PHILIPPINE LONG DISTANCE TELEPHONE CO
Form 6-K
November 04, 2004
MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the Nine Months Ended September 30, 2004

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

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

The financial information appearing in this report and in the accompanying consolidated financial statements is stated in Philippine pesos. All references to pesos, Philippine pesos or Php are to the lawful currency of the Philippines; all references to U.S. dollars, US$ or dollars are to the lawful currency of the United States; all references to Japanese yen, JP¥ or ¥ are to the lawful currency of Japan and all references to Euro or are to t lawful currency of the European Union. Translations of Philippine peso amounts into U.S. dollars in this report and in the accompanying consolidated financial statements were made based on the exchange rate of Php56.276 to US$1.00, the volume weighted average exchange rate at September 30, 2004 quoted through the Philippine Dealing System.

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

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

Our consolidated financial statements as of and for the nine months ended September 30, 2004 incorporate certain changes in accounting policies which have affected our financial position and results of operations retrospectively. For further discussion please see Note 2 Summary of Significant Accounting Policies to the accompanying consolidated financial statements.

Financial Highlights and Key Performance Indicators

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

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

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

Overview

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

• *Wireless* wireless telecommunications services provided by Smart Communications, Inc., or Smart and Pilipino Telephone Corporation, or Piltel, our cellular service providers, and Mabuhay Satellite Corporation, ACeS Philippines Cellular Satellite Corporation, and Telesat, Inc., our satellite and very small aperture terminal, or VSAT, operators;

• *Fixed Line* fixed line telecommunications services primarily provided through PLDT. We also provide fixed line services through PLDT Clark Telecom, Inc., Subic Telecommunications Company, Inc., PLDT-Maratel, Inc., Piltel and Bonifacio Communications Corporation, which together account for approximately 1% of our consolidated fixed lines in service, and PLDT Global Corporation; and

• *Information and Communications Technology* information and communications infrastructure and services for internet applications, internet protocol-based solutions and multimedia content delivery provided by PLDT s subsidiary ePLDT, Inc.; call center services provided by ePLDT s subsidiaries Parlance Systems, Inc. and Vocativ Systems, Inc.; internet access services provided by ePLDT s subsidiary, Infocom Technologies, Inc.; and e-commerce and IT-related services provided by other investees of ePLDT, as discussed in *Note 8 Investments* to the accompanying consolidated financial statements.

Accounting Changes

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

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

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

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

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

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

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

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

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

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

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

IAS 39	Financial Instruments: Recognition and Measurement	(14.56)	(12.02)	(5.74)
Earnings per common share, as restated		(Php3.08)	Php12.80	Php61.01

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

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

Results of Operations

The table below shows the contribution by each of our business segments to our consolidated operating revenues, operating expenses and net operating income (losses) for the nine months ended September 30, 2004 and 2003. Most of our revenues are derived from our operations within the Philippines. Our revenues derived from outside the Philippines consist primarily of revenues from incoming international calls to the Philippines.

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

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(1) Operating expenses and net operating income (losses) are computed as a percentage of operating revenues.

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

Consolidated Operating Revenues

Largely driven by the continued strong growth of our wireless business, particularly our cellular business, our consolidated operating revenues for the first nine months of 2004 increased by Php13,995 million, or 19%, to Php87,519 million from Php73,524 million in the same period in 2003. Our wireless business contributed Php50,648 million in revenues for the first nine months of 2004, an increase of Php13,212 million, or 35%, over its revenue contribution of

Php37,436 million for the same period in 2003. The revenue contribution of our wireless business accounted for 58% of our consolidated operating revenues for the first nine months of 2004, compared to 51% in the same period in 2003. Our fixed line business, on the other hand, contributed Php35,319 million in revenues in the first nine months of 2004, an increase of Php489 million, or 1%, from Php34,830 million in the same period in 2003. As a percentage of our total consolidated operating revenues, our fixed line business revenue decreased in the first nine months of 2004 to 40% from 47% in the same period in 2003 due to the strong growth of our wireless business.

