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20 May 2016

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RATINGS

Philippine Long Distance Telephone Company

Domicile	Philippines
Long Term Rating	Baa2
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information.The ratings and outlook shown reflect information as of the publication date.

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Philippine Long Distance Telephone Company

Heavy Investments in Network and Digital Businesses Will Weigh on Cash Flow

Summary Rating Rationale

The Philippine Long Distance Telephone Company's (PLDT) Baa2 rating reflects its dominant market position in the Philippines' duopolistic telecommunications market, as well as its strong operating and EBITDA margins when compared to its global telecommunications peers in the Baa rating category.

Data and broadband will drive earnings going forward. However, intense domestic competition in the cellular space and a continued shift of users away from texting and international inbound calling to over-the-top (OTT) options will constrain earnings. High levels of planned capital expenditure (capex) to improve its network and anticipated investments in its digital businesses will also weigh on cash flow.

As a result, we expect PLDT's adjusted leverage to remain around 2.3x in 2016, which is higher when compared to past levels of below 2.0x. However, the company's liquidity position will remain healthy, supported by continued access to the local bank and bond markets. PLDT has also demonstrated its ability to modestly reduce dividends to preserve cash and enhance liquidity if needed, which we view positively. Moreover, PLDT has some investment assets which it could monetize.

Rating Outlook

The stable outlook reflects our expectation that PLDT will maintain its solid margins and liquidity profile, given its dominant market position. We also expect that management will remain prudent in its use of cash, particularly during periods of high and accelerated capex.

Factors that Could Lead to an Upgrade

We will consider upgrading PLDT if the company: (1) maintains adjusted consolidated EBITDA margins that exceed 45%; (2) lowers adjusted consolidated debt/EBITDA to below 1.5x on a sustained basis; (3) increases retained cash flow/debt to above 30%; and (4) ensures that shareholder returns and asset investment policies do not substantially weaken its financial profile.

Factors that Could Lead to a Downgrade

PLDT's ratings will come under downward pressure if its (1) adjusted EBITDA margin falls below 40%; (2) adjusted debt/EBITDA exceeds the range of 2.0x-2.5x on a sustained basis; or (3) retained cash flow/debt declines to below 20%, as a result of a continued weak operating

performance or event risk.Any additional material investment in non-core businesses would also be negative for the ratings.

Key Indicators

Exhibit 1

	3/31/2016(L)	12/31/2015	12/31/2014	12/31/2013	12/31/2012
Scale (USD Billion)	$3.7	$3.8	$3.8	$4.0	$3.9
EBITDA Margin	48.5%	49.4%	52.8%	52.2%	56.2%
Debt / EBITDA	2.3x	2.2x	1.8x	1.5x	1.5x
FCF / Debt	-7.0%	-2.3%	-4.1%	3.2%	3.7%
RCF / Debt	18.3%	18.7%	21.8%	25.7%	28.9%
(FFO + Interest Expense) / Interest Expense	9.6x	9.9x	12.2x	12.4x	11.2x
(EBITDA - Capex) / Interest Expense	2.9x	4.7x	7.4x	8.5x	6.9x

Note: All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics

Credit Strengths

» Dominant market position in the Philippines' duopolistic telecommunications market

» Healthy liquidity profile

Credit Challenges

» Intense competition and decline in high-margin toll revenues

» Weak free cash flow, reflecting weaker profitability, heavy capex and high dividend payouts

» Event risks associated with investments in core and non-core businesses

» Adjusted leverage expected to remain around 2.5x in 2016

Corporate Profile

The Philippine Long Distance Telephone Company is the leading integrated provider of wireless and fixed-line services in the Philippines. It is headquartered in Manila and listed on the Philippine Stock Exchange, with American Depository Receipts traded on the New York Stock Exchange.

Detailed Rating Considerations

Dominant market position in the Philippines' duopolistic telecommunications market

PLDT's dominant position in a duopolistic telecommunications market supports its Baa2 rating.

The sector is effectively a duopoly with PLDT and **Globe Telecom Inc.** (unrated) as the top market players. Of note, the termination of the planned joint venture between **San Miguel Corporation** (unrated) and Telstra Corporation Limited (A2 stable) has delayed the entry of a potential third player to the Philippine market.

