 compared to the same period in 2004. Prepaid and postpaid monthly gross blended ARPU was Php355 in the first quarter of 2005, a decrease of 23% compared to Php461 in the same period in 2004. Monthly net blended ARPU decreased by 25% to Php286 in the first quarter of 2005 from Php380 in the same period in 2004.

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.

Prior to June 2004, a prepaid cellular subscriber was recognized as an active subscriber when that subscriber activated and used the SIM card in the handset, which 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; and by receiving loads of Php2, Php5, Php10 and Php15 via *Pasa Load*, or through their handsets using *Smart Money*. Reloads have validity periods ranging from one day to two months, depending on the amount reloaded. A prepaid cellular subscriber 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 but had not reloaded by May 31, this customer would not be counted as a subscriber. The rationale for this change stems from our observance of "SIM-swapping" activities in the market whereby "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 swap their SIM cards between mobile operators upon full usage of the pre-stored air time, which may result in our subscriber base reflecting a certain number of transient subscribers at any one point in time. We believe, however, that as "SIM swapping" activities decrease, these transient subscribers will be churned off by our system in due course.

For *Smart Buddy*, the average monthly churn rate for the first quarter of 2005 was 2.7%, compared to 2.2% in the same period in 2004 while the average monthly churn rate for *Talk 'N Text* subscribers was 4.6% in the first quarter of 2005 compared to 3.7% in the same period in 2004. The increased churn in our prepaid service can be attributed to the on-going "SIM-swapping" activities described above. Furthermore, churn is likely to increase in the immediate period after "SIM swapping" activities are scaled back or stopped.

The average monthly churn rate for Smart's postpaid subscribers for the first quarter of 2005 was 2.5%, compared to 0.2% in the same period in 2004 as a result of increased competition in this market segment. 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, charges for ACeS Philippines' satellite phone service and service revenues generated from a PLDT Global subsidiary's mobile virtual network operations. Gross revenues from these services for the first quarter of 2005 amounted to Php542 million, an increase of Php106 million, or 24%, from Php436 million in the same period in 2004.

Non-service Revenues

Our wireless non-service revenues consist of:

- Proceeds from sale of cellular handsets; and
- Proceeds from sale of cellular SIM-packs.

Our wireless non-service revenues decreased by Php1,856 million, or 71%, to Php759 million in the first quarter of 2005 as compared to Php2,615 million in the same period in 2004 mainly attributable to lower handset sales. In the first quarter of 2005, activations were driven more by SIM-pack sales and SIM-swap activities.

Other Income

All other income/gains such as rental income, gain on disposal of property, which do not fall under service and non-service revenues are included under this classification. Our wireless business segment generated other income of Php19 million in the first quarter of 2005, a decrease of Php85 million, or 82%, from Php104 million in the same period in 2004.

Expenses

Expenses associated with our wireless business in the first quarter of 2005 amounted to Php9,077 million, a decrease of Php3,633 million, or 29%, from Php12,710 million in the same period in 2004. A significant portion of this decrease was attributable to lower financing costs, costs of sales, and provisions. As a percentage of our wireless revenues and other income, expenses associated with our wireless business decreased to 48% in the first quarter of 2005 from 67% in the same period in 2004.

Cellular business expenses accounted for 96% of our wireless business expenses while satellite, VSAT and other business expenses accounted for the remaining 4% of our wireless business expenses in the first quarter of 2005, and 96% and 4%, respectively, in 2004.

The following table summarizes our wireless-related expenses for the three months ended March 31, 2005 and 2004 and the percentage of each expense item to the total:

	Three Months Ended March 31,					
					Increase (Decrease)	
	2005	**%**	**2004**(1)	**%**	**Amount**	**%**
			(Unaudited)			
(in millions)						
Wireless services						
Depreciation and amortization	Php2,460	27	Php2,794	22	(Php334)	(12)
Cost of sales	2,004	22	3,869	30	(1,865)	(48)
Selling and promotions	1,035	11	741	6	294	40
Rent	967	11	583	5	384	66
Compensation and benefits(2)	844	9	882	7	(38)	(4)
Maintenance	782	9	510	4	272	53
Financing costs	(575)	(6)	1,660	13	(2,235)	(135)
Taxes and licenses	376	4	227	2	149	66
Professional and other service fees	300	3	199	1	101	51
Insurance and security services	246	3	216	2	30	14
Provisions	(54)	(1)	514	4	(568)	(111)
Other expenses	692	8	515	4	177	34
Total	Php9,077	100	Php12,710	100	(Php3,633)	(29)

(1) As restated to reflect the effects of the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying unaudited consolidated financial statements.
(2) Includes salaries and benefits, incentive plan, pension and manpower rightsizing program, or MRP, costs.

Depreciation and amortization charges decreased by Php334 million, or 12%, to Php2,460 million in the first quarter of 2005 substantially due to a decrease in the depreciable asset base as certain of our wireless assets were fully depreciated by the end of 2004, partially offset by the effect of our full adoption of PAS 16 which increased depreciation charges by Php167 million for the first quarter of 2005. See *Note 2 – Summary of Significant Accounting Policies* to the accompanying unaudited consolidated financial statements.

Cost of sales decreased by Php1,865 million, or 48%, to Php2,004 million as activations in the first quarter of 2005 were driven more by SIM-pack sales and SIM-swap activities compared to handset sales in the same period in 2004. In addition, satellite air time cost decreased by Php20 million, or 31%, to Php45 million due to the change in the basis of payment for air time. In March 2004, air time costs reverted to the original charging rate on a per minute basis from the fixed amount per month based on the payment schedule in a standstill agreement in consideration for unlimited access. This was agreed to be the basis of air time cost until a new agreement is finalized. Please see *Note 5 – Revenues and Expenses* to the accompanying unaudited consolidated financial statements for further discussion. The breakdown of cost of sales for our wireless business for the three months ended March 31, 2005 and 2004 are as follows:

	Three Months Ended March 31,			
			Decrease	
	2005	**2004**	**Amount**	**%**
		(Unaudited)		
Cost of cellular handsets and SIM-packs sold	Php1,959	Php3,804	(Php1,845)	(49)
Cost of satellite air time	45	65	(20)	(31)
	Php2,004	Php3,869	(Php1,865)	(48)

Selling and promotion expenses increased by Php294 million, or 40%, to Php1,035 million due to advertising and promotions costs incurred to attract new subscriptions and retain existing subscribers.

Rent expenses increased by Php384 million, or 66%, to Php967 million on account of an increase in the number of transmission links and higher cell site and office space rentals for the increased number of cell sites, wireless centers and space requirements for increased personnel. As at March 31, 2005, we had 4,071 cell sites and 5,480 base stations, compared with 3,088 cell sites and 4,229 base stations as at March 31, 2004.

Compensation and benefits decreased by Php38 million, or 4%, to Php844 million primarily due to a higher accrual in 2004 of long-term incentive benefits of managers and executives of Smart, partially offset by an increase in headcount, salaries and performance bonuses of Smart's employees. Smart's employee headcount increased by 7% to 5,244 as at March 31, 2005 from 4,885 as at March 31, 2004.

