



**MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
For the Six Months Ended June 30, 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 and Practices 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 Php56.177 to US\$1.00, the volume weighted average exchange rate at June 30, 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 and Practices to the accompanying unaudited consolidated financial statements.

Financial Highlights and Key Performance Indicators

(in millions)	<u>June 30,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>	<u>Increase (Decrease)</u>	
	(Unaudited)	(Audited)	<u>Amount</u>	<u>%</u>
Consolidated Balance Sheets				
Total assets	Php263,189	Php265,473	(Php2,284)	(1)
Property, plant and equipment	190,176	194,525	(4,349)	(2)
Cash and cash equivalents and short-term investments	35,656	31,194	4,462	14
Total equity	59,304	48,515	10,789	22
Interest-bearing financial liabilities	146,265	164,489	(18,224)	(11)
Notes payable and long-term debt	131,611	149,088	(17,477)	(12)
Net debt to equity ratio ⁽¹⁾	1.62x	2.43x	–	–
Six Months Ended June 30,				
	<u>2005</u>	<u>2004⁽²⁾</u>	<u>Increase (Decrease)</u>	
		(Unaudited)	<u>Amount</u>	<u>%</u>
Consolidated Statements of Income				
Revenues and other income	Php61,138	Php62,299	(Php1,161)	(2)
Service income	59,522	57,841	1,681	3
Expenses	38,627	46,040	(7,413)	(16)
Income before income tax	22,511	16,259	6,252	38
Net income attributable to equity holders	16,785	12,423	4,362	35
Net income margin	27%	20%	–	–
Consolidated Statements of Cash Flows				
Net cash provided by operating activities	34,619	38,080	(3,461)	(9)
Net cash used in investing activities	2,220	13,435	(11,215)	(83)
Capital expenditures	7,012	11,575	(4,563)	(39)
Net cash used in financing activities	23,996	21,151	2,845	13
Operational Data				
Number of cellular subscribers	20,789,469	16,028,407	4,761,062	30
Number of fixed lines in service	2,137,813	2,201,257	(63,444)	(3)
Number of employees	18,649	17,849	800	4
Exchange Rates				
	<u>Php per US\$</u>	<u>Php per JPY</u>		
June 30, 2005	Php56.177	Php0.5067		
December 31, 2004	56.341	0.5495		
June 30, 2004	56.176	0.5166		
December 31, 2003	55.586	0.5193		

(1) Net debt is derived by deducting cash and cash equivalents and short-term investment from long-term debt.

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

Overview

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

- *Wireless* — wireless telecommunications services provided by Smart Communications, Inc., or Smart, and Pilipino Telephone Corporation, or Piltel, our cellular service providers, and Mabuhay Satellite Corporation, ACeS Philippines

Cellular Satellite Corporation, and Telesat, Inc., our satellite and very small aperture terminal, or VSAT, operators;

- *Fixed Line* — fixed line telecommunications services primarily provided through PLDT. We also provide fixed line services through PLDT'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* to the accompanying unaudited consolidated financial statements.

We registered total revenues and other income of Php61,138 million, a decrease of Php1,161 million in the first half of 2005 as compared to Php62,299 million in the same period in 2004 primarily due to the Php2,944 million decline in our non-service wireless revenues, partially offset by Php1,681 million net increase in our service revenues. Total service revenues increased by 3% in the first half of 2005 compared to the same period in 2004.

Expenses decreased by Php7,413 million, or 16%, to Php38,627 million in the first half of 2005 from Php46,040 million in the same period in 2004 largely resulting from decreases in financing costs mostly driven by the appreciation of the peso against the U.S. dollar and Japanese yen and lower cost of sales.

With the expiration of Smart's income tax holiday in May 2004, we recognized a higher provision for income tax of Php5,694 million for the first half of 2005 as compared to Php3,811 million in the same period in 2004.

As a result of the foregoing, our net income attributable to equity holders increased by Php4,362 million, or 35%, to Php16,785 million in the first half of 2005 from Php12,423 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 June 30, 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 exceed 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 for 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 Six Months Ended June 30, 2004
(in millions, except per share amounts)	
Net income, as previously reported	Php12,008
PAS 16 – Property, Plant and Equipment	(34)
PAS 17 – Leases	1
PAS 19 – Employee Benefits	(15)
PAS 21 – The Effects of Changes in Foreign Exchange Rates	1,226
PAS 27 – Consolidated and Separate Financial Statements	840
PAS 32 – Financial Instruments: Disclosure and Presentation	(647)
PAS 39 – Financial Instruments: Recognition and Measurement	(830)
PAS 40 – Investment Property	(7)
PFRS 2 – Share-Based Payment	(93)
PFRS 3 – Business Combinations, PAS 36 – Impairment of Assets and PAS 38 – Intangible Assets	(26)
Net income, as restated	<u>Php12,423</u>

For the Six Months
Ended June 30,
2004

Earnings per common share, as previously reported	Php65.62
Earnings per share impact of restated items:	
PAS 16 – Property, Plant and Equipment	(0.20)
PAS 17 – Leases	0.01
PAS 19 – Employee Benefits	(0.09)
PAS 21 – The Effects of Changes in Foreign Exchange Rates	7.17
PAS 27 – Consolidated and Separate Financial Statements	4.95
PAS 32 – Financial Instruments: Disclosure and Presentation	(3.04)
PAS 39 – Financial Instruments: Recognition and Measurement	(4.90)
PAS 40 – Investment Property	(0.04)
PFRS 2 – Share-Based Payment	(0.55)
PFRS 3 – Business Combinations, PAS 36 – Impairment of Assets and PAS 38 – Intangible Assets	(0.15)
Earnings per common share, as restated	Php68.78

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 Php698 million (Php475 million after tax effect) for the six months ended June 30, 2005.

For a detailed discussion regarding changes in accounting policies, please refer to *Note 2 – Summary of Significant Accounting Policies and Practices* 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 six months ended June 30, 2005 and 2004. Most of our revenues are derived from our operations within the Philippines.

(in millions)	<u>Wireless</u>	<u>Fixed Line</u>	<u>ICT</u>	<u>Inter-segment Transactions</u>	<u>Total</u>				
For the six months ended June 30, 2005 (Unaudited)									
Revenues and other income	Php38,051	Php24,336	Php1,587	(Php2,836)	Php61,138				
Service	36,703	24,214	1,328	(2,723)	59,522				
Non-service	1,291	–	215	(84)	1,422				
Other income	57	122	44	(29)	194				
Expenses	20,459	19,486	1,518	(2,836)	38,627				
Income before tax	17,592	4,850	69	–	22,511				
Net income attributable to equity holders	13,324	3,378	83	–	16,785				
For the six months ended June 30, 2004⁽¹⁾ (Unaudited)									
Revenues and other income	38,353	24,215	1,127	(1,396)	62,299				
Service	33,983	24,108	953	(1,203)	57,841				
Non-service	4,235	–	161	(85)	4,311				
Other income	135	107	13	(108)	147				
Expenses	23,055	23,307	1,074	(1,396)	46,040				
Income before tax	15,298	908	53	–	16,259				
Net income attributable to equity holders	11,735	638	50	–	12,423				
Increase (Decrease)									
Revenues and other income	(Php302)	(1)	Php121	–	Php460	41	(Php1,440)	(Php1,161)	(2)
Service	2,720	8	106	–	375	39	(1,520)	1,681	3
Non-service	(2,944)	(70)	–	–	54	34	1	(2,889)	(67)
Other income	(78)	(58)	15	14	31	238	79	47	32
Expenses	(2,596)	(11)	(3,821)	(16)	444	41	(1,440)	(7,413)	(16)
Income before tax	2,294	15	3,942	434	16	30	–	6,252	38
Net income attributable to equity holders	1,589	14	2,740	429	33	66	–	4,362	35

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

Wireless

Revenues and Other Income

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



The following table summarizes our service and non-service revenues and other income from our wireless business for the six months ended June 30, 2005 and 2004 by service segment:

	Six months ended June 30,					
	2005		2004 ⁽¹⁾		Increase (Decrease)	
	Amount	%	Amount	%	Amount	%
	(Unaudited)					
(in millions)						
Wireless services:						
Service Revenues						
Cellular	Php35,448	93	Php32,973	86	Php2,475	8
Satellite, VSAT, wireless broadband and others	1,255	3	1,010	3	245	24
	<u>36,703</u>	<u>96</u>	<u>33,983</u>	<u>89</u>	<u>2,720</u>	<u>8</u>
Non-service Revenues						
Sale of handsets and SIM-packs	1,291	4	4,235	11	(2,944)	(70)
Other Income	57	–	135	–	(78)	(58)
Total Wireless Revenues and Other Income	<u>Php38,051</u>	<u>100</u>	<u>Php38,353</u>	<u>100</u>	<u>(Php302)</u>	<u>(1)</u>

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

Service Revenues

Our wireless service revenues increased by Php2,720 million, or 8%, to Php36,703 million in the first half of 2005 compared to Php33,983 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 wireless revenues and other income, service revenues increased to 96% in the first half of 2005 from 89% 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 half of 2005 amounted to Php35,448 million, an increase of Php2,475 million, or 8%, from Php32,973 million in the same period in 2004. Cellular service revenues accounted for 97% of wireless service revenues in the first half of 2005 and 2004.