PLDT's consolidated revenues for the twelve months ended 31 March 2016 were PHP171 billion (approximately $3.7 billion), while Globe's total revenues were PHP120 billion (about $2.6 billion) for the same period, implying a 58%/42% revenue split, respectively, similar to the end of 2015, and compared to the 62%/38% split recorded at end-2014.

In response to intensifying competition and the loss of some market share to Globe in recent quarters, PLDT has become more aggressive on pricing, including matching competitor's pricing, particularly in the prepaid cellular space, which has - and will continue to - adversely impact margins.

Earnings constrained by intense competition and decline in high-margin SMS and toll revenues

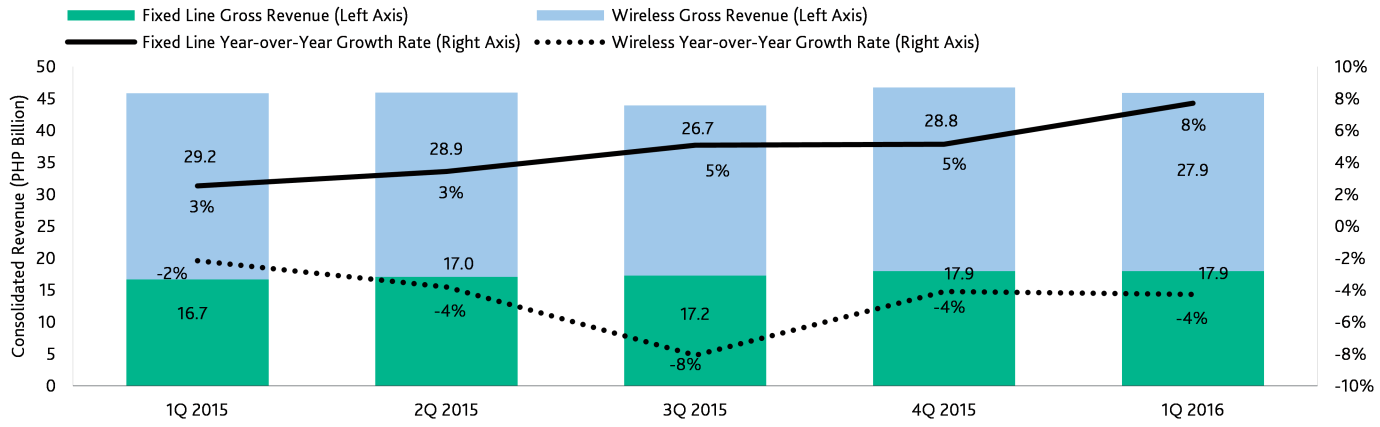
PLDT's reported consolidated revenues were up just 1%, at PHP 42.8 billion in 1Q 2016, although consolidated service revenues were flat at PHP40.6 billion as increasing usage of Internet data has shrunk usage of voice and texting, driving contractions in toll revenues from its international long distance (ILD) and national long distance (NLD) businesses.

As shown in Exhibit 2, gross revenues from its wireless segment declined 4% year-over-year to PHP27.9 billion, and accounted for 61% of PLDT's consolidated service revenues in 1Q 2016 (before inter-segment transactions). Within this segment, declines in cellular international voice and short messaging-cellular domestic voice -- both of which were affected by the availability of OTT options -- continued to offset solid growth in data/broadband and digital revenues.

At the same time, revenues from the fixed-line segment increased by 8% year-over-year to PHP17.9 billion, and accounted for 39% of PLDT's consolidated service revenues in 1Q 2016. Data and broadband continued to drive growth in this segment.

Exhibit 2

Consolidated Revenues Flat Year-over-Year in 1Q 2016 as Declines in Wireless Segment Stunt Growth