Maintenance expenses increased by Php272 million, or 53%, to Php782 million mainly on account of higher utility expenses, repairs and maintenance costs due to the continued growth in the number of cell sites and other network facilities as well as increased fuel and electricity costs.

Financing costs in the first quarter of 2005 amounted to a negative Php575 million, a decrease of 135% from Php1,660 million in the same period in 2004, primarily as a result of foreign exchange gains as the peso appreciated in the first quarter of 2005. Foreign exchange losses were recorded in the same period in 2004. In addition, interest income increased due to higher cash balances in 2005 as compared to 2004. The breakdown of our financing costs for the wireless business for the three months ended March 31, 2005 and 2004 is as follows:

	Three Months Ended March 31,			
			Change	
	2005	**2004**	**Amount**	**%**
		(Unaudited)		
Foreign exchange (gains) losses	(Php1,627)	Php763	(Php2,390)	(313)
Accretion on financial liabilities	628	633	(5)	(1)
Interest on loans and related items	456	452	4	1
Interest income	(293)	(174)	(119)	(68)
Loss (gain) on derivative transactions – net	128	(59)	187	317
Dividends on preferred stock subject to mandatory redemption	67	58	9	16
Financing charges	47	27	20	74
Capitalized foreign exchange losses	22	(16)	38	238
Capitalized interest	(3)	(24)	21	88
	(Php575)	Php1,660	(Php2,235)	(135)

Taxes and licenses increased by Php149 million, or 66%, to Php376 million mainly due to an increase in Smart's business-related permits and licenses.

Professional and other service fees increased by Php101 million, or 51%, to Php300 million mainly as a result of increased technical service, consultancy and payment facility fees.

Insurance and security services increased by Php30 million, or 14%, to Php246 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 network.

Provisions decreased by Php568 million, or 111%, to negative Php54 million mainly due to a lower carrier receivable balances as of March 31, 2005 as a result of significant settlements made during the third and fourth quarters of 2004. In addition, we recorded recoveries for handsets sold in the first quarter of 2005 which were previously written down to their net realizable values. The breakdown of provisions for the three months ended March 31, 2005 and 2004 is as follows:

	Three Months Ended March 31,			
			Decrease	
	2005	2004	Amount	%
	(Unaudited)			
Doubtful accounts	Php35	Php386	(Php351)	(91)
Write-down (reversal of write-down) of inventories at net realizable value	(89)	128	(217)	(170)
	(Php54)	Php514	(Php568)	(111)

Other expenses increased by Php177 million, or 34%, to Php692 million due to various business and operational-related expenses such as facility usage fees, travel, training, communication, delivery expenses and the amortization of intangible assets.

Provision for income tax

Provision for income tax increased by Php1,150 million, or 76%, to Php2,667 million in the first quarter of 2005 from Php1,517 million in the same period in 2004 as Smart's income tax holiday expired in the second quarter of 2004 and as Piltel's income tax position reversed from negative to payable. In the first quarter of 2005, the effective tax rate for our wireless business was 28% compared to 25% in the same period in 2004.

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 revenues by eligible GSM revenues (both gross of interconnection revenues) where the incremental GSM revenues were derived by deducting the Board of Investments, or 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

Our wireless business segment recorded a net income of Php6,952 million in the first quarter of 2005, an increase of Php2,335 million, or 51%, over Php4,617 million registered in the same period in 2004 due primarily to the growth in our cellular revenues, augmented by a 29% decrease in wireless expenses.

Fixed Line

Revenues and Other Income

Our fixed line business provides local exchange service, international and national long distance services, data and other network services, and miscellaneous services. Service revenues generated from our fixed line business in the first quarter of 2005 totaled Php11,805 million, a decrease of Php280 million, or 2%, from Php12,085 million in the same period in 2004.

The following table summarizes revenues from our fixed line business for the three months ended March 31, 2005 and 2004 by service segment:

	Three Months Ended March 31,					
					Increase (Decrease)	
	2005	%	2004(1)	%	Amount	%
			(Unaudited)			
(in millions)						
Fixed line services:						
Service Revenues						
Local exchange	Php5,155	44	Php5,295	44	(Php140)	(3)
International long distance	3,010	25	3,263	27	(253)	(8)
National long distance	1,297	11	1,835	15	(538)	(29)
Data and other network	2,058	17	1,447	12	611	42
Miscellaneous	285	3	245	2	40	16
	11,805	100	12,085	100	(280)	(2)
Other Income	53	–	21	–	32	152
Total Fixed Line Revenues	Php11,858	100	Php12,106	100	(Php248)	(2)

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

Service Revenues

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 at and for the three months ended March 31, 2005 and 2004:

	Three Months Ended March 31,			
			Increase (Decrease)	
	2005	2004	Amount	%
	(Unaudited)			
Consolidated local exchange service revenues (in millions)	Php5,155	Php5,295	(Php140)	(3)
Number of fixed lines in service	2,149,489	2,197,879	(48,390)	(2)
Number of fixed line employees	9,620	10,338	(718)	(7)
Number of fixed lines in service per employee	223	213	10	5

Revenues from our local exchange service decreased by Php140 million, or 3%, to Php5,155 million in the first quarter of 2005 from Php5,295 million in the same period in 2004. The decrease was primarily due to the 2% decline in number of fixed lines in service, the shift in subscriber preference from postpaid to prepaid services, which generate lower average revenue per subscriber, and the appreciation of the peso which required us to make downward adjustments in our monthly local service rates. The percentage contribution of local exchange revenues to our fixed line service revenues remained stable at 44% in the first quarters of 2005 and 2004.

Fixed line net reduction in the first quarter of 2005 was 2,538 as against net additions of 11,928 in the same period in 2004. While fixed line additions totaled 8,009 for prepaid fixed line services, postpaid fixed lines in service declined by 10,547 in the first quarter of 2005. As at March 31, 2005, postpaid and prepaid fixed line subscribers totaled 1,772,644 and 376,845, respectively, which accounted for approximately 82% and 18%, respectively, of 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 our 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 cards. 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 quarter of 2005, we implemented three downward adjustments in our monthly local service rates compared to three upward adjustments in the same period in 2004. The average peso-to-dollar rate in the first quarter of 2005 was Php54.982 to US$1.00, compared to the average of Php55.991 to US$1.00 in the same period in 2004. This change in the average peso-to-dollar rate translated to a peso appreciation of 2%, which resulted in an average net decrease of 2% in our monthly local service rates in the first quarter of 2005.

International Long Distance Service

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

- inbound call revenues representing settlements from foreign telecommunications carriers for inbound international calls, virtual transit and hubbing service and reverse charged calls such as received collect and home country direct service;
- access charges paid to us by other Philippine telecommunications carriers for terminating inbound international calls to our local exchange network; and
- outbound call revenues representing amounts billed to our customers (other than our cellular customers) for outbound international calls, net of amounts payable to foreign telecommunications carriers for terminating calls in their territories.