As at June 30, 2005, Smart and Piltel cellular subscribers reached 20,789,469, an increase of 4,761,062, or 30%, over the combined cellular subscriber base of 16,028,407 as at June 30, 2004. Prepaid subscribers accounted for 99% and 98% of our total subscriber base as at June 30, 2005 and 2004, respectively. Prepaid net subscriber activations totaled 1,587,478 in the first half of 2005, or a monthly average addition of 264,580 subscribers. Postpaid subscribers totaled 268,253 subscribers, reflecting a net reduction of 6,241 in the first half of 2005.

Smart markets nationwide cellular communications services under the brand names *Smart Buddy*, *Smart Gold*, *addict mobile*, *addict mobile prepaid*, or *amp*, *Smart Infinity*, *Smart Kid* and *Smart Kid prepaid*. *Smart Buddy*, *addict mobile prepaid* 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.

On August 1, 2004, Smart launched *Smart Padala*, one of the many innovative initiatives from our *Smart Money* platform. *Smart Padala* is the first cash remittance service through text and is faster and cheaper than traditional remittance arrangements. It was launched initially as an international remittance service for overseas Filipino workers but is now available for domestic remittances as well.

In order to test the apparent market demand for fixed rate or "bucket" plans for voice and text services, Smart launched from March 11, 2005 the *Smart 25⁸ Unlimited Call and Text* promotion wherein Smart and *Talk 'N Text* prepaid subscribers had the option for the duration of the promotion, to register for unlimited on-network (Smart-to-Smart) voice calls or unlimited on-network (Smart-to-Smart) text messaging service. Available as a promotion for 30 days initially, *Smart 25⁸* has since been extended and modified as follows:

- On April 22, 2005, *Smart 25⁸ Unlimited Call and Text* promotions were modified as follows:
 - the *Smart 25⁸ Unlimited Call* Php115 load are valid for seven days with a maximum call duration of three minutes for peak hours which is from 6:01am to 11pm and five minutes for off-peak hours beginning 11:01pm to 6am;
 - the *Smart 25⁸ Unlimited Text* Php60 load are valid for four days; and
 - subscribers could avail of *Smart 25⁸ Unlimited Call and Text* simultaneously.
- On July 31, 2005, *Smart 25⁸ Unlimited Text* added a Php30 load, which is only valid for two days.

We had 1.4 million subscribers registered under the *Smart 25⁸ Unlimited Text* promotion as of June 30, 2005.



The following table summarizes key measures of our cellular business as at and for the six months ended June 30, 2005 and 2004:

(in millions)	Six months ended June 30,			
	2005	2004	Increase	
			Amount	%
	(Unaudited)			
Cellular service revenues	Php35,448	Php32,973	Php2,475	8
<i>By component</i>	<i>34,546</i>	<i>32,174</i>	<i>2,372</i>	<i>7</i>
Voice	17,105	16,636	469	3
Data	17,441	15,538	1,903	12
<i>By service type</i>	<i>34,546</i>	<i>32,174</i>	<i>2,372</i>	<i>7</i>
Prepaid	32,439	30,146	2,293	8
Postpaid	2,107	2,028	79	4
<i>Others⁽¹⁾</i>	<i>902</i>	<i>799</i>	<i>103</i>	<i>13</i>

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

	As at June 30,			
	2005	2004	Increase (Decrease)	
			Amount	%
	(Unaudited)			
Cellular subscriber base	20,789,469	16,028,407	4,761,062	30
Prepaid	20,521,216	15,754,873	4,766,343	30
Smart	15,556,780	12,200,978	3,355,802	28
Piltel	4,964,436	3,553,895	1,410,541	40
Postpaid	268,253	273,534	(5,281)	(2)

	Six months ended June 30,			
	2005	2004	Increase	
			Amount	%
	(Unaudited)			
Systemwide traffic volumes ⁽¹⁾ (in millions)				
Calls (in minutes)	2,647	2,448	199	8
Domestic	1,912	1,764	148	8
International	735	684	51	7
Inbound	649	601	48	8
Outbound	86	83	3	4
Text messages	20,778	20,312	466	2
Smart	16,971	16,774	197	1
Piltel	3,807	3,538	269	8

(1) Excludes traffic volumes relating to Smart 25⁸ Unlimited Call and Text promotions.

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 Php469 million, or 3%, to Php17,105 million in the first half of 2005 from Php16,636 million in the same period in 2004 mainly due to an increase in subscriber base which compensated for a 24% drop in the average

voice usage per subscriber from 21 minutes per month in the first half of 2004 to 16 minutes per month in the same period in 2005.

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 Php1,903 million, or 12%, to Php17,441 million in the first half of 2005 from Php15,538 million in the same period in 2004. Cellular data services accounted for 49% of cellular service revenues in the first half of 2005, compared to 47% in the same period in 2004.

The following table shows the breakdown of cellular data revenues for the six months ended June 30, 2005 and 2004:

	Six months ended June 30,			
	2005	2004	Increase (Decrease)	
		(Unaudited)	Amount	%
(in millions)				
Text messaging				
Domestic	Php14,832	Php13,192	Php1,640	12
International	856	947	(91)	(10)
	<u>15,688</u>	<u>14,139</u>	<u>1,549</u>	<u>11</u>
Value-added services				
Non-Zed ⁽¹⁾	1,138	761	377	50
<i>Smart Zed</i> TM	287	293	(6)	(2)
<i>Smart Money</i>	47	20	27	135
Mobile Banking	3	1	2	200
Roaming SMS and WAP	278	324	(46)	(14)
	<u>1,753</u>	<u>1,399</u>	<u>354</u>	<u>25</u>
Total	<u>Php17,441</u>	<u>Php15,538</u>	<u>1,903</u>	<u>12</u>

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

Text messaging-related services contributed revenues of Php15,688 million in the first half of 2005, an increase of 11%, compared to Php14,139 million in the same period in 2004, and accounted for 90% and 91% of the total cellular data revenues for the first half of 2005 and 2004, respectively. The increase in revenues from text messaging-related services resulted mainly from an increase in domestic text messaging owing to the introduction of *Smart 25⁸ Unlimited Text* promotion in March 2005. Value-added services contributed revenues of Php1,753 million in the first half of 2005, increasing by Php354 million, or 25%, from Php1,399 million in the same period in 2004 as a result of a significant increase in ringtone/caller ringtones download activity as well as increased usage emanating from *Smart Padala*.

Subscriber Base, ARPU and Churn Rates

Prepaid subscribers accounted for approximately 99% of our 20,789,469 subscribers as at June 30, 2005, while postpaid subscribers accounted for the remaining 1%. The cellular prepaid subscriber base grew by 30% to 20,521,216 as at June 30, 2005 from 15,754,873 as at June 30, 2004, whereas postpaid subscriber base decreased by 2% to 268,253 as at June 30, 2005 from



273,534 as at June 30, 2004.