Wireless

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

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

	Nine Months Ended September 30,					
					Increase	
	2004	**%**	**2003**(1) (Unaudited)	**%**	**Amount**	**%**
(in millions)						
Wireless services:						
Cellular						
Smart	Php46,201	91	Php34,502	92	Php11,699	34
Piltel	3,952	8	2,577	7	1,375	53
Subtotal	50,153	99	37,079	99	13,074	35

Satellite, VSAT and others	495	1	357	1	138	39
Total	Php50,648	100	Php37,436	100	Php13,212	35

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

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

Cellular Service

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

Our cellular service revenues consist of:

- revenues derived from actual usage of the network by prepaid subscribers and any unused peso value of expired prepaid cards or electronic air time loads, net of discounts given to dealers;

- monthly service fees from postpaid subscribers, including (1) charges for calls in excess of allocated free local calls, (2) toll charges for national and international long distance calls, (3) charges for text messages of our GSM service customers in excess of allotted free text messages, and (4) charges for value-added services, net of related content provider costs;

- revenues generated from incoming calls and messages to our subscribers, net of interconnection expenses; fees from reciprocal traffic from international correspondents; and revenues from inbound international roaming calls for the GSM service; and

- other charges, including those for reconnection and migration.

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

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

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

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

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

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

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

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

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

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

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

(2) Refers to other non-subscriber-related revenues, such as inbound international roaming fees.

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

Voice Services

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

Prior to January 2004, Smart prepaid subscribers were charged a rate of Php8.00 per minute for calls made during peak hours and Php4.00 per minute for calls made during off-peak hours regardless of whether the calls were made to subscribers within our network or to other mobile operators networks. Beginning January 2004, we implemented all-day flat air time rates for calls made by our prepaid subscribers. *Smart Buddy* subscribers calls terminating to subscribers within our network are charged Php6.50 per minute, while an all-day flat rate of Php7.50 per minute is charged for calls terminating to other cellular network subscribers as well as local and NDD calls. *Talk N Text* subscribers, on the other hand, are charged Php5.50 for calls made to subscribers within our network, while an all-day flat rate of Php6.50 are charged for calls terminating to other cellular network subscribers as well as local and NDD calls.

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

Data Services

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

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

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

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

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

Subscriber Base, ARPU and Churn Rates

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

The table below shows our average monthly activations:

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

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

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

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

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

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

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

Prepaid service revenues consist mainly of charges for subscribers' actual usage of their loads. Gross monthly ARPU for *Smart Buddy* subscribers in the first nine months of 2004 was Php439, a decrease of 15%, compared to Php517 in the same period in 2003. The decline was attributable mainly to a decrease in the average outbound local voice revenue per subscriber in the first nine months of 2004. On a net basis, ARPU in the first nine months of 2004 decreased by 12% to Php364 from Php415 in the same period in 2003. The lower rate of decrease in net ARPU compared to the decrease in gross ARPU resulted mainly from a decrease in the average interconnection expense per subscriber on the back of the increasing percentage of Smart-to-Smart traffic to local voice traffic, to 64% in the first nine months of 2004 from 60% in the same period in 2003. In addition, the introduction of *Smart Load* helped mitigate the decline in net ARPU due to a lower dealer discount of 5% applied to over-the-air loading compared to 10% for prepaid cards. Smart currently expects its prepaid ARPUs to continue to decline now that lower-denomination reloads are available and as it continues its expansion into the lower end of the market. Gross monthly ARPU for *Talk N Text* subscribers in the first nine months of 2004 was Php323, a decrease of 8% compared to Php353 in the same period in 2003. The decline was attributable mainly to a decrease in the average outbound local voice revenue per subscriber in the first nine months of 2004. On a net basis, ARPU in the first nine months of 2004 decreased by 6% to Php272 from Php288 in the same period in 2003.

Monthly ARPU for Smart s postpaid GSM services is calculated in a manner similar to that of prepaid service, except that the revenues consist mainly of monthly service fees and charges on usage in excess of the monthly service fees.