The following table shows information about our international fixed line long distance business for the three months ended March 31, 2005 and 2004:

	Three Months Ended March 31,			
			Increase (Decrease)	
	2005	2004	Amount	%
		(Unaudited)		
Consolidated international long distance service revenues (in millions)	Php3,010	Php3,263	(Php253)	(8)
Inbound	2,484	2,599	(115)	(4)
Outbound	526	664	(138)	(21)
International call volumes (in million minutes, except call ratio)	585	585	–	–
Inbound	549	547	2	–
Outbound	36	38	(2)	(5)
Inbound-outbound call ratio	15.3:1	14.4:1	–	–

Our consolidated international long distance service revenues decreased by Php253 million, or 8%, to Php3,010 million in the first quarter of 2005 from Php3,263 million in the same period in 2004. The percentage contribution of international long distance service revenues to our fixed line service revenues decreased to 25% in the first quarter of 2005 from 27% in the same period in 2004.

Our revenues from inbound international long distance service decreased by Php115 million, or 4%, to Php2,484 million in the first quarter of 2005 from Php2,599 million in the same period in 2004 primarily due to the change in call mix in favor of transit calls with lower hubbing rates. Our inbound international long distance call volumes in the first quarter of 2005 increased by 2 million minutes to 549 million minutes from 547 million minutes in the same period in 2004, largely due to an increase in transit calls.

The 3% appreciation of the peso during the first quarter of 2005 contributed to the decrease 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 peso at the time of billing.

Our revenues from outbound international long distance service decreased by Php138 million, or 21%, to Php526 million in the first quarter of 2005 from Php664 million in the same period in 2004. The decrease resulted from the decline in call volumes and the appreciation of the peso as outbound international calls are charged in U.S. dollar rates and billed to subscribers in pesos at the prevailing exchange rates at the time of billing.

Our outbound international long distance call volumes declined by 5% in the first quarter of 2005 as compared to the same period in 2004 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 service 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 service revenues and call volumes for the three months ended March 31, 2005 and 2004:

	Three Months Ended March 31,			
			Decrease	
	2005	**2004**	**Amount**	**%**
	(Unaudited)			
Consolidated national long distance service revenues (in millions)	Php1,297	Php1,835	(Php538)	(29)
National long distance call volumes (in million minutes)	449	489	(40)	(8)

Our national long distance service revenues decreased by Php538 million, or 29%, to Php1,297 million in the first quarter of 2005 from Php1,835 million in the same period in 2004 as a result of: (1) a decrease in call volumes; (2) a decrease in average revenue per minute brought about by our Php10 per call promo starting February 14, 2005; and (3) the integration of local exchanges into a single calling area. Accordingly, the percentage contribution of national long distance revenues to our fixed line service revenues decreased to 11% for the first quarter of 2005 compared to 15% in the same period in 2004.

Our national long distance call volumes decreased by approximately 8% to 449 million minutes in the first quarter of 2005 from 489 million minutes in the same period in 2004. 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.

On February 14, 2005, we launched a Php10 per call promo to any PLDT landline subscriber nationwide and to all Smart and *Talk N' Text* subscribers. This promo was launched with the objective of determining a more effective tariff structure that would stimulate landline usage. Under the promo, NDD calls between any PLDT landline subscriber nationwide and to all Smart and *Talk 'N Text* subscribers are charged Php10 per call instead of being charged on a per minute basis. The promo has been extended to run until May 11, 2005.

The integration of some of our local exchanges into a single local calling area, as approved by the NTC, has also negatively affected our national long distance call volumes, and consequently, our revenues. Because of this integration, calls between two exchanges located within the same province are no longer considered national long distance calls but treated as local calls.

Data and Other Network Services

Our data and other network services in the first quarter of 2005 posted revenues of Php2,058 million, an increase of Php611 million, or 42%, from Php1,447 million in the same period in 2004. The revenue contribution of this service segment to our fixed line service revenues increased to 17% in the first quarter of 2005 from 12% in the same period in 2004.

Data and other network services we currently provide include traditional bandwidth services, broadband and narrowband internet-based services and other packet-based switching services. These services are used for domestic and international communications such as private networking, broadband and narrowband internet-based data communications, and packet-based communication.

Of our total first quarter 2005 revenues, broadband and narrowband internet-based services accounted for 48%, traditional bandwidth services accounted for 47% and other services accounted for the remaining 5%, compared to 54%, 40% and 6%, respectively, in the same period in 2004. These percentage changes indicate a continuing demand for broadband services, particularly the high bandwidth clear data requirements of business process outsourcing companies, or BPOs, and call centers. We expect this trend to continue, that is, almost parity contribution from IP-based services and traditional services due to growth in the areas of e-commerce, online services and BPOs particularly among call centers, medical transcription, animation and shared services.

Internet-based products are bannered by *PLDT Vibe*, *PLDT DSL* (*myDSL and BizDSL*) and I-Gate. *PLDT Vibe,* or PLDT's dial-up/narrowband Internet service, is targeted for light to medium residential or individual internet users; while *PLDT DSL* broadband Internet service is targeted for heavy individual internet users as well as for small and medium enterprises. I-Gate on the other hand is targeted to enterprises and value-added service providers.

As at March 31, 2005, the number of PLDT's fixed line subscribers for *PLDT Vibe* stood at 405,054, of which 152,493 are exclusive postpaid users, 185,796 are exclusive prepaid users, and 66,765 are both postpaid and prepaid users. As at March 31, 2004, *PLDT Vibe* subscribers totaled 253,635, of which 126,292 were exclusive postpaid users, 93,472 were exclusive prepaid users, and 33,871 were both postpaid and prepaid users. In addition, PLDT *DSL* has reached 72,674 subscribers as at March 31, 2005 compared with 28,172 subscribers during the same period of 2004. I-Gate subscription grew by 91% from a base of 70 as at March 2004 to 134 as of the first quarter of 2005.

The continued growth in data services revenues can be attributed to several product offerings, the majority of which are international data services. The steady demand for dedicated connection or private networking from the corporate market using PLDT's traditional bandwidth offerings – Fibernet, Arcstar, Acacia, I-Gate, Diginet, BRAINS, among others – continues to provide us with a stable revenue source. In addition, we provide Smart's increasing fiber optic and leased line data requirements included under our national data services.

PLDT expects to further generate strong demand for data connectivity after adding *PLDT WeRoam* to its portfolio of data and other network services. *PLDT WeRoam*, introduced last March 10, 2005 and running on SMART's nationwide wireless network (using GPRS, EDGE and WiFi technologies) and PLDT's extensive IP infrastructure, provides laptop-carrying mobile employees and remote offices under Local Area Network, wireless data connectivity to their corporate headquarters' Intranet and/or to the global Internet.

Miscellaneous

Miscellaneous service revenues are derived mostly from directory advertising and facilities rental. In the first quarter of 2005, these revenues increased by Php40 million, or 16%, to Php285 million from Php245 million in the same period in 2004. The improvement was mainly due to an increase in co-location charges from more co-location sites coupled with an increase in rent income on duct utilization and cable restoration. Miscellaneous service revenues accounted for approximately 2% of our fixed line service revenues in the first quarters of 2005 and 2004.