Our net subscriber activations (reductions) for the first half of 2005 and 2004 are as follows:

	Six months ended June 30,			
	2005	2004	Decrease	
			Amount	%
Prepaid	1,587,478	3,056,653	(1,469,175)	(48)
Smart	1,235,492	2,369,843	(1,134,351)	(48)
Piltel	351,986	686,810	(334,824)	(49)
Postpaid	(6,241)	24,557	(30,798)	(125)
Total	1,581,237	3,081,210	(1,499,973)	(49)

Our quarterly net subscriber activations (reductions) for the four quarters of 2004 and first two quarters of 2005 are as follows:

	2004				2005	
	1Q	2Q	3Q	4Q	1Q	2Q
Prepaid	1,380,339	1,676,314	1,433,664	1,745,201	1,050,638	536,840
Smart	1,162,301	1,207,542	797,686	1,322,624	920,885	314,607
Piltel	218,038	468,772	635,978	422,577	129,753	222,233
Postpaid	16,866	7,691	10,445	(9,485)	(6,357)	116
Total	1,397,205	1,684,005	1,444,109	1,735,716	1,044,281	536,956

Revenues attributable to our cellular prepaid service amounted to Php32,439 million in the first half of 2005, an 8% increase over the Php30,146 million earned in the same period in 2004. Prepaid service revenues in the first half of 2005 and 2004 accounted for 94% of voice and data revenues. Revenues attributable to Smart's postpaid service amounted to Php2,107 million in the first half of 2005, a 4% increase over the Php2,028 million earned in the same period in 2004. Postpaid service revenues in the first half of 2005 and 2004 accounted for 6% of voice and data revenues.

The following table summarizes our cellular ARPUs for the six months ended June 30, 2005 and 2004:

	Six months ended June 30,							
	Gross		Increase (Decrease)		Net		Increase (Decrease)	
	2005	2004	Amount	%	2005	2004	Amount	%
	(Unaudited)							
Prepaid								
Smart	Php357	Php459	(Php102)	(22)	Php292	Php381	(Php89)	(23)
Piltel	266	341	(75)	(22)	216	288	(72)	(25)
Prepaid – Blended	335	433	(98)	(23)	274	361	(87)	(24)
Postpaid – Smart	1,831	1,709	122	7	1,308	1,282	26	2
Prepaid and Postpaid Blended	355	456	(101)	(22)	287	377	(90)	(24)

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 prepaid subscribers in the first half of 2005 was Php357, a decrease of 22%, compared to Php459 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 half of 2005. On a net basis, ARPU in the first half of 2005 decreased by 23% to Php292 from Php381 in the same period in 2004. Gross monthly ARPU for *Talk 'N Text* subscribers in the first half of 2005 was Php266, a decrease of 22% 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 half of 2005. On a net basis, ARPU in the first half of 2005 decreased by 25% to Php216 from Php288 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 7% to Php1,831 while net monthly ARPU increased by 2% to Php1,308, in the first half of 2005 compared to the same period in 2004. Prepaid and postpaid monthly gross blended ARPU was Php355 in the first half of 2005, a decrease of 22% compared to Php456 in the same period in 2004. Monthly net blended ARPU decreased by 24% to Php287 in the first half of 2005 from Php377 in the same period in 2004.

Our quarterly prepaid and postpaid ARPUs for 2005 and 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
Second Quarter	357	294	262	212	1,896	1,360

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; 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. In May 2005, we terminated our “SIM swapping” promotions. As a result, we expect our churn rates to increase significantly in the next few months as the subscribers acquired through “SIM swapping” leave the system.

For Smart prepaid, the average monthly churn rate for the first half of 2005 was 3.4%, compared to 2.0% in the same period in 2004 while the average monthly churn rate for *Talk ‘N Text* subscribers was 4.6% in the first half of 2005 compared to 3.2% in the same period in 2004. The increased churn in our prepaid service can be attributed to the “SIM-swapping” activities described above.

The average monthly churn rate for Smart's postpaid subscribers for the first half of 2005 was 2.3%, compared to 0.4% 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, Wireless Broadband and Other Services

Our revenues from satellite, VSAT, wireless broadband and other services consist mainly of rentals received for the lease of Mabuhay Satellite's transponders and Telesat's VSAT facilities to other companies, wireless broadband service revenues for Meridian, 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 half of 2005 amounted to Php1,255 million, an increase of Php245 million, or 24%, from Php1,010 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 Php2,944 million, or 70%, to Php1,291 million in the first half of 2005 as compared to Php4,235 million in the same period in 2004 mainly attributable to lower handset sales. In the first half 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 Php57 million in the first half of 2005, a decrease of Php78 million, or 58%, from Php135 million in the same period in 2004.

Expenses

Expenses associated with our wireless business in the first half of 2005 amounted to Php20,459 million, a decrease of Php2,596 million, or 11%, from Php23,055 million in the same period in 2004. A significant portion of this decrease was attributable to lower cost of sales, financing costs, and depreciation and amortization, partially offset by higher cash expenses particularly rent and maintenance. As a percentage of our total wireless revenues and other income, expenses associated with our wireless business decreased to 54% in the first half of 2005 from 60% in the same period in 2004.

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



The following table summarizes our wireless-related expenses for the six months ended June 30, 2005 and 2004 and the percentage of each expense item to the total:

	Six months ended June 30,					
	2005		2004 ⁽¹⁾		Increase (Decrease)	
	Amount	%	Amount	%	Amount	%
	(Unaudited)					
(in millions)						
Wireless services						
Depreciation and amortization	Php4,970	24	Php5,779	25	(Php809)	(14)
Cost of sales	3,271	16	6,599	28	(3,328)	(50)
Rent	2,255	11	1,071	5	1,184	111
Compensation and benefits ⁽²⁾	1,890	9	1,781	8	109	6
Selling and promotions	1,702	8	1,598	7	104	7
Maintenance	1,617	8	1,163	5	454	39
Financing costs	1,214	6	2,079	9	(865)	(42)
Taxes and licenses	667	3	417	2	250	60
Professional and other service fees	595	3	485	2	110	23
Insurance and security services	492	3	443	2	49	11
Provisions	437	2	608	3	(171)	(28)
Other expenses	1,349	7	1,032	4	317	31
Total	Php20,459	100	Php23,055	100	(Php2,596)	(11)

- (1) As restated to reflect the effects of the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies and Practices 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 Php809 million, or 14%, to Php4,970 million in the first half 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 Php336 million for the first half of 2005. See Note 2 – Summary of Significant Accounting Policies and Practices to the accompanying unaudited consolidated financial statements.

Cost of sales decreased by Php3,328 million, or 50%, to Php3,271 million as activations in the first half of 2005 were driven more by SIM-pack sales and SIM-swap activities compared to handset sales in the same period in 2004. The breakdown of cost of sales for our wireless business for the six months ended June 30, 2005 and 2004 is as follows:

	Six months ended June 30,			
	2005	2004	Increase (Decrease)	
	Amount	Amount	Amount	%
	(Unaudited)			
Cost of cellular handsets and SIM-packs sold	Php3,149	Php6,478	(Php3,329)	(51)
Cost of satellite air time and terminal units	122	121	1	1
	Php3,271	Php6,599	(Php3,328)	(50)

Rent expenses increased by Php1,184 million, or 111%, to Php2,255 million on account of an increase in the number of leased lines, transmission links and higher cell site space rentals for the increased number of cell sites. As at June 30, 2005, we had 4,148 cell sites and 5,573 base stations, compared with 3,494 cell sites and 4,565 base stations as at June 30, 2004.

Compensation and benefits increased by Php109 million, or 6%, to Php1,890 million primarily due to an increase in headcount, salaries and performance bonuses of Smart's employees. Smart's employee headcount increased by 4% to 5,105 as at June 30, 2005 from 4,903 as at June 30, 2004.

Selling and promotion expenses increased by Php104 million, or 7%, to Php1,702 million due to advertising and promotions costs incurred to attract new subscriptions and retain existing subscribers.

Maintenance expenses increased by Php454 million, or 39%, to Php1,617 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 half of 2005 amounted to Php1,214 million, a decrease of Php865 million, or 42%, from Php2,079 million in the same period in 2004, primarily as a result of a 0.3% and 8% appreciation of the average of the peso to the U.S. dollar and Japanese yen, respectively, from December 31, 2004 to June 30, 2005. Foreign exchange losses were recorded in the same period in 2004 with the peso depreciation against the U.S. dollar by 1%, partially offset by approximately 1% peso appreciation against the Japanese yen from December 31, 2003 to June 30, 2004. In addition, interest income increased due to higher cash balances in 2005 as compared to 2004. The breakdown of our financing costs for wireless business for the six months ended June 30, 2005 and 2004 is as follows:

	Six months ended June 30,			
	2005	2004	Change	
		(Unaudited)	Amount	%
Accretion on financial liabilities	Php1,303	Php1,315	(Php12)	(1)
Interest on loans and related items	905	904	1	-
Foreign exchange losses (gains) – net	(772)	219	(991)	(453)
Interest income	(543)	(367)	(176)	(48)
Loss (gain) on derivative transactions – net	148	(84)	232	276
Dividends on preferred stock subject to mandatory redemption	132	117	15	13
Financing charges	48	27	21	78
Capitalized interest	(7)	(52)	45	87
	<u>Php1,214</u>	<u>Php2,079</u>	<u>(Php865)</u>	<u>(42)</u>

Taxes and licenses increased by Php250 million, or 60%, to Php667 million mainly due to an increase in Smart's business-related taxes.

