PHILIPPINE LONG DISTANCE TELEPHONE CO
Form 6-K
May 05, 2005
MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the Three Months Ended March 31, 2005

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

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

The financial information appearing in this report and in the accompanying unaudited consolidated financial statements is stated in Philippine pesos. All references to pesos, Philippine pesos or Php are to the lawful currency of the Philippines; all references to U.S. dollars, US$ or dollars are to the lawful currency of the United States; all references to Japanese yen, JP¥ or ¥ are to the lawful currency of Japan and all references to Euro or are to t lawful currency of the European Union. Translations of Philippine peso amounts into U.S. dollars in this report and in the accompanying unaudited consolidated financial statements were made based on the exchange rate of Php54.747 to US$1.00, the volume weighted average exchange rate at March 31, 2005 quoted through the Philippine Dealing System.

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

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

Our audited consolidated financial statements as at and for the year ended December 31, 2004 incorporate certain changes in accounting policies which have affected our financial position and results of operations retrospectively. For further discussion please see Note 2 Summary of Significant Accounting Policies to the accompanying unaudited consolidated financial statements.

Financial Highlights and Key Performance Indicators

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

	Three Months Ended March 31,			
	2005	**2004**(1) (Unaudited)	**Increase (Decrease) Amount**	**%**
Consolidated Statements of Income				
Revenues and other income	Php30,251	Php30,823	(Php572)	(2)
Service income	29,361	28,107	1,254	4
Expenses	17,325	23,107	(5,782)	(25)
Income before income tax	12,926	7,716	5,210	68
Net income attributable to equity holders	9,361	5,686	3,675	65
Net income margin	31%	18%		
Consolidated Statements of Cash Flows				
Net cash provided by operating activities	15,250	18,103	(2,853)	(16)
Net cash used in investing activities	2,191	5,363	(3,172)	(59)
Capital expenditures	4,263	4,316	(53)	(1)
Net cash used in financing activities	10,245	7,528	2,717	36

Operational Data				
Number of cellular subscribers	20,252,513	14,356,186	5,896,327	41
Number of fixed lines in service	2,149,489	2,197,879	(48,390)	(2)
Number of employees	18,581	17,346	1,235	7

Php per US$ Exchange Rates	
March 31, 2005	Php54.747
December 31, 2004	53.341
March 31, 2004	56.216
December 31, 2003	55.586

____

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

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

Overview

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

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

- *Fixed Line* fixed line telecommunications services primarily provided through PLDT. We also provide fixed line services through PLDT s subsidiaries PLDT Clark Telecom, Inc., Subic Telecommunications Company, Inc., PLDT-Maratel, Inc., Piltel and Bonifacio Communications Corporation, which together account for approximately 3% of our consolidated fixed lines in service, and PLDT Global Corporation; and

- *Information and Communications Technology* information and communications infrastructure and services for internet applications, internet protocol-based solutions and multimedia content delivery provided by PLDT s subsidiary ePLDT, Inc.; call center services provided by ePLDT s subsidiaries Parlance Systems, Inc., Vocativ Systems, Inc. and ePLDT Ventus, Inc.; internet access and gaming services provided by ePLDT s subsidiaries, Infocom Technologies, Inc., Digital Paradise, Inc. and netGames, Inc.; and e-commerce, and IT-related services provided by other investees of ePLDT, as discussed in *Note 9 Investments in Associates at equity* to the accompanying unaudited consolidated financial statements.

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

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

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

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

Accounting Changes

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(continued)

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

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

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

Results of Operations

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

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

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

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

Wireless

Revenues and Other Income

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

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

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

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

Service Revenues

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

Cellular Service

Our cellular service revenues consist of:

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

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

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

- other charges, including those for reconnection and migration.

Our cellular service revenues in the first quarter of 2005 amounted to Php17,406 million, an increase of Php1,727 million, or 11%, from Php15,679 million in the same period in 2004. Cellular service revenues accounted for 97% of wireless service revenues in the first quarters of 2005 and 2004.

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

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

Piltel markets its cellular prepaid service under the brand name *Talk N Text* and is provided through Smart s network. On December 22,