Other Income

All other income/gains such as rental income, gain on disposal of property, which do not fall under service and non-service revenues are included under this classification. In 2005, our fixed line business segment registered an increase in other income of Php32 million, or 152%, to Php53 million in the first quarter of 2005 from Php21 million in the same period in 2004 mainly due to higher service and facilities fees.

Expenses

Expenses related to our fixed line business in the first quarter of 2005 totaled Php8,611 million, a decrease of Php1,942 million, or 18%, compared to Php10,553 million in the same period in 2004. The decrease was primarily due to lower financing costs and provisions. As a percentage of our total fixed line revenues, fixed line-related expenses decreased to 73% in the first quarter of 2005, compared to 87% in the same period in 2004.

The following table shows the breakdown of our total consolidated fixed line-related expenses for the three months ended March 31, 2005 and 2004 and the percentage of each expense item to the total:

	Three Months Ended March 31,					
					Increase (Decrease)	
	2005	%	2004(1)	%	Amount	%
			(Unaudited)			
(in millions)						
Fixed line services:						
Depreciation and amortization	Php3,001	35	Php2,476	23	Php525	21
Compensation and benefits(2)	1,934	22	1,930	18	4	–
Maintenance	810	9	813	8	(3)	–
Provisions	653	8	819	8	(166)	(20)
Financing costs	629	7	2,748	26	(2,119)	(77)
Rent	391	5	389	4	2	1
Selling and promotions	354	4	352	3	2	1
Professional and other service fees	229	3	253	2	(24)	(9)
Taxes and licenses	188	2	156	2	32	21
Insurance and security services	163	2	181	2	(18)	(10)
Asset impairment	–	–	85	1	(85)	(100)
Other expenses	259	3	351	3	(92)	(26)
Total	Php8,611	100	Php10,553	100	(Php1,942)	(18)

(1) As restated to reflect the effects of the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying unaudited consolidated financial statements.
(2) Includes salaries and benefits, incentive plan, pension and MRP costs.

Depreciation and amortization charges increased by Php525 million, or 21%, to Php3,001 million mainly due to higher depreciation of our regular asset base primarily resulting from additional completed projects and the effect of our full adoption of PAS 16 which increased our depreciation charges by Php180 million for the first quarter of 2005.

Compensation and benefits increased by Php4 million to Php1,934 million mainly due to the effect of the recently concluded collective bargaining agreement-related increases on salaries and benefits of PLDT employees and an increase in incentive plan-related accruals partially offset by a reduction in headcount due to PLDT's MRP.

Maintenance expenses decreased by Php3 million to Php810 million primarily due to lower maintenance costs of the domestic fiber optic network due to reduced remedial works done in the first quarter of 2005 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 quarter of 2004.

Provisions decreased by Php166 million, or 20%, to Php653 million primarily on account of a negative provision for onerous contracts by PLDT as a result of the peso appreciation. We make provisions for anticipated uncollectible accounts based on the aging profile of our accounts receivables. PLDT's provision for doubtful accounts for the first quarters of 2005 and 2004 was equivalent to 6% of its service revenues. The breakdown of provisions for our fixed line business for the three months ended March 31, 2005 and 2004 is as follows:

	Three Months Ended March 31,			
			Decrease	
	2005	2004	Amount	%
	(Unaudited)			
Doubtful accounts	Php703	Php710	(Php7)	(1)
Onerous contracts	(50)	109	(159)	(146)
	Php653	Php819	(Php166)	(20)

Financing costs decreased by Php2,119 million, or 77%, to Php629 million due to: (1) the strengthening of the peso relative to the U.S. dollar resulting in foreign exchange gains in the first quarter of 2005 as compared to foreign exchange losses recorded during the first quarter of 2004; and (2) lower interest on loans and related items owing to lower debt balances in the first quarter of 2005 compared with the same period in 2004. The breakdown of our financing costs for our fixed line business for the three months ended March 31, 2005 and 2004 is as follows:

	Three Months Ended March 31,			
			Change	
	2005	2004	Amount	%
	(Unaudited)			
Interest on loans and related items	Php2,470	Php2,785	(Php315)	(11)
Foreign exchange (gains) losses	(1,625)	1,650	(3,275)	(198)
Gains on derivative transactions – net	(360)	(1,804)	1,444	80
Hedge cost	241	203	38	19
Capitalized interest	(94)	(128)	34	27
Accretion on financial liabilities	89	79	10	13
Interest income	(73)	(38)	(35)	(92)
Financing charges	(19)	58	(77)	(133)
Capitalized foreign exchange losses	–	(57)	57	100
	Php629	Php2,748	(Php2,119)	(77)

Rent expenses increased by Php2 million, or 1%, to Php391 million due to an increase in international leased circuits and rental for bundled sales/value added service units.

Selling and promotion expenses increased by Php2 million, or 1%, to Php354 million mainly as a result of an increase in PLDT's promotional activities in relation to various products and services, partially offset by reduced corporate public relations expenses.

Professional and other service fees decreased by Php24 million, or 9%, to Php229 million due to a decrease in number of consultants coupled with a decrease in collection agency fees on account of lower final accounts subject for collection, partially offset by higher legal fees in the first quarter of 2005 for various services.

Taxes and licenses increased by Php32 million, or 21%, to Php188 million mainly on account of higher business-related taxes paid in the first quarter of 2005 as compared to the same period in 2004.

Insurance and security services decreased by Php18 million, or 10%, to Php163 million primarily due to lower premiums on property all-risk, industrial all-risk and industrial fire insurance and a lower number of contracted security guards.

Asset impairment decreased by Php85 million owing to an impairment of a fixed line subsidiary's facilities in the first quarter of 2004; no impairment charge was recognized in the first quarter of 2005.

Other expenses decreased by Php92 million, or 26%, to Php259 million due to lower office supplies consumption and printing costs resulting from PLDT's continuing cost-containing activities, partially offset by higher contracted costs for technical and helpdesk resources and related computer and maintenance and in-house systems development.

Provision for income tax

Provision for income tax increased by Php356 million to Php876 million in the first quarter of 2005 from Php520 million in the same period in 2004 due to higher income subject to tax. In the first quarter of 2005, our effective tax rate was 27%. Our effective tax rate was lower than the 32% statutory corporate tax rate due to the following: income already subjected to final tax; income already subjected to lower tax rate; and equity in net income of our subsidiaries, which has already been subjected to tax and therefore, is no longer subject to income tax.

Net Income

In the first quarter of 2005, our fixed line business segment contributed a net income of Php2,370 million, compared to Php1,029 million in the same period in 2004 mainly as a result of a decrease in fixed line-related expenses by 18% particularly financing costs and provisions.

Information and Communications Technology

Revenues and Other Income

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

In the first quarter of 2005, our information and communications technology business generated revenues of Php751 million, an increase of Php277 million, or 58%, from Php474 million in the same period in 2004. Going forward, we expect revenues from our call center and Internet and gaming businesses to continue to contribute significantly to our information and communications technology revenues with the growing demand for our call center services.