Professional and other service fees increased by Php110 million, or 23%, to Php595 million mainly as a result of increased technical service, consultancy and payment facility fees.

Insurance and security services increased by Php49 million, or 11%, to Php492 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 Php171 million, or 28%, to Php437 million mainly due to a lower carrier receivable balances as of June 30, 2005 as a result of significant settlements made during 2004 and the first quarter of 2005. The breakdown of provisions for the six months ended June 30, 2005 and 2004 is as follows:

	Six months ended June 30,			
	2005	2004	Increase (Decrease)	
		(Unaudited)	Amount	%
Doubtful accounts	Php112	Php480	(Php368)	(77)
Write-down of inventories at net realizable value	325	128	197	154
	<u>Php437</u>	<u>Php608</u>	<u>(Php171)</u>	<u>(28)</u>

Other expenses increased by Php317 million, or 31%, to Php1,349 million due to various business and operational-related expenses such as facility usage fees, travel, training, communication and delivery expenses and the amortization of intangible assets.

Provision for Income Tax

Provision for income tax increased by Php688 million, or 19%, to Php4,217 million in the first half of 2005 from Php3,529 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 net tax loss to net tax payable. In the first half of 2005, the effective tax rate for our wireless business after the reversal of the deferred tax asset in the utilized portion of Piltel's NOLCO and the release of certain valuation allowances was 24% compared to 23% 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 Php13,324 million in the first half of 2005, an increase of Php1,589 million, or 14%, over Php11,735 million registered in the same period in 2004 due primarily to the growth in our cellular revenues, augmented by an 11% 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. Total fixed line revenues generated from our fixed line business in the first half of 2005 totaled Php24,336 million, an increase of Php121 million from Php24,215 million in the same period in 2004.

The following table summarizes revenues from our fixed line business for the six months ended June 30, 2005 and 2004 by service segment:

	Six months ended June 30,					
	2005		2004 ⁽¹⁾		Increase (Decrease)	
	Amount	%	Amount	%	Amount	%
(Unaudited)						
(in millions)						
Fixed line services:						
Service Revenues						
Local exchange	Php10,227	42	Php10,591	44	(Php364)	(3)
International long distance	6,253	26	6,454	27	(201)	(3)
National long distance	2,538	10	3,554	15	(1,016)	(29)
Data and other network	4,589	19	3,036	12	1,553	51
Miscellaneous	607	2	473	2	134	28
	24,214	99	24,108	100	106	–
Other Income	122	1	107	–	15	14
Total Fixed Line Revenues and Other Income	Php24,336	100	Php24,215	100	Php121	–

(1) As restated to reflect the effects of the changes in accounting policies, as discussed in Note 2 – Summary of Significant Accounting Policies and Practices 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 six months ended June 30, 2005 and 2004:

	Six months ended June 30,			
	2005	2004	Increase (Decrease)	
			Amount	%
	(Unaudited)			
Total local exchange service revenues (in millions)	Php10,227	Php10,591	(Php364)	(3)
Number of fixed lines in service	2,137,813	2,201,257	(63,444)	(3)
Number of fixed line employees	9,582	10,197	(615)	(6)
Number of fixed lines in service per employee	223	216	7	3

Revenues from our local exchange service decreased by Php364 million, or 3%, to Php10,227 million in the first half of 2005 from Php10,591 million in the same period in 2004. The decrease was primarily due to the 3% decline in number of fixed lines in service 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 decreased to 42% in the first half of 2005 compared to 44% in the same period in 2004.

Fixed line net reduction in the first half of 2005 was 14,214 as against net additions of 11,862 in the same period in 2004. While fixed line additions totaled 1,391 for postpaid fixed line services, prepaid fixed lines in service declined by 15,605 in the first half of 2005. As at June 30, 2005, postpaid and prepaid fixed line subscribers totaled 1,784,582 and 353,231, respectively, which accounted for approximately 83% and 17%, respectively, of our 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 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 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 half of 2005, we implemented four downward adjustments in our monthly local service rates compared to four upward adjustments and one downward adjustment in the same period in 2004. The average Philippine peso to U.S. dollar rate factored in our monthly local service rates in the first half of 2005 was Php54.94 to US\$1.00, compared to the average of Php55.75 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 1.5%, which resulted in an average net decrease of 1.4% in our monthly local service rates in the first half 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 six months ended June 30, 2005 and 2004:

	Six months ended June 30,			
	2005	2004	Increase (Decrease)	
			Amount	%
	(Unaudited)			
Total international long distance service revenues (in millions)	Php6,253	Php6,454	(Php201)	(3)
Inbound	5,165	5,218	(53)	(1)
Outbound	1,088	1,236	(148)	(12)
International call volumes (in million minutes, except call ratio)	1,155	1,159	(4)	-
Inbound	1,084	1,083	1	-
Outbound	71	76	(5)	(7)
Inbound-outbound call ratio	15.3:1	14.3:1	-	-

Our total international long distance service revenues decreased by Php201 million, or 3%, to Php6,253 million in the first half of 2005 from Php6,454 million in the same period in 2004. The percentage contribution of international long distance service revenues to our fixed line service revenues decreased to 26% in the first half of 2005 from 27% in the same period in 2004.

Our revenues from inbound international long distance service decreased by Php53 million, or 1%, to Php5,165 million in the first half of 2005 from Php5,218 million in the same period in 2004 primarily due to the peso appreciation in 2005. Our inbound international long distance call volumes in the first half of 2005 increased by 1 million minutes to 1,084 million minutes from 1,083 million minutes in the same period in 2004, largely due to an increase in transit calls.

The 2% appreciation of the average of the peso to the U.S. dollar from Php54.835 during the first half of 2005 compared to Php55.952 during the same period in 2004 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 Php148 million, or 12%, to Php1,088 million in the first half of 2005 from Php1,236 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 7% in the first half 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 six months ended June 30, 2005 and 2004:

	<u>Six months ended June 30,</u>			
	<u>2005</u>	<u>2004</u>	<u>Increase (Decrease)</u>	
			<u>Amount</u>	<u>%</u>
		(Unaudited)		
Total national long distance service revenues (in millions)	Php2,538	Php3,554	(Php1,016)	(29)
National long distance call volumes (in million minutes)	995	969	26	3

Our national long distance service revenues decreased by Php1,016 million, or 29%, to Php2,538 million in the first half of 2005 from Php3,554 million in the same period in 2004 as a result of: (1) a decrease in average revenue per minute brought about by our Php10 per call promotion starting February 14, 2005; and (2) 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 10% for the first half of 2005 compared to 15% in the same period in 2004.

On February 14, 2005, we launched a Php10 per call promotion to any PLDT landline subscriber nationwide and to all Smart and *Talk N' Text* subscribers. This promotion was launched with the objective of determining a more effective tariff structure that would stimulate landline usage. Under the promotion, 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.

On May 12, 2005, PLDT began offering the Php10 per call promotion with an additional Php5 per call for the same unlimited talktime to Smart and *Talk 'N Text* subscribers. PLDT to PLDT NDD calls below the equivalent Php10 toll usage are charged based on the regular rate per minute.

Our national long distance call volumes increased by approximately 3% to 995 million minutes in the first half of 2005 from 969 million minutes in the same period in 2004. This was mainly due to the Php10 per call promotion currently being offered to PLDT landline subscribers nationwide.

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 half of 2005 posted revenues of Php4,589 million, an increase of Php1,553 million, or 51%, from Php3,036 million in the same period in 2004. The revenue contribution of this service segment to our fixed line service revenues increased to 19% in the first half of 2005 from 12% in the same period in 2004.