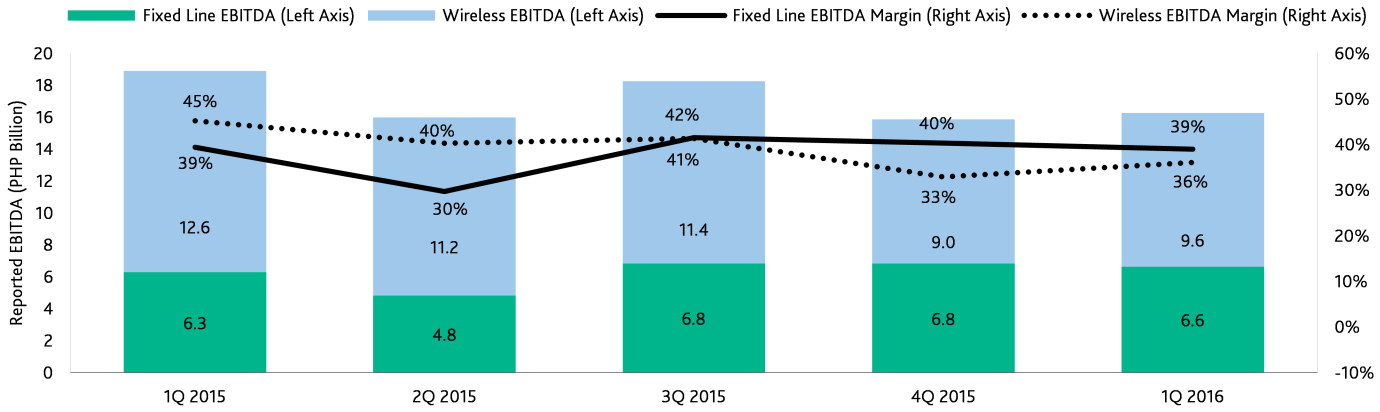


Source: Company filings

PLDT also reported a 14% contraction in EBITDA year-over-year to PHP16.6 billion in 1Q 2016, primarily driven by a 24% contraction in EBITDA in the wireless segment reflecting a rise in subsidies (modems and handsets) associated with accelerating broadband and smartphone penetration. These initiatives were driven by the company's efforts to grow postpaid cellular revenues, as well as increase smartphone ownership among its prepaid subscriber base, in order to further stimulate data usage.

Exhibit 3

Rise in Subsidies in Wireless Segment Drives 14% Year-over-Year Contraction in Consolidated EBITDA in 1Q 2016



Source: Company filings

Still, PLDT`s consolidated adjusted EBITDA margin of 48.5% for the twelve months to March 2016 was strong relative to similarly rated global industry peers with EBITDA margins in the 30%-40% range.

We expect the continuing decline in PLDT's toll revenues -- international long distance (ILD) and national long distance (NLD)) that accounted for 12% of consolidated service revenues in 2015 -- to weigh heavily on revenue growth for a few more years.

As a result, we expect adjusted consolidated EBITDA margin to erode slightly over the next 12-18 months, as domestic competition remains intense, pricing pressures persist, and high-margin toll and SMS revenues continue to decline.

In addition, the company will continue to drive its "digital pivot", with network and service investments to support anticipated increases in data usage and to improve customers' data experience. As a result, we expect reported cash flow from operations (CFO) to be approximately PHP60 billion in 2016 and lower than the PHP70 billion recorded in 2015.

Weak free cash flow, reflecting weaker profitability, heavy capex and high dividend payouts

PLDT has reported negative free cash flows (after dividends) since 2014. We expect this trend to continue in 2016, as capex requirements remain elevated and the company maintains a high dividend payout.

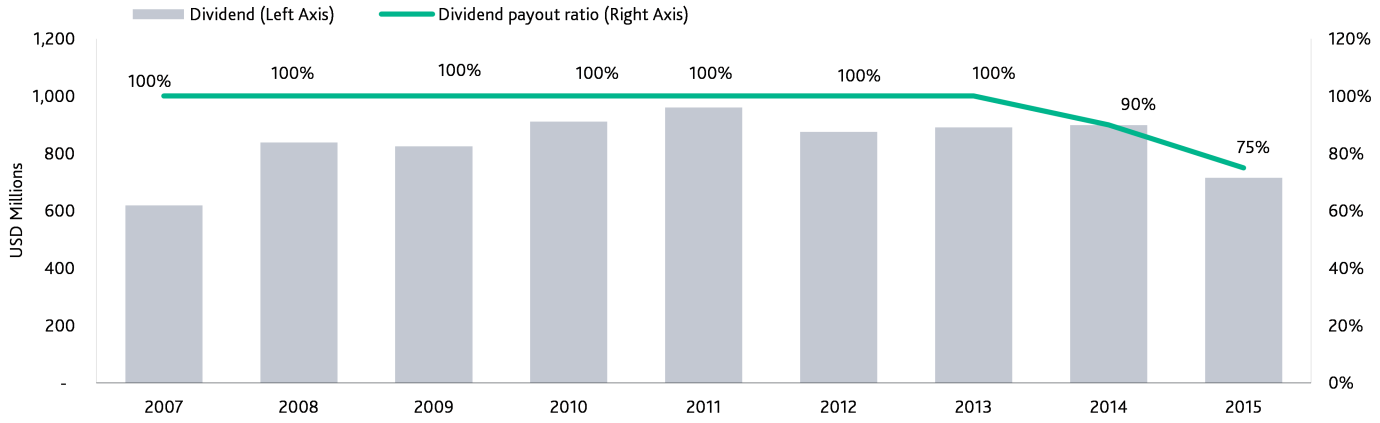
We expect capex of around PHP43 billion in 2016, or 25% of revenues, to support high growth in data usage and network demand. This capex will be funded from a combination of internally generated cash flows and debt.