The following table summarizes revenues from our information and communications technology business for the three months ended March 31, 2005 and 2004 by service segment:

	Three Months Ended March 31,					
					Increase (Decrease)	
	2005	**%**	**2004**(1)	**%**	**Amount**	**%**
			(Unaudited)			
Service Revenues						
Call center	Php408	54	Php266	56	Php142	53
Internet and gaming	146	20	103	22	43	42
Vitro™ data center	81	11	50	11	31	62
Others	17	2	16	3	1	6
	652	87	435	92	217	50
Non-service Revenues						
Point of Product Sales	66	9	36	7	30	83
Other Income	33	4	3	1	30	1,000
Total ICT Revenues	Php751	100	Php474	100	Php277	58

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 999-seat call center facility with 795 customer service representatives, or CSRs, exclusively for clients of a global provider of customer relationship management services;
- Parlance Systems, Inc., or Parlance, which owns and operates a 1,234-seat call center facility with 1,234 CSRs, exclusively for one of the largest direct-to-home satellite service providers in the United States for customer support and billing requirements; and
- ePLDT Ventus, Inc, or Ventus, which owns a 400-seat call center facility located in Iloilo province commenced full commercial operations in April 2005. Ventus will be expanding in Metro Manila with a 678-seat call center facility to accommodate current and new client requirements. This facility is expected to be completed by November 2005.

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.

Revenues related to our call center business in the first quarter of 2005 increased by Php142 million, or 53%, to Php408 million from Php266 million in the same period in 2004 due to the 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

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

Call center revenues accounted for 63% and 61% of total information and communications technology service revenues in the first quarters of 2005 and 2004, respectively.

Internet and gaming

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

- a 99.6% interest in Infocom, one of the country's leading internet service providers. Infocom offers consumer prepaid and postpaid internet access, corporate leased lines, dedicated dial-up, multi-user dial-up, broadband internet access thru DSL or *NOW* cable internet; web consulting, development and hosting;

- a 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 140 branches and over 6,000 work stations. DigiPar offers high-speed internet services, including internet advertising, gaming and printing; and

- a 63% interest in netGames, Inc., a publisher for Massively Multi-player Online Game in the Philippines. netGames, which was incorporated on June 21, 2004, is the Philippine licensee of Khan Online, the country's first full 3D online game. netGames commenced full commercial operations in February 2005.

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.

Revenues from our internet business for the first quarter of 2005 increased by Php43 million, or 42%, to Php146 million from Php103 million in the same period in 2004 primarily due to the consolidation of DigiPar in June 2004. Our internet business revenues accounted for 22% and 24% of service revenues from information and communications technology business in the first quarters of 2005 and 2004, respectively.

Vitro™ data center

ePLDT operates an internet data center under the brand name *Vitro*™. Granted pioneer status as an internet data center by the 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; and

- monthly service fees or one-time fees generated from professional services of Vitro's certified professionals.

In the first quarter of 2005, *Vitro*™ contributed revenues of Php81 million, an increase of Php31 million, or 62%, from Php50 million in the same period in 2004, primarily due to an increase in co-location revenues, server hosting and other services. *Vitro*™ revenues accounted for 12% and 11% of service revenues from information and communications technology business in the first quarters of 2005 and 2004, respectively.

Others

Other revenues consist of:

- fees generated for issuance of digital certificates; and

- revenues derived from IT helpdesk/contact center solutions and terminals for credit, debit and credit card transactions.

Revenues from other businesses related to our information and communications technology segment in the first quarter of 2005 increased to Php17 million from Php16 million in the same period in 2004 largely due to IT helpdesk/contact center services rendered coupled with an increase in number of digital certificates sold.

Please refer to *Note 9 – Investments in Associates – at equity* to the accompanying unaudited consolidated financial statements for further discussion on ePLDT's other information and communications technology services.

Non-service Revenues

Non-service revenues consist of sales generated from resellership of Microsoft software licenses and Cisco hardware equipment. In the first quarter of 2005, non-service revenues generated by our information and communications technology business increased by Php30 million, or 83%, to Php66 million prompted by higher point of product sales of Cisco equipment and Microsoft licenses.

Other Income

All other income/gains which do not fall under service and non-service revenues are included under this classification. Other income generated from our information and communications technology business segment increased to Php33 million in the first quarter of 2005 from Php3 million in the same period in 2004 owing to Infocom's sale of its *NOW* cable internet brand on February 1, 2005.

Expenses

Expenses associated with our information and communications technology business totaled Php721 million in the first quarter of 2005, an increase of Php286 million, or 66%, from Php435 million in the same period in 2004. As a percentage of our information and communications technology revenues, expenses related to our information and communications technology business were at 96% and 92% for the first quarters of 2005 and 2004, respectively.

The following table shows the breakdown of our total consolidated information and communications technology-related expenses for the three months ended March 31, 2005 and 2004 and the percentage of each expense item to the total:

	Three Months Ended March 31,					
					Increase (Decrease)	
	2005	%	2004(1)	%	Amount	%
			(Unaudited)			
(in millions)						
Information and communications technology services:						
Compensation and benefits(2)	Php308	43	Php172	40	Php136	79
Rent	99	14	84	19	15	18
Depreciation and amortization	95	13	67	15	28	42
Maintenance	70	10	46	11	24	52
Selling and promotions	64	9	32	7	32	100
Professional and other service fees	19	3	12	3	7	58
Financing costs	13	2	10	2	3	30
Taxes and licenses	10	1	4	1	6	150
Insurance and security services	3	–	1	–	2	200
Provisions	–	–	3	1	(3)	(100)
Other expenses	40	5	4	1	36	900
Total	Php721	100	Php435	100	Php286	66

(1) As restated to reflect the effects of the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies to the accompanying unaudited consolidated financial statements.
(2) Includes salaries and benefits, incentive plan, pension and MRP costs.

Compensation and benefits increased by Php136 million, or 79%, to Php308 million mainly due to the expansion of our call center facilities which resulted in an increase in headcount coupled with an increase in salaries, bonuses and various incentives of employees.

Rent expenses increased by Php15 million, or 18%, to Php99 million due to the opening of several *Netopia* branches countrywide and abroad in the second half of 2004.

Depreciation and amortization charges increased by Php28 million, or 42%, to Php95 million primarily due to an increase in depreciable asset base in relation to the expansion of our call center business segment.

Maintenance expenses increased by Php24 million, or 52%, to Php70 million primarily due to a change in maintenance agreement which resulted in higher annual maintenance in respect of our digital certificate business.

Selling and promotion expenses increased by Php32 million, or 100%, to Php64 million mainly as a result of increased advertising and promotions expenses in the first quarter of 2005 compared to the same period in 2004.

Professional and other service fees increased by Php7 million, or 58%, to Php19 million primarily due to higher training and shuttling expenses relating to our call center representatives.

Financing costs increased by Php3 million, or 30%, to Php13 million due to higher interest expense on loans as debt balances increased in the first quarter of 2005 as compared to the same period in 2004.

Taxes and licenses increased by Php6 million, or 150%, to Php10 million mainly on account of higher business-related taxes paid in the first quarter of 2005 as compared to the same period in 2004.

Insurance and security services increased by Php2 million, or 200%, to Php3 million primarily due to high insurance and security costs in the first quarter of 2005 as compared to same period in 2004.

Provisions decreased by Php3 million owing to specifically identified subscriber accounts of Infocom already provided for in 2004.

