

PHILIPPINE LONG DISTANCE TELEPHONE CO  
Form 20-F/A  
July 16, 2003

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 20-F**

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(B) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2002**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-03006**

**Philippine Long Distance Telephone Company**

(Exact name of Registrant as specified in its charter)

**Republic of the Philippines**

(Jurisdiction of incorporation or organization)

**Ramon Cojuangco Building**

**Makati Avenue**

**Makati City, Philippines**

(Address of principal executive or organization)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Capital Stock, Par Value Five Philippine Pesos Per Share	New York Stock Exchange
American Depositary Shares, evidenced by American Depositary Receipts, each representing one share of Common Capital Stock	New York Stock Exchange
Series III Convertible Preferred Stock, Par Value Ten Philippine Pesos Per Share	Pacific Exchange New York Stock Exchange*
Global Depositary Shares, evidenced by Global Depositary Receipts, each representing one share of Series III Convertible Preferred Stock	New York Stock Exchange

\* Registered on the New York Stock Exchange not for trading but only in connection with the registration of American Depositary Shares or Global Depositary Shares, as the case may be, pursuant to the requirements of such stock exchanges.

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

8.500% Notes due 2003	10.625% Notes due 2007
10.625% Notes due 2004	10.500% Notes due 2009
9.875% Notes due 2005	11.375% Notes due 2012
9.250% Notes due 2006	8.350% Notes due 2017

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2002:

169,360,901 shares of Common Capital Stock, Par Value Five Philippine Pesos Per Share

458,434,729 shares of Serial Preferred Stock, Par Value Ten Philippine Pesos Per Share

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes  No

-

Indicate by check mark which financial statement item the registrant has elected to follow: Item 17  Item 18

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## CERTAIN CONVENTIONS AND TERMS USED IN THIS REPORT

Unless the context indicates or otherwise requires, references to we, us, our or PLDT Group mean Philippine Long Distance Telephone Company and its consolidated subsidiaries, and references to PLDT mean Philippine Long Distance Telephone Company, not including its consolidated subsidiaries (see Note 2 to our financial statements in Item 18 for a list of these subsidiaries, including a description of their respective principal business activities).

Any discrepancies in any table between totals and the sums of the amounts listed are due to rounding.

All references to the Philippines contained in this report mean the Republic of the Philippines and all references to the U.S. or the United States are to the United States of America.

In this report, unless otherwise specified or the context otherwise requires, all references to pesos, Philippine pesos or Php are to the lawful currency of the Philippines, all references to dollars, U.S. dollars or US\$ 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. Unless otherwise indicated, translations of peso amounts into U.S. dollars in this report were made based on the volume weighted average exchange rate quoted through the Philippine Dealing System, which was Php53.254 = US\$1.00 on December 31, 2002. On June 30, 2003, the volume weighted average exchange rate quoted was Php53.522 = US\$1.00.

In this report, each reference to:

- ACeS Philippines means ACeS Philippines Cellular Satellite Corporation, an 88.5%-owned subsidiary of PLDT and 11.5%-owned by Piltel;
- AMPS means advanced mobile phone system;
- ARPU means average monthly revenue per user;
- BSP means Bangko Sentral ng Pilipinas;

- CDMA means code division multiple access;
- Clark Telecom means PLDT Clark Telecom, Inc., our wholly-owned subsidiary;
- ePLDT means ePLDT, Inc., our wholly-owned subsidiary;
- ETACS means enhanced total access communications system;
- First Pacific means First Pacific Company Limited;
- GAAP means generally accepted accounting principles;
- GSM means global system for mobile communications;
- ISP means internet service provider;
- Infocom means Infocom Technologies, Inc., a 99.6%-owned subsidiary of ePLDT;
- Mabuhay Satellite means Mabuhay Philippines Satellite Corporation, our 67%-owned subsidiary;
- MaraTel means Maranao Telephone Company, Inc., our 97.5%-owned subsidiary;
- NTC means the National Telecommunications Commission of the Philippines;
- NTT Communications means NTT Communications Corporation, a wholly-owned subsidiary of Nippon Telegraph and Telephone Corporation of Japan;

- PAPTELCO means Philippine Association of Private Telephone Companies;
- Parlance means Parlance Systems, Inc., a wholly-owned subsidiary of ePLDT;
- Piltel means Pilipino Telephone Corporation, in which we have a 45.3% ownership interest and which is treated as a consolidated subsidiary under U.S. GAAP;
- PLDT Beneficial Trust Fund means the beneficial trust fund created by PLDT to provide benefit and retirement plans for PLDT's employees;
- PLDT Global means PLDT Global Corporation, our wholly-owned subsidiary;
- SMS means short message service;
- Smart means Smart Communications, Inc., our wholly-owned subsidiary;
- Subic Telecom means Subic Telecommunications Company, Inc., our wholly-owned subsidiary;
- Telesat means Telesat, Inc., our 94.4%-owned subsidiary;
- Vocativ means Vocativ Systems, Inc., a wholly-owned subsidiary of ePLDT; and
- VSAT means very small aperture terminal.