PLDT's dividends are based on core EPS, with the company having the flexibility to conduct a "look back" at year-end to distribute excess cash as special dividends.

In 2015, to conserve cash to support higher capex requirements, PLDT only paid the 75% regular dividend - which was lower than the 90% payout of 2014 - and the 100% payout of the seven preceding years (see Exhibit 4).

Exhibit 4

PLDT Reduced Dividends in 2015 to Conserve Cash



Sources: Company filings, Moody's Financial Metrics

Event risk associated with investments in core and non-core businesses

PLDT's rating continues to consider the company's investment appetite, as major investments will require debt financing or asset sales. Although we understand management's intention to keep investments modestly sized, we continue to evaluate the business and financial risks associated with any potential investments on a case by case basis.

Historically, the company has made some large investments in core and non-core businesses.

For example, in 2009, PLDT made a PHP20 billion investment in the **Manila Electric Company** (Meralco, unrated), an electricity distributor with assets, such as towers and poles that could be used for telecommunications and a fiber-optic network. Although a major PLDT objective was to secure access to these assets, the acquisition was, in our view, non-core.

PLDT later acquired Digitel (then Philippines' third-largest cellular operator) in 2011 for about PHP70 billion via a share swap. Although a non-cash transaction, PLDT's adjusted leverage rose to around 1.5x in 2012 from 1.2x in 2010, given the consolidation of c.USD500 million of Digitel's debt. Still this acquisition was aligned with PLDT's core business and has since increased PLDT's market position and spectrum holdings have increased.

Then in August 2014, PLDT debt financed its EUR333 million (PHP19.6 billion) purchase of a 10% stake in **Rocket Internet AG** (unrated), a German Internet company, to jointly develop mobile and online payment technologies and services for the Philippines and other emerging markets. This investment not only increased PLDT's leverage but exposed the company to the highly competitive Internet business. PLDT's stake was subsequently reduced to 6.1% after Rocket completed its IPO in October and a subsequent private placement in February 2015.

We expect PLDT to continue to invest in internet and multimedia sectors, as it aims to strengthen its ability to deliver multimedia content through its broadband and mobile networks and grow its e-commerce business, given its strategy to transform itself into a multi-media organization.

However, management has indicated that any new acquisitions in this space (probably three to four per year) will be in the range of US $10 million to US$20 million each.

Notably, PLDT has also received dividends from some of its investments which has helped to supplement cash flows.

For example, **Beacon Electric Asset Holding Inc.** (unrated) -- in which PLDT indirectly owns about 50% -- had agreed to sell a 5% stake in Meralco in June 2014 and another 10% in April 2015. Consequently, PLDT received a PHP5.1 billion dividend from Beacon in 1H 2015, and it should receive another PHP3 billion to PHP4 billion in dividends in June 2016. PLDT's indirect holding of Meralco currently stands at around 17.5%.

However, despite the dividends expected from Beacon in 2016, we still expect PLDT's adjusted free cash flow to remain negative for the full year.