Data and other network services we currently provide include leased lines, IP-based, packet-based and switch-based 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 half 2005 revenues, leased lines accounted for 53%, IP-based services accounted for 30%, packet-based services accounted for 12% and switched-based services accounted for the remaining 5%, compared to 51%, 25%, 16% and 8%, respectively, in the same period in 2004. These percentage increases 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 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 June 30, 2005, the number of PLDT's fixed line subscribers for *PLDT Vibe* stood at 449,685, of which 161,899 are exclusive postpaid users, 211,917 are exclusive prepaid users, and 75,869 are both postpaid and prepaid users. As at June 30, 2004, *PLDT Vibe* subscribers totaled 299,950, of which 136,591 were exclusive postpaid users, 119,265 were exclusive prepaid users, and 44,094 were both postpaid and prepaid users. In addition, *PLDT DSL* has reached 68,827 subscribers as at June 30, 2005 compared with 33,576 subscribers during the same period of 2004. I-Gate subscription grew by 84% from a base of 93 as at June 2004 to 171 as of the first half of 2005.

The continued growth in data services revenues can be attributed to several product offerings. 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 half of 2005, these revenues increased by Php134 million, or 28%, to Php607 million from Php473 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 remained flat at 2% of our fixed line service revenues in the first half 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 Php15 million, or 14%, to Php122 million in the first half of 2005 from Php107 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 half of 2005 totaled Php19,486 million, a decrease of Php3,821 million, or 16%, compared to Php23,307 million in the same period in 2004. The decrease was primarily due to lower financing costs partially offset by higher depreciation and amortization, selling and promotions, and compensation and benefits expenses. As a percentage of our total fixed line revenues, fixed line-related expenses decreased to 80% in the first half of 2005, compared to 96% in the same period in 2004.



The following table shows the breakdown of our total fixed line-related expenses for the six months ended June 30, 2005 and 2004 and the percentage of each expense item to the total:

	Six months ended June 30,					
	2005		2004 ⁽¹⁾		Increase (Decrease)	
	Amount	%	Amount	%	Amount	%
	(Unaudited)					
(in millions)						
Fixed line services:						
Depreciation and amortization	Php5,704	29	Php5,000	21	Php704	14
Compensation and benefits ⁽²⁾	3,977	20	3,823	16	154	4
Financing costs	3,127	16	7,799	33	(4,672)	(60)
Maintenance	1,718	9	1,665	7	53	3
Provisions	1,531	8	1,568	7	(37)	(2)
Selling and promotions	866	5	632	3	234	37
Rent	860	4	871	4	(11)	(1)
Professional and other service fees	464	2	535	2	(71)	(13)
Taxes and licenses	349	2	344	2	5	1
Insurance and security services	329	2	364	2	(35)	(10)
Asset impairment	–	–	85	–	(85)	(100)
Other expenses	561	3	621	3	(60)	(10)
Total	Php19,486	100	Php23,307	100	(Php3,821)	(16)

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

(2) Includes salaries and benefits, incentive plan, pension and MRP costs.

Depreciation and amortization charges increased by Php704 million, or 14%, to Php5,704 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 Php362 million for the first half of 2005.

Compensation and benefits increased by Php154 million, or 4%, to Php3,977 million mainly due to the effect of the 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.

Financing costs decreased by Php4,672 million, or 60%, to Php3,127 million due to: (1) the strengthening of the peso relative to the U.S. dollar and Japanese yen resulting in foreign exchange gains in the first half of 2005 as compared to foreign exchange losses recorded during the first half of 2004; (2) recorded gains on derivatives in the first half of 2005 as compared to recorded losses on derivatives in the first half of 2004; and (3) lower interest on loans and related items owing to lower debt balances in the first half of 2005 compared with the same period in 2004. The breakdown of our financing costs for our fixed line business for the six months ended June 30, 2005 and 2004 is as follows:

	Six months ended June 30,			
	2005	2004	Change	
			Amount	%
		(Unaudited)		
Interest on loans and related items	Php4,737	Php5,574	(Php837)	(15)
Loss (gains) on derivative transactions – net	(1,335)	589	(1,924)	(327)
Foreign exchange losses (gains) – net	(603)	1,177	(1,780)	(151)
Hedge cost	557	567	(10)	(2)
Capitalized interest	(196)	(250)	54	22
Interest income	(193)	(98)	(95)	(97)
Accretion on financial liabilities	134	181	(47)	(26)
Financing charges	26	59	(33)	(56)
	<u>Php3,127</u>	<u>Php7,799</u>	<u>(Php4,672)</u>	<u>(60)</u>

Maintenance expenses increased by Php53 million, or 3%, to Php1,718 million primarily due to higher maintenance costs for foreign cable and wire facilities as more operating and maintenance-related restorations were incurred in the first half of 2005 as compared to the same period in 2004.

Provisions decreased by Php37 million, or 2%, to Php1,531 million primarily on account of a lower provision for onerous contracts by PLDT as a result of the peso appreciation partially offset by an increase in our provision for doubtful accounts. 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 half of 2005 and 2004 was equivalent to 6% of its service revenues. The breakdown of provisions for our fixed line business for the six months ended June 30, 2005 and 2004 is as follows:

	Six months ended June 30,			
	2005	2004	Increase (Decrease)	
			Amount	%
		(Unaudited)		
Doubtful accounts	Php1,414	Php1,395	Php19	1
Onerous contracts	117	173	(56)	(32)
	<u>Php1,531</u>	<u>Php1,568</u>	<u>(Php37)</u>	<u>(2)</u>

Selling and promotion expenses increased by Php234 million, or 37%, to Php866 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.

Rent expenses decreased by Php11 million, or 1%, to Php860 million due to a decrease in international leased circuits and rental for bundled sales/value added service units.

Professional and other service fees decreased by Php71 million, or 13%, to Php464 million due to a decrease in number of consultants coupled with lower legal fees in the first half of 2005 for various services, partially offset by an increase in collection agency fees.

Taxes and licenses increased by Php5 million, or 1%, to Php349 million mainly on account of higher business-related taxes paid in the first half of 2005 as compared to the same period in 2004.

Insurance and security services decreased by Php35 million, or 10%, to Php329 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 half of 2004; no impairment charge was recognized in the first half of 2005.

Other expenses decreased by Php60 million, or 10%, to Php561 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 Php1,187 million to Php1,471 million in the first half of 2005 from Php284 million in the same period in 2004 due to higher income subject to tax. In the first half of 2005, our effective tax rate was 30%. Our effective tax rate was lower than the 32% statutory corporate tax rate due to 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 half of 2005, our fixed line business segment contributed a net income of Php3,378 million, compared to Php638 million in the same period in 2004 mainly as a result of a decrease in fixed line-related expenses by 16% particularly financing costs.

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 half of 2005, our information and communications technology business generated revenues of Php1,587 million, an increase of Php460 million, or 41%, from Php1,127 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 six months ended June 30, 2005 and 2004 by service segment:

	Six months ended June 30,					
	2005		2004 ⁽¹⁾		Increase	
	Amount	%	Amount	%	Amount	%
	(Unaudited)					
Service Revenues						
Call center	Php836	53	Php551	49	Php285	52
Internet and gaming	287	18	276	25	11	4
<i>Vitro</i> TM data center	173	11	100	9	73	73
Others	32	2	26	2	6	23
	<u>1,328</u>	<u>84</u>	<u>953</u>	<u>85</u>	<u>375</u>	<u>39</u>
Non-service Revenues						
Point of Product Sales	215	13	161	14	54	34
Other Income	44	3	13	1	31	238
Total ICT Revenues and Other Income	<u>Php1,587</u>	<u>100</u>	<u>Php1,127</u>	<u>100</u>	<u>Php460</u>	<u>41</u>

Call Center

We are focused on developing our call center business which capitalizes on the availability of English-speaking college graduates in the Philippines with a strong customer service orientation. 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 1,300-seat call center facility with 890 customer service representatives, or CSRs, providing customer and technical support to its clients in the Philippines, U.S. and U.K.;
- Parlance Systems, Inc., or Parlance, which owns and operates a 1,230-seat call center facility with 1,300 CSRs exclusively for one of the largest direct-to-home satellite service providers in the United States for customer support and billing requirements; Parlance is expanding with another 670-seat call center facility in Mandaluyong City which is expected to be completed in December 2005; and
- ePLDT Ventus, Inc., or Ventus, which owns a 400-seat call center facility located in Iloilo province and commenced commercial operations in March 2005. CSR headcount in Ventus-Iloilo reflected seasonal swings from a core of 50 CSRs to a high of 350 CSRs in the first half of 2005, as the company addressed seasonal requirements of its client. Ventus will be expanding in Metro Manila with a 270-seat call center facility in Makati and a 640-seat call center facility in Ortigas, Pasig City to accommodate current and new client requirements. These facilities are expected to be completed by October 2005 and January 2006, respectively.