#### **FORWARD-LOOKING STATEMENTS**



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 assumed facts or bases almost always vary from actual results, and the differences between results implied by the forward-looking statements, 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 other 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 statements in this report after the date hereof. In light of these risks and uncertainties, you should keep in mind that any forward-looking statement made in this report or elsewhere might not occur.

## **PART I**

### **Item 1. Identity of Directors, Senior Management and Advisors**

Not applicable.

### **Item 2. Offer Statistics and Expected Timetable**

Not applicable.

### **Item 3. Key Information**

#### **Selected Financial Data**

The selected consolidated financial information below should be read in conjunction with, and is qualified in its entirety by reference to, our audited consolidated financial statements, including the notes, included elsewhere in this report. The financial statements have been prepared and presented in conformity with U.S. GAAP. Due to our decision to commence this year using U.S. GAAP for our Annual Report on Form 20-F, we are unable to provide without unreasonable effort and expense U.S. GAAP consolidated financial information with respect to the fiscal years ended December 31, 1998 and 1999. As a result, we have omitted such information in the table below. In our previous Annual Reports on Form 20-F we disclosed financial statements, including the financial information with respect to the years ended December 31, 1998 and 1999, prepared in accordance with Philippine GAAP, along with a reconciliation to U.S. GAAP.

Prior to 2002, our financial statements included in our Annual Report on Form 20-F filed with the U.S. Securities and Exchange Commission were prepared in accordance with Philippine GAAP. Philippine GAAP varies in certain significant respects from U.S. GAAP. A description of the significant differences between U.S. GAAP and Philippine GAAP and a quantitative reconciliation of such differences in the net income and shareholders' equity to U.S. GAAP was disclosed in a note to our previously filed financial statements. In connection with the preparation of our consolidated balance sheets as of December 31, 2002 and 2001, and the related statements of income, changes in stockholders' equity and cash flows for the years ended December 31, 2002, 2001, and 2000 in accordance with U.S. GAAP, we identified differences in the U.S. GAAP amounts previously disclosed for 2001 and 2000. Please see Note 4 to our consolidated financial statements included herein for a discussion of such differences.

	<b>Consolidated Financial Data</b>			
	<b>Years Ended December 31,</b>			
	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2002(1)</b>
	<b>(in millions, except net operating income</b>			
	<b>(loss) per share, earnings (loss) per</b>			
	<b>common share, ratio of earnings to fixed</b>			
	<b>charges and dividends declared per</b>			
	<b>common share)</b>			
<i>Amounts in accordance with</i>				
<i>U.S. GAAP:</i>				
<b>Statement of Operating Data:</b>				
Operating revenues	Php61,949	Php79,128	Php95,540	US\$1,794
Operating expenses	50,504	83,070	80,647	1,513
Net operating income (loss)	11,445	(3,942)	14,893	280
Net operating income (loss) per share				
Basic	64.66	(35.50)	72.44	1.36
Diluted	64.66	(35.50)	67.22	1.26
Net income (loss)	(24,713)	(27,484)	(4,559)	(86)
Earnings (loss) per common share(2)	(154.34)	(175.08)	(42.60)	(0.80)
<b>Balance Sheet Data:</b>				
Cash and cash equivalents		4,276	10,974	206
Total assets		283,301	266,876	5,011
Total long-term debt-net of current portion		170,813	171,774	3,226
Long-term debt		190,099	190,950	3,586
Total debt(3)		196,561	191,710	3,600

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Total liabilities(4)	249,857	239,126	4,490
Total stockholders equity	21,573	15,122	284
<b>Other Data:</b>			
EBITDA(5)	(7,642)	2,375	29,443
Depreciation and amortization	13,049	16,454	17,663
Ratio of earnings to fixed charges(6)			1.0
Net cash provided by operating activities	24,033	21,641	36,849
Net cash used in investing activities	(29,015)	(32,777)	(15,140)
Net cash provided by (used in) financing activities	6,035	5,714	(14,975)
Dividends declared to common shareholders	752	202	
Dividends declared per common share(7)	4.80	1.20	

(1) We maintain our accounts in Philippine pesos. For convenience, the peso financial information as of and for the year ended December 31, 2002, has been translated into U.S. dollars at the exchange rate of Php53.254 = US\$1.00, the rate quoted through the Philippine Dealing System as of December 31, 2002. This translation should not be construed as a representation that the Philippine peso amounts represent, or have been or could be converted into, U.S. dollars at that rate or any other rate.