Other expenses increased by Php36 million, or 900%, to Php40 million due to various business and operational-related expenses such as travel, supplies and communication expenses.

Provision for (benefit from) income tax

A provision for income tax of Php47 thousand was recorded in the first quarter of 2005 as a substantial portion of our ICT business are under income tax holiday. Benefit from income tax of Php1 million was recognized in the first three months of 2004 due to a tax loss position as non-tax deductible charges were higher during the first quarter of 2004.

Net Income

In the first quarter of 2005, our information and communications technology business segment registered a net income of Php39 million, a decrease of 3%, compared to a net income of Php40 million posted in the same period in 2004 as expenses increased by 66% compared with a 58% increase in revenues and other income. The increase in expenses for the first quarter of 2005 was reflective of the continuing expansion of our call center business as well as our *Netopia* internet café business.

Liquidity and Capital Resources

The following table shows our consolidated cash flows for the three months ended March 31, 2005 and 2004 as well as consolidated capitalization and other selected financial data as at March 31, 2005 and 2004:

	Three Months Ended March 31,	
	2005	**2004**(1)
	(Unaudited)	
(in millions)		
Cash Flows		
Net cash provided by operating activities	Php15,250	Php18,103
Net cash used in investing activities	2,191	5,363
Capital expenditures	4,263	4,316
Net cash used in financing activities	10,245	7,528
Net increase in cash and cash equivalents	2,456	5,223

	March 31, 2005	**December 31, 2004**(1)
(in millions)	(Unaudited)	(Audited)
Capitalization		
Interest-bearing financial liabilities:		
Long-term financial liabilities:		
Long-term debt	Php113,040	Php121,012
Obligations under capital lease	514	601
Preferred stock subject to mandatory redemption	14,094	14,375
	127,648	135,988
Interest-bearing financial liabilities maturing within one year:		
Notes payable	2	58
Long-term debt maturing within one year	22,972	28,018
Obligations under capital lease maturing within one year	448	425
	23,422	28,501
Total interest-bearing financial liabilities	151,070	164,489
Total equity	54,383	48,515
	Php205,453	Php213,004
Other Financial Data		
Total assets	Php261,403	Php265,473
Property, plant and equipment – net	192,921	194,525
Cash and cash equivalents	29,777	27,321

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

As at March 31, 2005, our consolidated cash and cash equivalents totaled Php29,777 million. Principal sources of consolidated cash and cash equivalents in the first quarter of 2005 were cash flows from operations amounting to Php15,250 million and drawings from Smart's facilities aggregating Php5,471 million. These funds were used principally for capital outlays of Php4,263 million, total debt principal payments of Php14,431 million and interest payments of Php2,518 million.

Operating Activities

Our consolidated net cash flows from operating activities in the first quarter of 2005 decreased by Php2,853 million, or 16%, to Php15,250 million from Php18,103 million in the same period in 2004 as we settled current liabilities relating to various trade suppliers in the first three months of 2005.

A growing portion of our cash flow is generated by our wireless business, which accounted for 59% and 56% of our service revenues in the first quarters of 2005 and 2004, respectively. Revenues from our fixed line and information and communications technology services accounted for 39% and 2%, respectively, of our service revenues in the first quarter of 2005 compared to 42% and 2%, respectively, in the same period in 2004.

In the first quarter of 2005, cash flows from operating activities of our wireless business accounted for 66% of our consolidated cash flows from operations compared to 56% in 2004 owing to the growth of our cellular service revenues. Our fixed line business contributed 32% and 44% to our consolidated cash flows from operations in the first three months of 2005 and 2004, respectively. We settled current liabilities outstanding as of December 31, 2004 during the first quarter of 2005. 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 at March 31, 2005.

While 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, Smart has been able to obtain waivers from Finnvera and certain of its lenders for each of the dividend payments made by Smart to PLDT in 2004, 2003 and 2002 aggregating Php16,100 million, Php6,166 million and Php1,540 million, respectively. Smart has also obtained the necessary consents from its lenders to make similar distributions to PLDT amounting to Php19,891 million in 2005, of which Php6,000 million was paid by Smart to PLDT in March 2005.

Investing Activities

Net cash used in investing activities in the first quarter of 2005 amounted to Php2,191 million, a decrease of Php3,172 million, or 59%, compared to Php5,363 million in the same period in 2004. This decrease was primarily the result of matured short-term investments relating to prepaid forward exchange contracts of Smart; Smart did not book additional prepaid forwards due to the improvement of the peso.

Our consolidated capital expenditures in the first quarter of 2005 totaled Php4,263 million, a decrease of Php53 million, or 1%, from Php4,316 million in the same period in 2004 primarily due to Smart's lower capital spending partially offset by PLDT's higher capital spending. Smart's capital spending of Php1,753 million in the first quarter of 2005 was used to further expand and upgrade its transmission network facilities to increase capacity and coverage in respect of basic and advanced cellular services. PLDT's capital spending of Php2,344 million was principally used to finance the expansion of its fixed line data and IP-based network services. ePLDT and its subsidiaries' capital spending of Php158 million was used to primarily fund its *Vitro*™, Infocom and call center business operations. The balance represented other subsidiaries' capital spending. Consolidated capital expenditures in the first quarter of 2004 amounted to Php4,316 million, of which Php3,463 million, Php796 million and Php32 million were attributable to Smart, PLDT and ePLDT, respectively. The balance represented other subsidiaries' capital spending.

Financing Activities

On a consolidated basis, we used net cash of Php10,245 million for financing activities in the first quarter of 2005, compared to Php7,528 million in the same period in 2004. The net cash used in financing activities in the first quarter of 2005 was mainly attributable to interest payments and debt repayments by PLDT in line with its ongoing debt reduction program.

Debt Financing

Additions to our consolidated long-term debt in the first quarter of 2005 totaled Php5,471 million from Smart's drawings related to the refinancing of its Phase 5A/5B loan facilities. Payments in respect of principal and interest of our total debt amounted to Php14,431 million and Php2,518 million, respectively, in the first quarter of 2005, of which Php8,295 million and Php2,216 million were attributable to PLDT, respectively.

The following table shows our long-term debt, including current portion as at March 31, 2005 and 2004:

	March 31,	December 31,	Increase (Decrease)	
	2005	2004	Amount	%
(in millions)	(Unaudited)	(Audited)		
U.S. Dollar Debt:				
Export Credit Agencies-Supported Loans	Php37,027	Php41,266	(Php4,239)	(10)
Fixed Rate Notes	65,593	68,795	(3,202)	(5)
Term Loans	16,793	20,492	(3,699)	(18)
Restructured Loans	4,738	4,815	(77)	(2)
Satellite Acquisition Loans	3,663	4,064	(401)	(10)
	127,814	139,432	(11,618)	(8)
Japanese Yen Debt:				
JBIC's Overseas Investment Loan	4,275	5,363	(1,088)	(20)
Export Credit Agency-Supported Loan	1,125	1,212	(87)	(7)
	5,400	6,575	(1,175)	(18)
Philippine Peso Debt:				
Peso Fixed Rate Corporate Notes	1,675	1,675	–	–
Term Loans	756	985	(229)	(23)
Restructured Loans	367	363	4	1
	2,798	3,023	(225)	(7)
	Php136,012	Php149,030	(Php13,018)	(9)

For a complete discussion of long-term debt, see *Note 17 – Interest-bearing Financial Liabilities* to the accompanying unaudited consolidated financial statements.