In addition, domestic call center projects are being undertaken by ePLDT which operates an 80-seat facility in Makati and a 180-seat facility in Quezon City, with a combined headcount of 330 CSRs. The total seat count of each facility covers workstations of CSRs and business support units that are intrinsic to the delivery of the business.

Call center revenues consist of:

- inbound calls for customer care, product inquiries, sales and technical support based on active minutes, billable hours and full-time equivalents;
- outbound calls for sales and collections based on active minutes, billable hours and full-time equivalents; 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 half of 2005 increased by Php285 million, or 52%, to Php836 million from Php551 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;
- an upward price adjustment by Parlance for its inbound and outbound projects, coupled with an increase in the number of registered minutes;
- continuous ramp up of CSRs by 868, or 50%, from a total of 1,730 in the first half of 2004 to 2,598 in the same period in 2005; and
- commencement of Ventus operations in Iloilo in March 2005.

Call center revenues accounted for 63% and 58% of total information and communications technology service revenues in the first half 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 through DSL, web consulting and development, hosting and other value-added services;
- a 69% interest in Digital Paradise, Inc., or DigiPar, an internet café business which assumed the assets of Netopia Computer Technologies, Inc., and the brand *Netopia*. *Netopia* is now one of the largest and fastest growing internet café chains in the country with over 160 branches and over 7,000 work stations. DigiPar offers high-speed internet services, including internet advertising, gaming and printing;
- a 51% interest in Digital Paradise Thailand, Inc., an affiliate of Digital Paradise, Inc. offering similar products and services. Digital Paradise Thailand currently has three branches in addition to its head office all situated in Bangkok, Thailand; and

- a 60% interest in netGames, Inc., a publisher for Massively Multi-player Online Game in the Philippines. netGames 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;
- sales revenues from retailing of prepaid cards for cellular, landline and internet access;
- franchise fees for *Netopia* Internet cafés, including a one-time subscription fee and monthly recurring franchise fees based on certain conditions on the franchise agreement; 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 half of 2005 increased by Php11 million, or 4%, to Php287 million from Php276 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 29% of service revenues from information and communications technology business in the first half of 2005 and 2004, respectively.

*Vitro*TM data center

ePLDT operates an internet data center under the brand name *Vitro*TM. Granted pioneer status as an internet data center by the BOI, *Vitro*TM 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*TM 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 of services; and
- monthly service fees or one-time fees generated from professional services of Vitro's certified professionals.

In the first half of 2005, *Vitro*TM contributed revenues of Php173 million, an increase of Php73 million, or 73%, from Php100 million in the same period in 2004, primarily due to an increase in co-location revenues, server hosting and other services. *Vitro*TM revenues accounted for 13% and 10% of service revenues from information and communications technology business in the first half 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 half of 2005 increased to Php32 million from Php26 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* 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 products, server solutions, networking products, storage products and data security products. In the first half of 2005, non-service revenues generated by our information and communications technology business increased by Php54 million, or 34%, to Php215 million prompted by higher revenues from sales of networking 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 Php44 million in the first half of 2005 from Php13 million in the same period in 2004 owing to Infocom's sale of its *NOW* cable internet business on February 1, 2005.

Expenses

Expenses associated with our information and communications technology business totaled Php1,518 million in the first half of 2005, an increase of Php444 million, or 41%, from Php1,074



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 95% for the first half of 2005 and 2004, respectively.

The following table shows the breakdown of our total information and communications technology-related expenses for the six months ended June 30, 2005 and 2004 and the percentage of each expense item to the total:

	Six months ended June 30,					
	2005		2004 ⁽¹⁾		Increase (Decrease)	
	Amount	%	Amount	%	Amount	%
	(Unaudited)					
(in millions)						
Information and communications technology services:						
Compensation and benefits ⁽²⁾	Php625	41	Php392	36	Php233	59
Rent	208	14	154	14	54	35
Selling and promotions	205	14	158	15	47	30
Depreciation and amortization	187	12	148	14	39	26
Maintenance	149	10	124	12	25	20
Professional and other service fees	36	2	42	4	(6)	(14)
Taxes and licenses	18	1	10	1	8	80
Financing costs	8	1	23	2	(15)	(65)
Insurance and security services	5	—	3	—	2	67
Other expenses	77	5	20	2	57	285
Total	Php1,518	100	Php1,074	100	Php444	41

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

(2) Includes salaries and benefits, incentive plan, pension and MRP costs.

Compensation and benefits increased by Php233 million, or 59%, to Php625 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 Php54 million, or 35%, to Php208 million due to the opening of several *Netopia* branches countrywide and abroad in the first half of 2005.

Selling and promotion expenses increased by Php47 million, or 30%, to Php205 million mainly as a result of the consolidation of DigiPar in June 2004 and the continuous expansion of its *Netopia* branches nationwide in the first half of 2005 compared to the same period in 2004. In addition, selling expenses for *Khan Online* were recognized starting February 2005 when netGames commenced its commercial operations.

Depreciation and amortization charges increased by Php39 million, or 26%, to Php187 million primarily due to an increase in depreciable asset base in relation to the expansion of our call center business and internet and gaming segments.

Maintenance expenses increased by Php25 million, or 20%, to Php149 million primarily due to a change in maintenance agreement which resulted in higher annual maintenance in respect of our digital certificate business.

Professional and other service fees decreased by Php6 million, or 14%, to Php36 million primarily due to lower training and shuttling expenses relating to our call center representatives.

Taxes and licenses increased by Php8 million, or 80%, to Php18 million mainly on account of documentary stamp taxes paid by ePLDT and Ventus in its issuance of additional capital stock in the first half of 2005 as compared to the same period in 2004.

Financing costs decreased by Php15 million, or 65%, to Php8 million due to lower interest expense on loans as debt balances decreased in the first half of 2005 as compared to the same period in 2004.

Insurance and security services increased by Php2 million, or 67%, to Php5 million primarily due to higher premium costs and an increase in the assets insured in the first half of 2005 as compared to same period in 2004.

Other expenses increased by Php57 million, or 285%, to Php77 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 Php6 million was recorded in the first half of 2005 as a substantial portion of our ICT business are under income tax holiday. Benefit from income tax of Php2 million was recognized in the first six months of 2004 due to a tax loss position as non-tax deductible charges were higher during the first half of 2004.

Net Income

In the first half of 2005, our information and communications technology business segment registered a net income of Php83 million compared to a net income of Php50 million posted in the same period in 2004 mainly on account of higher net income contribution of our call center business, partially offset by Infocom's operating loss in 2005 and DigiPar's high operating costs due to expansion.

Liquidity and Capital Resources

The following table shows our consolidated cash flows for the six months ended June 30, 2005 and 2004 as well as consolidated capitalization and other selected financial data as at June 30, 2005 and 2004:

	Six months ended June 30,	
	2005	2004⁽¹⁾
	(Unaudited)	
(in millions)		
Cash Flows		
Net cash provided by operating activities	Php34,619	Php38,080
Net cash used in investing activities	2,220	13,435
Capital expenditures	7,012	11,575
Net cash used in financing activities	23,996	21,151
Net increase in cash and cash equivalents	8,308	3,427
	June 30,	December 31,
	2005	2004
	(Unaudited)	(Audited)
(in millions)		
Capitalization		
Long-term portion of interest-bearing financial liabilities – net of current portion		
Long-term debt	Php102,675	Php121,012
Obligations under capital lease	516	601
Preferred stock subject to mandatory redemption	13,611	14,375
	<u>116,802</u>	<u>135,988</u>
Current portion of interest-bearing financial liabilities		
Notes payable	56	58
Long-term debt maturing within one year	28,880	28,018
Obligations under capital lease maturing within one year	527	425
	<u>29,463</u>	<u>28,501</u>
Total interest-bearing financial liabilities	146,265	164,489
Total equity	59,304	48,515
	<u>Php205,569</u>	<u>Php213,004</u>
Other Financial Data		
Total assets	Php263,189	Php265,473
Property, plant and equipment – net	190,176	194,525
Cash and cash equivalents	35,629	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 and Practices to the accompanying unaudited consolidated financial statements.