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

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

In the past, a prepaid cellular subscriber was recognized as an active subscriber when that subscriber activated and used the SIM card in the handset, which already contains Php50 of pre-stored air time (reduced from Php100 in April 2004). Subscribers can reload their air time by purchasing prepaid call and text cards that are sold in denominations of Php300, Php500 and Php1,000 or, by purchasing additional air time over the air via *Smart Load* in smaller denominations of Php30, Php60, Php115 and Php200, by receiving loads of Php2, Php5, Php10 and Php15 via *Pasa Load*, or through their handsets using *Smart Money*. Reloads have validity periods ranging from one day to two months, depending on the amount reloaded. A GSM prepaid account is disconnected if the subscriber does not reload within four months after the full usage or expiry of the last reload. Our current policy is to recognize a prepaid subscriber as active only when the subscriber activates and uses the SIM card and reloads at least once during the month of initial activation or in the immediate succeeding month. For example, if a customer activated a SIM card in April 2004 but had not reloaded by May 31, 2004, this customer would not be counted as a subscriber. The rationale for this change stems from our observance of the aggressive SIM-swapping activities in the market beginning February 2004. SIM-swapping refers to the promotional activity wherein subscribers can exchange their current prepaid SIM card for another operator s SIM card at no cost to the subscriber. We believe that these activities have given rise to a situation where certain subscribers may swap their SIM cards between mobile operators upon full usage of the pre-stored air time, which, without the adjustment to subscriber recognition, would have led, based on the approach used in the past, to an overstatement of our prepaid subscriber base.

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

In May 2003, Smart introduced *Smart Load*, an over-the-air electronic loading facility designed to make reloading of air time credits more convenient for, and accessible to consumers. These over-the-air reloads, which have both voice and text functions, are packaged in smaller denominations of Php30, Php60, Php115 and Php200, but have shorter validity periods of three days, six days, 12 days and 30 days, respectively. Starting with just 50,000 outlets when it was launched, *Smart Load s* distribution network now encompasses over 600,000 retail agents, approximately 90% of which are micro businesses. As of September 30, 2004, approximately 97% of *Smart Buddy* subscribers and 99% of *Talk N Text* subscribers were using *Smart Load* as their reloading mechanism. In the first nine months of 2004, *Smart Load* has accounted for approximately 66% of sales derived from reloads.

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

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

The average monthly churn rate for Smart's postpaid GSM subscribers for the first nine months of 2004 was 1.0%, compared to 3.6% in the same period in 2003. Smart's policy is to redirect outgoing calls to an interactive voice response system if the postpaid subscriber's account is either 45 days overdue or the subscriber has exceeded the prescribed credit limit. If the subscriber does not make a payment within 44 days of redirection, the account is disconnected. Within this 44-day period, a series of collection activities are implemented, involving the sending of a collection letter, call-out reminders and collection messages via text messaging.

Satellite, VSAT and Other Services

Our revenues from satellite, VSAT and other services consist mainly of rentals received for the lease of Mabuhay Satellite's transponders and Telesat's VSAT facilities to other companies and charges for ACeS Philippines satellite phone service. Total revenues from these services for the first nine months of 2004 amounted to Php495 million, an increase of Php138 million, or 39%, from Php357 million in the same period in 2003.

Fixed Line

Our fixed line business provides local exchange service, international and national long distance services, data and other network services, and miscellaneous services. Revenues generated from this business for the first nine months of 2004 totaled Php35,319 million, an increase of Php489 million, or 1%, from Php34,830 million for the same period in 2003. This increase was due to higher revenues generated from our international and national long distance services and data and other network services, partially offset by decreased revenues from local exchange and miscellaneous services. As a percentage of our consolidated operating revenues, however, fixed line revenues decreased for the first nine months of 2004 to 40% from 47% in the same period in 2003 principally due to the continued strong growth of our wireless business.

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

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

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

Local Exchange Service

Our local exchange service revenues consist of:

• flat monthly fees for our postpaid service;

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

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

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

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

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

	Nine Months Ended September 30,			
			Increase (Decrease)	
	2004	**2003**	**Amount**	**%**
	(Unaudited)			
Consolidated local exchange revenues (in millions)	Php15,752	Php15,930	(Php178)	(1)
Number of fixed lines in service:				
PLDT Group	2,184,411			