Our long-term debt decreased by Php13,018 million, or 9%, to Php136,012 million as at March 31, 2005 largely due to debt amortizations and prepayments in line with PLDT's efforts to reduce its overall debt level and the appreciation of the peso. PLDT's debt was reduced by 10% to Php98,519 million by the end of the first quarter 2005. In addition, the debt levels of Smart, Mabuhay, ePLDT and Maratel as at March 31, 2005 relative to the debt balances as at December

31, 2004 decreased by 3%, 10%, 19% and 24% to Php33,584 million, Php3,663 million, Php238 million and Php8 million, respectively, due to the peso appreciation and debt amortizations during the first quarter of 2005.

As at March 31, 2005, PLDT had no undrawn committed long-term credit facilities. The JP¥3,095 million undrawn portion of the JP¥5,615 million syndicated term loan facility supported by Nippon Export and Investment Insurance of Japan and US$4 million undrawn portion of the US$12 million term loan facility extended by DEG-Deutsche Investitions-und Entwicklungsgesellschaft mbH were cancelled on December 3, 2004 and September 26, 2004, respectively. In addition, PLDT also waived further disbursements from the US$149 million Kreditanstalt für Wiederaufbau refinancing facility effective September 1, 2004, thus, canceling the undrawn portion of US$9 million. As at March 31, 2005, 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 outstanding consolidated long-term debt at nominal values as at March 31, 2005 are as follows:

Year	US$ Loans(1)		JP¥ Loans(2)		Peso Loans	Total
			(in millions)			
2005(3)	US$325	Php17,781	JP¥2,024	Php1,034	Php652	Php19,467
2006	353	19,330	3,418	1,747	851	21,928
2007	474	25,988	3,418	1,747	78	27,813
2008	119	6,520	1,709	874	67	7,461
2009	271	14,831	–	–	56	14,887
2010 and onwards	972	53,201	–	–	1,214	54,415

(1) The exchange rate used was Php54.747 to US$1.00.
(2) The exchange rate used was Php0.5111 to JP¥1.00.
(3) April 1, 2005 through December31, 2005.

Approximately Php91,556 million principal amount of our consolidated outstanding long-term debt as at March 31, 2005 is scheduled to mature over the period from 2005 to 2009. Of this amount, approximately Php66,710 million is attributable to PLDT, Php20,937 million to Smart, and the remainder to Mabuhay Satellite, Maratel and ePLDT.

Debt Covenants

Our debt instruments contain restrictive covenants, including covenants that could prohibit us from paying common dividends under certain circumstances, 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. We have complied with all of our maintenance ratios as required under our loan covenants and other debt instruments.

Please see *Note 17 – Interest-bearing Financial Liabilities* for a detailed discussion of our covenants.

Financing Requirements

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

Since 2002, we have been utilizing internally generated cash particularly from our cellular business to reduce our overall level of indebtedness. In line with this objective, we have managed our capital expenditures, reduced our investments and suspended dividend payments to common shareholders from April 2001 to 2004. As a result of our improving cash flows and reduced debt levels, we have restored the payment of common dividends in May 2005 and intend to gradually increase our dividend payout ratio in succeeding years as we improve our leverage ratios.

Credit Ratings

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 May 3, 2005, Fitch Ratings upgraded PLDT’s long-term local currency rating to “BB+” with a stable outlook. Simultaneously, Fitch has affirmed PLDT’s long-term foreign currency rating, global bonds and senior notes at “BB” and PLDT’s convertible preferred stock at “B+”. The outlook on the affirmed ratings remains negative, reflecting the outlook of the Republic of the Philippines’ long-term foreign currency rating.

On February 16, 2005, Moody’s Investor Service, or Moody’s, downgraded the foreign currency senior unsecured debt rating of PLDT by one-notch to Ba3 from Ba2 with a stable outlook. The rating action was taken as part of Moody’s two-notch downgrade of the Republic of the Philippines’ foreign currency country ceiling to B1 from Ba2. On the same date, Moody’s affirmed PLDT’s B1 preferred stock rating with a stable outlook. Moody's views that there is a differential between PLDT's foreign currency rating and the sovereign rating. According to Moody's, PLDT's foreign currency bond rating is a function of its own risk of default and is less likely to be subject to a debt moratorium which the Philippine government may declare in case of an event of default by government.

On January 17, 2005, Standard and Poor’s Ratings Group, or Standard and Poor’s, revised its long-term foreign currency rating on PLDT from “BB” to “BB-“ (BB minus) with a stable outlook. The rating action was taken immediately after Standard and Poor’s downgraded the foreign currency rating on the Republic of the Philippines to “BB-“ (BB minus).

Equity Financing

PLDT raised Php82 million from the exercise by certain officers and executives of stock options in the first quarter of 2005. In addition, through our subscriber investment plan, or SIP, which provides postpaid fixed line subscribers the opportunity to buy shares of our 10% cumulative convertible preferred stock as part of the upfront payments collected from subscribers, PLDT was able to raise Php1 million in the first quarter of 2005 and Php3 million in the same period in 2004. As approved by the NTC, the SIP was made optional in 2003 from being compulsory in earlier years.

Cash dividend payments in the first quarter of 2005 amounted to Php320 million, compared to Php334 million in the same period in 2004, all of which were paid to preferred shareholders of PLDT. On March 2, 2005, PLDT declared cash dividends of Php14 per common share to holders of record as at March 31, 2005 payable on May 12, 2005. This is the first cash dividend declaration to common shareholders in four years since April 2001.

Contractual Obligations and Commercial Commitments

Contractual Obligations

The following table discloses our contractual obligations outstanding as at March 31, 2005:

	Payments Due by Period				
	Total	Within 1 year	2–3 years	4–5 years	After 5 years
			(Unaudited)		
(in millions)					
Long-term debt (1)	Php145,971	Php22,978	Php48,137	Php21,080	Php53,776
Long-term lease obligations:					
Operating Lease	5,278	1,284	2,202	732	1,060
Capital Lease	1,698	708	533	13	444
Unconditional purchase obligations(2)	11,595	4,195	2,199	2,190	3,011
Other long-term obligations	21,126	–	3,283	17,843	–
Total contractual obligations	Php185,668	Php29,165	Php56,354	Php41,858	Php58,291

(1) Before deducting unamortized debt discount and debt issuance costs.
(2) Based on the original Air Time Purchase Agreement with AIL.

Long-term Debt

For a discussion of our long-term debt, see *Note 17 – Interest-bearing Financial Liabilities* to the accompanying unaudited consolidated financial statements.