As at June 30, 2005, our consolidated cash and cash equivalents totaled Php35,629 million. Principal sources of consolidated cash and cash equivalents in the first half of 2005 were cash flows from operations amounting to Php34,619 million and drawings from Smart's facilities aggregating Php5,471 million. These funds were used principally for capital outlays of Php7,012 million, total debt principal payments of Php22,441 million and interest payments of Php5,671 million.

Operating Activities

Our consolidated net cash flows from operating activities in the first half of 2005 decreased by Php3,461 million, or 9%, to Php34,619 million from Php38,080 million in the same period in 2004 as we settled current liabilities relating to various trade suppliers in the first six months of

2005.

A growing portion of our cash flow is generated by our wireless business, which accounted for 59% and 57% of our service revenues in the first half 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 half of 2005 compared to 41% and 2%, respectively, in the same period in 2004.

Cash flows from operating activities of our wireless business amounted to Php20,540 million in the first half of 2005, a decrease of Php2,431 million, or 11%, compared to Php22,971 million in the same period in 2004. Likewise, our fixed line business contributed Php13,846 million in the first half of 2005, a decrease of Php1,099 million, or 7%, compared to Php14,945 million in the same period in 2004. The decline in both our wireless and fixed line business segments was mainly due to settlement of our outstanding current liabilities in the first half of 2005. Our wireless business segment accounted for 59% of our cash flows from operating activities while our fixed line segment accounted for 41% during the first half 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 June 30, 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 in 2005, amounting to about Php20,000 million, of which Php6,000 million and Php8,000 million was paid by Smart to PLDT in March and June 2005, respectively.

Investing Activities

Net cash used in investing activities in the first half of 2005 amounted to Php2,220 million, a decrease of Php11,215 million, or 83%, compared to Php13,435 million in the same period in 2004. This decrease resulted from the decline in short-term investments and capital expenditures by Php5,784 million and Php4,563 million, respectively.

In the first half of 2005, short-term investments of Php3,847 million matured relating to prepaid forward exchange contracts of Smart. Smart did not book additional prepaid forwards in the first half of 2005; conversely, Smart booked short-term investments of Php1,937 million in the first half of 2004.

Our consolidated capital expenditures in the first half of 2005 totaled Php7,012 million, a decrease of Php4,563 million, or 39%, from Php11,575 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 Php3,569 million in the first half 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 Php3,118 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 Php305 million was used to primarily fund its *Vitro*TM, DigiPar and call center business operations. The balance represented other subsidiaries' capital spending. Consolidated capital expenditures in the first half of 2004 amounted to Php11,575 million, of which

Php8,826 million, Php2,667 million and Php75 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 Php23,996 million for financing activities in the first half of 2005, compared to Php21,151 million in the same period in 2004. The net cash used in financing activities in the first half of 2005 was mainly attributable to debt repayments and interest payments by PLDT in line with its ongoing debt reduction program and dividend payments distributed to common and preferred stockholders.

Debt Financing

Additions to our consolidated long-term debt in the first half 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 Php22,441 million and Php5,671 million, respectively, in the first half of 2005, of which Php13,380 million and Php4,747 million were attributable to PLDT, respectively.

The following table shows our long-term debt, including current portion as at June 30, 2005 and 2004:

(in millions)	<u>June 30,</u>	<u>December 31,</u>	<u>Increase (Decrease)</u>	
	<u>2005</u>	<u>2004</u>	<u>Amount</u>	<u>%</u>
	(Unaudited)	(Audited)		
U.S. Dollar Debt:				
Export Credit Agencies-Supported Loans	Php32,802	Php41,266	(Php8,464)	(21)
Fixed Rate Notes	66,043	68,795	(2,752)	(4)
Term Loans	16,466	20,492	(4,026)	(20)
Restructured Loans	4,917	4,815	102	2
Satellite Acquisition Loans	3,635	4,064	(429)	(11)
	<u>123,863</u>	<u>139,432</u>	<u>(15,569)</u>	<u>(11)</u>
Japanese Yen Debt:				
JBIC's Overseas Investment Loan	4,238	5,363	(1,125)	(21)
Export Credit Agency-Supported Loan	956	1,212	(256)	(21)
	<u>5,194</u>	<u>6,575</u>	<u>(1,381)</u>	<u>(21)</u>
Philippine Peso Debt:				
Peso Fixed Rate Corporate Notes	1,575	1,675	(100)	(6)
Term Loans	552	985	(433)	(44)
Restructured Loans	371	363	8	2
	<u>2,498</u>	<u>3,023</u>	<u>(525)</u>	<u>(17)</u>
	<u>Php131,555</u>	<u>Php149,030</u>	<u>(Php17,475)</u>	<u>(12)</u>

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 Php17,475 million, or 12%, to Php131,555 million as at June 30, 2005 largely due to debt amortizations and prepayments in line with PLDT's efforts to reduce its overall debt level and also due to the appreciation of the peso. PLDT's debt was reduced by 13% to Php95,731 million by the end of the first half 2005. In addition, the debt levels of Smart, Mabuhay, ePLDT and Maratel as at June 30, 2005 relative to the debt balances as at December 31, 2004 decreased by 8%, 11%, 30% and 55% to Php31,977 million, Php3,635 million,

Php207 million and Php5 million, respectively, due to the peso appreciation and debt amortizations during the first half of 2005.

As at June 30, 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 June 30, 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 June 30, 2005 are as follows:

Year	US\$ Loans ⁽¹⁾		JP¥ Loans ⁽²⁾ (in millions)		Peso Loans	Total
2005(3)	US\$238	Php13,389	JP¥1,709	Php866	Php368	Php14,623
2006	337	18,947	3,418	1,732	847	21,526
2007	443	24,882	3,418	1,732	73	26,687
2008	118	6,630	1,709	866	61	7,557
2009	271	15,219	–	–	52	15,271
2010 and onwards	972	54,590	–	–	1,214	55,804

(1) The exchange rate used was Php56.177 to US\$1.00.

(2) The exchange rate used was Php0.5067 to JP¥1.00.

(3) July 1, 2005 through December 31, 2005.

Approximately Php85,664 million principal amount of our consolidated outstanding long-term debt as at June 30, 2005 is scheduled to mature over the period from 2005 to 2009. Of this amount, approximately Php63,064 million is attributable to PLDT, Php18,751 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 financial ratios as required under our loan covenants and other debt instruments.

Please see *Note 17 – Interest-bearing Financial Liabilities* to the accompanying unaudited consolidated financial statements 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 July 11, 2005, Fitch Ratings revised the outlook on PLDT's long-term foreign currency rating to negative from stable. The revision in outlook reflects a similar change in Fitch's outlook on the Republic of the Philippines' "BB" long-term foreign currency rating to negative from stable. PLDT's long-term foreign currency rating, global bonds and senior notes has been maintained at "BB" and convertible preferred stock remain unchanged at "B+." The outlook on PLDT's long-term local currency rating has also been affirmed as "BB+" and the stable outlook on this rating still remains in place.

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+."

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 Php131 million and Php64 million from the exercise by certain officers and executives of stock options in the first half of 2005 and 2004, respectively. 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 Php2 million in the first half of 2005 and Php4 million in the same period in 2004.

Cash dividend payments in the first half of 2005 amounted to Php2,963 million, of which Php2,372 million and Php591 million were paid to common and preferred shareholders, respectively, compared to Php601 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 paid on May 12, 2005. This was the first cash dividend declaration to common shareholders in four years since April 2001. In addition, on May 5, 2005, PLDT declared cash dividend of Php21 per common share to holders of record as at June 3, 2005 paid on July 14, 2005.

Contractual Obligations and Commercial Commitments

Contractual Obligations

The following table discloses our contractual obligations outstanding as at June 30, 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⁾	Php141,468	Php29,036	Php38,385	Php21,173	Php52,874
Long-term lease obligations:					
Operating Lease	3,704	624	1,103	843	1,134
Capital Lease	1,742	760	524	13	445
Unconditional purchase obligations ⁽²⁾	11,861	4,556	2,249	2,247	2,809
Other long-term obligations	19,633	–	5,853	13,780	–
Total contractual obligations	Php178,408	Php34,976	Php48,114	Php38,056	Php57,262

(1) Before deducting unamortized debt discount and debt issuance costs.