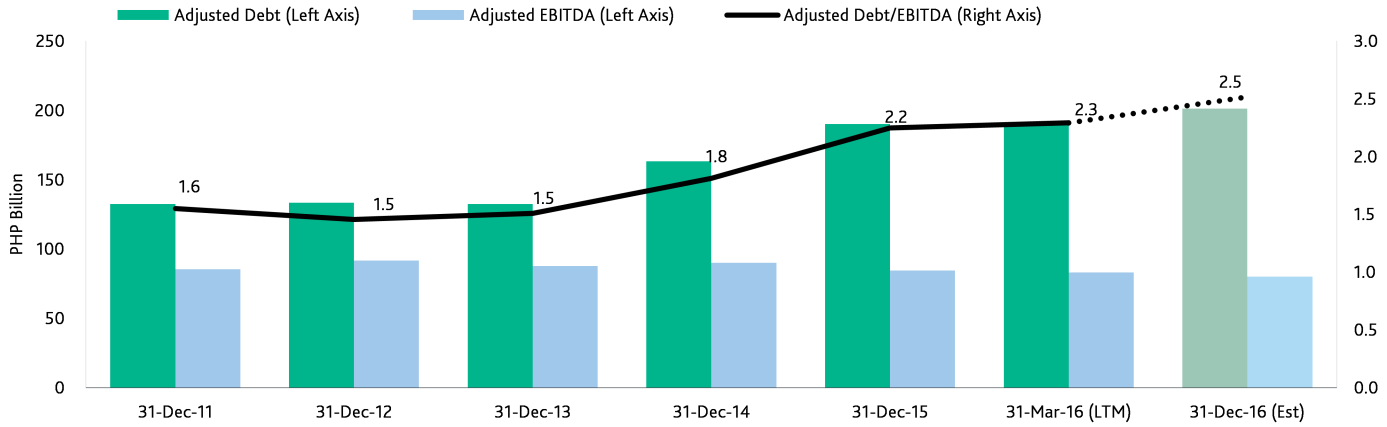
Adjusted leverage expected to remain around 2.5x in 2016

As shown in Exhibit 5, PLDT's adjusted leverage rose to 2.3x for the twelve months ended 31 March 2016 from 1.8x at end-2014, reflecting high capex outlays and weaker profitability.

We expect adjusted leverage to trend towards 2.5x in 2016 as intense domestic competition and declining revenues in toll revenues constrain revenue growth and margin expansion, in addition to the influence of elevated capex and ongoing investments to support its "digital pivot" initiatives.

Exhibit 5

PLDT's Leverage Is Increasing On the Back of High Capex and Soft Operating Performance



Sources: Company filings, Moody's Financial Metrics, Moody's Investors Service estimates

Furthermore, as significant debt reduction is unlikely without the sale of major assets, PLDT's adjusted leverage will likely remain at the top end of leverage tolerance for its Baa2 rating over the next 12 months and above its historical levels of below 2.0x

Liquidity Analysis

PLDT's healthy liquidity position with cash and cash equivalents of PHP45 billion at 31 March 2016. However, a portion of this cash was used to fund a dividend payment of around PHP12 billion in the early part of 2Q 2016.

Thereafter, its cash on balance sheet -- coupled with our projected cash flows from operations of about PHP60 billion -- should be sufficient to cover current debt maturities and capex over the next 12 months.

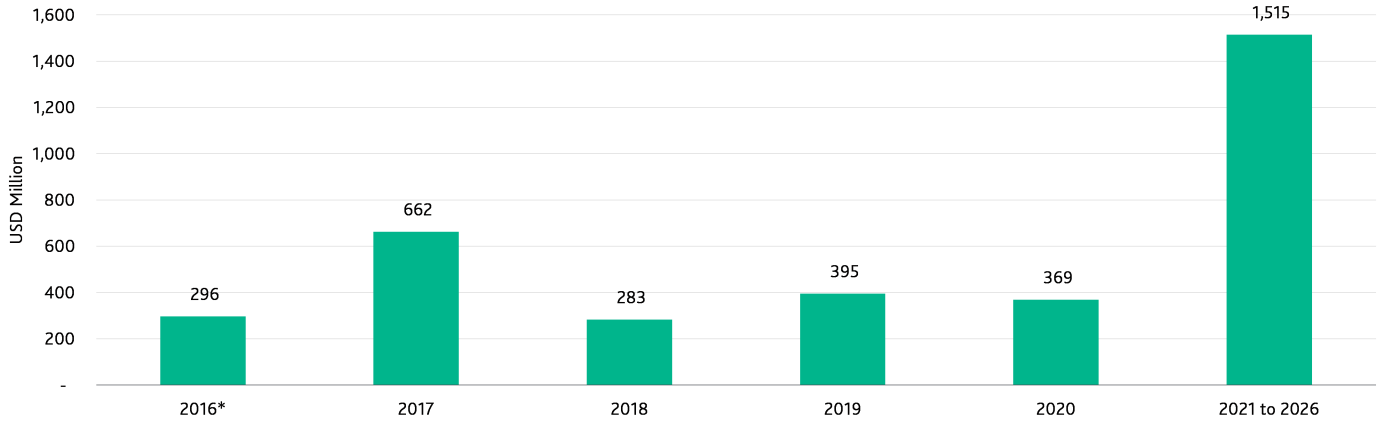
As shown in Exhibit 6, aside from around $296 million of debt maturities through year-end 2016, PLDT has an additional $662 million (PHP30 billion) of debt maturing through year-end 2017 (together representing 27% of total reported debt), which includes the company's USD228 million Senior Unsecured Notes due March 2017.