Long-term Operating Lease Obligations

Domestic Fiber Optic Network Submerged Plant Maintenance Agreement. On July 4, 2000, PLDT entered into an agreement with NTT World Engineering Marine Corporation, or NTT WEMC for the submarine cable repair and other allied services in relation to 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 WEMC 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 at March 31, 2005, PLDT’s aggregate remaining obligation under this agreement was approximately Php38 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 at March 31, 2005, PLDT’s aggregate remaining obligation under these contracts amounted to approximately Php26 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 at March 31, 2005, PLDT's aggregate remaining obligation under this agreement was approximately Php40 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 Php3,032 million as at March 31, 2005 in respect of office and cell site rentals with over 2,000 lessors nationwide.

*Long-term Capital Lease Obligation*s

For a discussion of our long-term capital lease obligations, see *Note 17 – Interest-bearing Financial Liabilities* to the accompanying unaudited consolidated financial statements.

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 AIL 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 at March 31, 2005, PLDT's aggregate remaining minimum obligation under the original Air Time Purchase Agreement was approximately Php11,574 million. Negotiations are continuing with the relevant parties towards an amicable settlement of this matter. Prior to further negotiation of a definitive transaction agreement among the parties, PLDT deposited US$21.5 million in an escrow account on March 28, 2005 which was to be disbursed upon the execution and delivery of a mutually agreeable definitive transaction agreement on or before April 29, 2005. The parties involved had not reached an agreement to date and on May 2, 2005, PLDT has formally requested for the return of amount deposited. Copies of the necessary banking instructions have been received by the escrow bank, but only upon receipt of the original instructions will the abovementioned funds be returned. See *Note 20 – Related Party Transactions* and *Note 23 – Provisions and Contingencies* to the accompanying unaudited 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 to 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 to 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 at March 31, 2005, ePLDT's aggregate remaining minimum obligation under this agreement was approximately Php17 million pertaining to annual support fee.

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

Other Long-term Obligations

Mandatory Conversion and Purchase of Shares. As discussed in *Note 9 – Investments in Associates* – a*t equity* and *Note 17 – Interest-bearing Financial Liabilities*, as at March 31, 2005 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 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 common share. 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's 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 at March 31, 2005, 515,818 shares of Series V Convertible Preferred Stock and 522,700 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 at March 31, 2005 was Php21,126 million, of which Php13,131 million is payable on June 4, 2008 and Php7,995 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 Php14,944 million, based on the market price of PLDT common shares of Php1,385 per share as at March 31, 2005.

Please refer to *Note 17 – Interest-bearing Financial Liabilities* to the accompanying unaudited consolidated financial statements for further discussion.

Commercial Commitments

As at March 31, 2005, our outstanding commercial commitments, in the form of letters of credit, amounted to Php1,639 million. These commitments will expire within one year.

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 at March 31, 2005, the Philippine peso had appreciated by 3% against the U.S. dollar to Php54.747 to US$1.00 from Php56.341 to US$1.00 as at December 31, 2004. As at March 31, 2004, however, the peso depreciated by 1% to Php56.216 to US$1.00 from Php55.586 to US$1.00 as at December 31, 2003. As such, we recognized foreign exchange gains of Php3,211 million in the first quarter of 2005 as compared to foreign exchange losses of Php2,414 million recorded in the same period in 2004. In the first quarter of 2005, consolidated capitalized net foreign exchange gains which qualified as borrowing costs were Php22 million, as against net capitalized foreign exchange losses of Php73 million in the same period in 2004. These capitalized net foreign exchange gains (losses) which qualified as borrowing costs were attributable to foreign currency-denominated liabilities used to finance our capital investments and were therefore recorded as additions (reductions) to the carrying value of the related property accounts.

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 at March 31, 2005, approximately 98% of our total consolidated debts were denominated in foreign currencies. Of our foreign currency-denominated debts, 4% 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 62% of our consolidated 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 17 – Interest-bearing Financial Liabilities* to the accompanying unaudited 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. In order to manage hedge costs of these contracts, we utilize structures that include credit-linkage with PLDT as the reference entity, combination of currency option contracts, and fixed to floating coupon only swap agreements. Accounted as either cash flow hedges or transactions not designated as hedges, changes in the fair value of these instruments are recognized as cumulative translation adjustments in equity until the hedged item is recognized in earnings or directly to income for the period. As at March 31, 2005, PLDT's outstanding forward foreign exchange contracts, principal-only long-term cross-currency swap contracts and currency option contracts amounted to US$107 million and JP¥247 million; US$550 million; and US$263 million, respectively. Smart's outstanding forward foreign exchange contracts amounted to US$39 million as at March 31, 2005.

For further discussions of these contracts, see *Note 24 –Financial Assets and Liabilities – Derivative Financial Instruments* to the accompanying unaudited 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. As at March 31, 2005, PLDT's outstanding interest rate swap contracts amounted to US$125 million. For further discussions of these contracts, see *Note 24 – Financial Assets and Liabilities – Derivative Financial Instruments* to the accompanying unaudited consolidated financial statements.

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.

Impact of Inflation and Changing Prices

Inflation can be a significant factor in the Philippine economy, and we are continually seeking ways to minimize its impact. In recent periods, while decreases in the relative value of the peso have had a significant effect on us, we do not believe inflation has had a material impact on our operations. The average inflation rate in the Philippines in the first quarter of 2005 was 8.4%, compared to 3.5% in the same period in 2004.

OTHER INFORMATION

Related Party Transactions

In the ordinary course of business, a number of companies related to but 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 subsidiaries are 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 in PLDT or its subsidiaries, as at March 31, 2005 and December 31, 2004 and for the three months ended March 31, 2005 and 2004 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 conventional international telecommunication services. Total fees under these agreements totaled Php81 million and Php70 million for the first quarters of 2005 and 2004, respectively. PLDT's outstanding obligations under these agreements amounted to Php52 million and Php49 million as at March 31, 2005 and December 31, 2004, respectively.

Agreements between Smart and Asia Link B.V. — agreements under which Asia Link undertakes to provide technical support services and assistance in the operations and maintenance of Smart's cellular business. Total fees under these agreements totaled Php123 million and Php107 million for the first quarters of 2005 and 2004, respectively. Under these agreements, Smart had outstanding payables of Php246 million and Php117 million as at March 31, 2005 and December 31, 2004, 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. In addition, PLDT has an insurance policy with Malayan Insurance Co., Inc., or Malayan, wherein premiums are directly paid to Malayan. Total payments to Gotuaco and Malayan covering the 12-month period ending July 31, 2005 amounted to Php452 million. Two directors of PLDT have direct/indirect interests in or serve as a director/officer of Gotuaco and Malayan.

For a more detailed discussion of the related party transactions enumerated above, see *Note 20 – Related Party Transactions* to the accompanying unaudited consolidated financial statements.

Transfer of Piltel Common Shares from PLDT to Smart

On April 25, 2005, PLDT and Smart entered into a subscription and assignment agreement covering the transfer and assignment to Smart of 767 million Piltel common shares owned by PLDT. The Piltel common shares were transferred to Smart in consideration and in exchange for 11.3 million Smart preferred shares subscribed by and issued to PLDT for a total price of Php157.2 million. As a result, Smart now owns 92.1% of the total outstanding common stock of Piltel, thereby consolidating the PLDT Group's wireless business under Smart.