(2) Based on the original Air Time Purchase Agreement with ALL.

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 related services in relation to the maintenance of PLDT's domestic fiber optic network, or DFON, submerged plant for a period of five years up to July 4, 2005. This agreement has been extended up to the end of 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 June 30, 2005, PLDT's aggregate remaining obligation under this agreement was approximately Php39 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 June 30, 2005, PLDT's aggregate remaining obligation under these contracts amounted to approximately Php24 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 June 30, 2005, PLDT's aggregate remaining obligation under this agreement was approximately Php40 million.

Other Long-term Operating Lease Obligations. The PLDT Group has 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 Php3,325 million as at June 30, 2005 in respect of office and cell site rentals with over 3,000 lessors nationwide. PLDT has lease obligations aggregating Php96 million as at June 30, 2005, and ePLDT has lease obligations aggregating Php180 million as at June 30, 2005 in respect of certain office space rentals.

Long-term Capital Lease Obligations

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 required PLDT to purchase from AIL a minimum of US\$5 million worth of air time annually over ten years commencing on January 1, 2002, the date of commercial operations of the Garuda I Satellite.

In the event that 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.

PLDT and the other founder NSPs are endeavoring to amend the Air Time Purchase Agreement due to the occurrence of partial satellite loss, changes in the primary business of AceS and the other events affecting the business.

In March 2003, PLDT, together with the other founder NSPs, entered into a Standstill Agreement with AIL suspending the application and enforcement of the minimum and supplemental air time payments under the original Air Time Purchase Agreement. The parties agreed that AIL shall provide PLDT and the other founder shareholders, with unlimited use of air time for the year 2003 in exchange for a fixed fee in the amount of US\$3.8 million for PLDT. Moreover, PLDT is also obliged to purchase from AIL 13,750 satellite phone units in 2003 at US\$395 F.O.B. per unit, subject to quarterly price adjustments. The parties to the Standstill Agreement also agreed to negotiate in good faith and use their best efforts to reach an agreement on a revised Air Time Purchase Agreement before November 15, 2003 that will cover, among other things, the amended minimum and supplemental air time payment provisions subject to the

approval of AIL's creditors.

On February 10, 2004, notwithstanding the ongoing negotiations, AIL advised PLDT of the termination of the Standstill Agreement and the reinstatement of the terms under the original Air Time Purchase Agreement effective January 1, 2002 following the lapse of the November 15, 2003 deadline set in the Standstill Agreement for the negotiation of a revised Air Time Purchase Agreement.

As at June 30, 2005, PLDT's aggregate remaining minimum obligation under the original Air Time Purchase Agreement was approximately Php11,857 million. Negotiations are continuing with the relevant parties towards an amicable settlement of this matter. 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 were 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 was reduced from US\$0.3 million to US\$ 40,000 and for contract years 5 to 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.

Moreover, effective July 1, 2004, VeriSign has agreed to amend the Agreement and issued Addendum 8 as extension of Addendum 6. Under this amendment, 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 June 30, 2005, ePLDT's aggregate remaining minimum obligation under this agreement was approximately Php4 million pertaining to annual support fee.

License Purchase Agreement with I-Contact Solutions Pte. Ltd. On April 2, 2003, iPlus Intelligent Network Inc., or iPlus, a wholly-owned subsidiary of ePLDT and the Philippines' pioneer in IP-based IT response center, entered into an Application Services Provider, or ASP, and Reseller Contract with I-Contact Solutions Pte. Ltd., or I-Contact, of Singapore. Under the agreement, iPlus will purchase licenses of the CosmoCall Universe™ IP-based contact center solution. CosmoCall Universe supports multi-channel customer interactions including telephone, web chat, web voice, web video, web collaboration, e-mail and voicemail in one high capacity, high availability, multi-tenant platform. CosmoCall Universe is a complete, unified contact center suite that includes ACD, IVR, CTI, predictive dialing, multimedia recording and a complement of other

management applications. The aggregate value of these licenses is US\$2.1 million and these licenses will be delivered quarterly over a two-year period. Further to the agreement, I-Contact will appoint iPlus as the exclusive reseller and ASP for the Philippine market and will provide iPlus with all the necessary support in terms of sales, marketing, and technical services. Effective March 30, 2004, I-Contact has agreed to amend the agreement and waived all financial obligations and committed seats requirement over the two-year period. iPlus will pay all its remaining obligations pertaining only to the 300 seats delivered by I-Contact. In June 2005, iPlus committed to purchase additional 50 predictive dialer and Cosmocorder licenses in the amount of Php18 million.

Other Long-term Obligations

Mandatory Conversion and Purchase of Shares. As discussed in *Note 9 – Investments in Associates* and *Note 17 – Interest-bearing Financial Liabilities*, as at June 30, 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 a total of 58 million shares of Series K Class I Convertible Preferred Stock of Piltel, pursuant to the debt restructuring plan of Piltel adopted in June 2004.

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 PLDT common shares. Under a put option exercisable for 30 days, holders of common shares received on mandatory conversion of the Series V, VI and VII Convertible Preferred Stock will be able to require PLDT to purchase such PLDT common shares for Php1,700 per share, US\$36.132 per share, and JP¥4,071.89 per share, respectively.

As at June 30, 2005, 1,435,905 shares of Series V Convertible Preferred Stock and 604,449 shares of Series VI Convertible Preferred Stock had been converted to PLDT common shares. The aggregate value of the put option based on outstanding shares as at June 30, 2005 was Php19,633 million, of which Php11,706 million is payable on June 4, 2008 and Php7,927 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. As at June 30, 2005, 1,285,535 shares of Series V, 4,690,655 shares of Series VI and 3,842,000 shares of Series VII Convertible Preferred Stock remain outstanding. The market value of the underlying shares of common stock was Php13,549 million, based on the market price of PLDT common shares of Php1,620 per share as at June 30, 2005.

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

Commercial Commitments

As at June 30, 2005, our outstanding commercial commitments, in the form of letters of credit, amounted to Php947 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 June 30, 2005, the Philippine peso had appreciated against the U.S. dollar to Php56.177 to US\$1.00 from Php56.341 to US\$1.00 as at December 31, 2004. As at June 30, 2004, on the other hand, the peso depreciated by 1% to Php56.176 to US\$1.00 from Php55.586 to US\$1.00 as at December 31, 2003. As at June 30, 2005, the Philippine peso had appreciated by 8% against the Japanese yen to Php0.5067 to JP¥1 from Php0.5495 to JP¥1 as at December 31, 2004. Likewise, as at June 30, 2004, the peso appreciated by approximately 1% to Php0.5166 to JP¥1 from Php0.5193 to JP¥1 as at December 31, 2003. As such, we recognized foreign exchange gains of Php1,530 million in the first half of 2005 as compared to foreign exchange losses of Php1,452 million recorded in the same period in 2004.

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 June 30, 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 June 30, 2005, PLDT's outstanding forward foreign exchange contracts, principal-only long-term cross-currency swap contracts and currency option contracts amounted to US\$87 million and JP¥879 million; US\$550 million; and US\$263 million, respectively. Smart's has no outstanding forward foreign exchange contracts as at June 30, 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 June 30, 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 half of 2005 was 7.1%, compared to 5.1% 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 is a party, in which a director or key officer or owner of more than 10% of the common shares of PLDT, or any member of the immediate family of a director or key officer or owner of more than 10% of the common shares of PLDT had a direct or indirect material interest in PLDT or its subsidiaries, as at June 30, 2005 and December 31, 2004 and for the six months ended June 30, 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 DFON; (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 Php114 million and Php146 million for the six months ended June 30, 2005 and 2004, respectively. PLDT's outstanding obligations under these agreements amounted to Php55 million and Php49 million as at June 30, 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 Php278 million and Php239 million for the six months ended June 30, 2005 and 2004, respectively. Under these agreements, Smart had outstanding payables of Php284 million and Php267 million as at June 30, 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 insurance expenses paid under these agreements amounted to Php268 million and Php238 for the six months ended June 30, 2005 and 2004, respectively. 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.