(2) Our convertible preferred shares were deemed anti-dilutive based on a calculation of the required dividends on preferred shares for each series of convertible preferred shares divided by the number of equivalent common shares assuming such preferred shares were converted into common shares and compared against the basic earnings per share. Since the amount of dividends on preferred shares over the equivalent number of common shares were greater than the basic earnings per share, the amounts for basic and diluted earnings (loss) per share are the same.

(3) Total debt represents current portion of long-term debt, long-term debt net of current portion and notes payable.

(4) Total liabilities on a consolidated basis represent the difference between total assets and minority interest in net losses of consolidated subsidiaries, preferred stock subject to mandatory redemption and stockholders equity.

(5) On a consolidated basis, EBITDA is defined as income (loss) before minority interest in net income (loss) of consolidated subsidiaries and adding back interest expense and related items, taxes, and depreciation and amortization and deducting interest income and is presented because it is generally accepted as providing useful information regarding a company's ability to service and/or incur debt. EBITDA should not be considered in isolation or as a substitute for operating income, net income, cash flows from operating activities and other income or cash flow statement data prepared in accordance with applicable generally accepted accounting principles, or as a measure of PLDT's profitability or liquidity. A quantitative reconciliation of EBITDA from income (loss) before minority interest in net income (loss) of consolidated subsidiaries is provided in the following table:

**Consolidated Financial Data**  
**Years Ended December 31,**  
**2000      2001      2002      2002(3)**  
**(in millions)**

*Amounts in accordance with U.S. GAAP:*

Income (loss) before minority interest in net income (losses) of consolidated subsidiaries	Php(24,713)	Php(26,691)	Php(4,914)	US\$(92)
Add/(deduct):				
Interest expenses and related items, net of capitalized interest	14,209	14,639	14,662	275
Interest income	(1,946)	(1,391)	(1,063)	(20)
Provision for income tax	(8,240)	(636)	3,125	59
Depreciation and amortization	13,049	16,454	17,633	332
EBITDA	Php(7,642)	Php2,375	Php29,443	US\$553

(6) *For purposes of this ratio, Earnings consist of income before provision for income tax (excluding PLDT's share in undistributed income of less than 50% owned affiliates) and fixed charges (excluding capitalized interest). Fixed charges consist of interest (including capitalized interest, discounts and other financing costs) on all indebtedness, amortization of deferred financing costs and the estimated financing component of rent expense (i.e., one-third of rent expense).*

*Due to PLDT's losses in 2000 and 2001, the coverage ratio on a consolidated basis was less than 1.0x in both of these three years. In order to achieve a coverage ratio of 1.0x, we would have had to generate additional consolidated earnings of Php37,925 million, and Php26,700 million for the years ended December 31, 2000 and 2001, respectively, to achieve a coverage ratio of 1.0x.*

(7) *The most recent cash dividend declaration made by PLDT on its common stock was in March 2001, which was paid in April 2001.*

## Capital Stock

The following table summarizes PLDT's capital stock outstanding as of December 31, 2000, 2001 and 2002.

**December 31,**  
**2000      2001      2002**

(in millions)

Serial Preferred Stock			
Cumulative Convertible			
10% Convertible			
A to CC	Php3,515	Php3,724	Php4,068
Series III	46	46	46
Series V		26	26
Series VI		48	46
Series VII		38	38
Cumulative Nonconvertible			
Series IV	360	360	360
	Php3,921	Php4,242	Php4,584
Common Stock	Php843	Php845	Php847

### Dividends Declared

	<b>Years Ended</b>		
	<b>December 31,</b>		
	<b>2000</b>	<b>2001</b>	<b>2002</b>
Cash dividends declared per share of PLDT's common stock (in pesos)(1)	Php4.80	Php1.20	Php

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*(1) The most recent cash dividend declaration made by PLDT on its common stock was in March 2001, which was paid in April 2001. PLDT does not expect to declare cash dividends on these shares in 2003.*

### Dividends Paid

A summary of dividends paid per share of PLDT's common stock stated in both Philippine pesos and U.S. dollars follows:

**In Philippine Pesos   In U.S. Dollars**

1998		
January 15	1.20	0.029
April 15	1.20	0.031
July 15	1.20	0.029
October 15	1.20	0.028
1999		
January 15	1.20	0.031
April 15	1.20	0.031
July 15	1.20	0.031
October 15	1.20	0.030
2000		
January 14	1.20	0.030
April 14	1.20	0.029
July 15	1.20	0.027
October 15	1.20	0.025
2001		
January 15	1.20	0.023
April 16	1.20	0.024