Thereafter, the company's debt maturity profile is relatively long dated with the majority of debt maturing after 2021.

We expect the company to prudently manage its dividend payouts over the next 12-18 months, as well as retain access to the local bank and bond markets, to ensure scheduled debt maturities over the same period are refinanced in a timely manner. In addition, PLDT has investment assets (including a 17.5% stake in Meralco and a 20% ownership in **SPi Global** (unrated) – a business process outsourcing company) which it could monetize.

Exhibit 6

PLDT's Debt Maturity Profile as of March 2016



*April 2016 through December 2016

Sources: Company filings, Moody's Financial Metrics

Rating Methodology and Scorecard Factors

Telecommunications Methodology: In accordance with Moody's global rating methodology for the telecommunications sector (please refer to Rating Methodology: Global Telecommunications Industry, December 2010), PLDT's overall performance -- relative to the rating methodology grid with regard to financials for the twelve months to March 2016 -- indicates a Baa2 level rating, which is in line with its assigned rating.

Exhibit 7

Global Telecommunications Industry Grid	Current LTM 3/31/2016	Moody's 12 Month Forward View
Factor 1: Scale And Business Model, Competitive Environment And Technical Positioning (27%)	Score	Score
a) Scale (USD Billion)	Ba	Ba
b) Business Model, Competitive Environment and Technical Positioning	A	A
Factor 2: Operation Environment (16%)		
a) Regulatory and Political	Baa	Baa
b) Market Share	Aa	Aa
Factor 3: Financial Policy (5%)		
a) Financial Policy	A	A
Factor 4:Operating Performance (5%)		
a) EBITDA Margin	Aa	Aa
Factor 5: Financial Strength (47%)		
a) Debt / EBITDA	Baa	Baa
b) FCF / Debt	Caa	Caa
c) RCF / Debt	B	B
d) (FFO + Interest Expense) / Interest Expense	Aa	Aa
e) (EBITDA - Capex) / Interest Expense	Ba	Ba
Rating:		
a) Indicated Rating from Grid	Baa2	Baa2
b) Actual Rating Assigned	Baa2	

Note: All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics

Major Shareholders: PLDT's major shareholders are First Pacific Company Limited (FirstPac, unrated) and NTT Communications/ NTT DoCoMo (the NTT Group, Aa3 stable), with effective common shareholdings at March 2016 of approximately 26% and 20% respectively.

In addition, following the Digitel acquisition, about 8% of PLDT is held by JG Summit Holdings (unrated).

We understand that the NTT Group has an existing shareholders' agreement with FirstPac that specifies that the NTT Group should not increase its stake in PLDT beyond 21%.

Moreover, the NTT Group and FirstPac have a right of first refusal over the other's PLDT shares. Furthermore, under its cooperation agreement with PLDT, the NTT Group must give prior approval to any major acquisitions, investments or transactions involving PLDT and its subsidiaries.

In our view, this arrangement partially tempers the risk of PLDT being used as a conduit for FirstPac investments. While no rating uplift is factored into PLDT's rating because of the NTT Group's ownership stake, we view positively the presence of a financially strong investor with the potential to aid technology transfers.

Foreign currency risk: Exposures to US dollar/peso exchange rate movements are partially mitigated by hedging arrangements. Approximately 39% of gross debt was US dollar-denominated as of March 2016. The unhedged portion equates to 13% of total debt, or $0.5 billion, after taking into account PLDT's US dollar cash holdings and currency hedges.

In addition, approximately 17% of PLDT's consolidated service revenues were denominated in and/or linked with the US dollar in 2015.

Ratings

Exhibit 8

Category	Moody's Rating
PHILIPPINE LONG DISTANCE TELEPHONE COMPANY	
Outlook	Stable
Issuer Rating -Dom Curr	Baa2
Senior Unsecured	Baa2

Source: Moody's Investors Service

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