*(Note: Dividends on PLDT's common stock are declared and paid in Philippine pesos. For the convenience of the reader, the peso dividends are translated into U.S. dollars based on exchange rates on the respective dates of dividend payments. Dividends paid in January of each of the calendar years 1998-2001 were declared in the preceding December. Accordingly, total amounts shown for cash dividends declared under Dividends Declared above may differ from the amounts shown for cash dividends paid under Dividends Paid. )*

## Exchange Rates

The Philippine government does not administratively fix the exchange rate between the Philippine peso and the U.S. dollar. Since August 1, 1992, a market average rate has been determined daily in inter-bank trading using the Philippine Dealing System, known as the Philippine Dealing System Reference Rate. The Philippine Dealing System is a specialized off-floor direct dealing service for the trading of Philippine pesos-U.S. dollars by member banks of the Bankers Association of the Philippines and *Bangko Sentral ng Pilipinas*, or BSP, the central bank of the Philippines. All members of the Bankers Association of the Philippines are required to make their Philippine peso-U.S. dollar trades through this system, which was established by Telerate Financial Information Network of Hong Kong.

The following shows the exchange rates between the Philippine peso and the U.S. dollar, expressed in pesos per U.S. dollar, for the periods indicated, based on the volume-weighted average exchange rate for each business day in each of the periods presented:

**Year Ended December 31,**

	<b>Period End</b>	<b>Average(1)</b>	<b>Low(2)</b>	<b>High(3)</b>
1998	Php39.145	Php40.942	Php36.989	Php45.420
1999	40.298	39.096	37.566	41.112
2000	49.986	44.179	39.830	51.680
2001	51.690	51.009	47.550	55.013
2002	53.254	51.583	49.336	53.841
2003 (through June 30, 2003)	53.522	53.504	52.021	55.075

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*Source: Philippine Dealing System Reference Rate*

*(1) Simple average of exchange rates for the period.*

*(2) Lowest exchange rate for the period.*

*(3) Highest exchange rate for the period.*

	<b>Period End</b>	<b>Average(1)</b>	<b>Low(2)</b>	<b>High(3)</b>
<b>Month</b>				
2003				
January	53.837	53.590	53.402	53.837
February	54.492	54.109	53.899	54.492
March	53.604	54.549	53.373	55.075
April	52.612	52.755	52.272	53.337
May	53.230	52.538	52.021	53.282
June	53.522	53.414	53.176	53.706

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*Source: Philippine Dealing System Reference Rate*

*(1) Simple average of exchange rates for the month.*

*(2) Lowest exchange rate for the month.*

*(3) Highest exchange rate for the month.*

This report contains conversions of peso amounts into U.S. dollars for your convenience. Unless otherwise specified, these conversions were made at the exchange rate as of December 31, 2002 of Php53.254 = US\$1.00. You should not assume that such peso amounts represent such U.S. dollar amounts or could have been or could be converted into U.S. dollars at the rate indicated, or at any particular rate. As of June 30, 2003, the exchange rate quoted through the

Philippine Dealing System was Php53.522 = US\$1.00.

## **Risk Factors**

### *Risks Relating to Us*

Our substantial indebtedness could impair our ability to fulfill our financial obligations, service our other debt and carry out new financings

We have substantial indebtedness. As of December 31, 2002, we had consolidated total indebtedness of approximately Php191,710 million (US\$3,600 million), including short-term debt of approximately Php760 million (US\$14 million) and a consolidated ratio of debt to equity (total debt on a consolidated basis divided by stockholders' equity) of 12.68x. Our consolidated ratio of earnings to fixed charges was less than the minimum required ratio of 1.0x for the year ended December 31, 2002. For an explanation of how we calculate our consolidated ratio of earnings to fixed charges, see footnote 6 to our consolidated financial data table under Selected Financial Data and Exhibit 7 in Item 19. Our existing debt contains covenants, which, among other things, require PLDT to maintain certain financial ratios calculated in accordance with Philippine GAAP on a consolidated and non-consolidated basis, limit our ability to incur indebtedness, make investments, incur expenditures and pay dividends. Financial statements prepared in conformity with Philippine GAAP differ in some material respects from financial statements prepared in conformity with U.S. GAAP. For a description of some of these covenants, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Financing Activities Debt Financing Covenants.

Our substantial indebtedness and the requirements and limitations imposed by our debt covenants could have important consequences. For example, they could:

- make it more difficult for us to satisfy our debt obligations;
- require us to dedicate a substantial portion of our cash flow to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate requirements;
- limit our ability to refinance our debt obligations or incur new debt needed to finance our working capital, capital expenditure or other requirements;



- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate; and
  
- place us at a competitive disadvantage compared to our competitors.

If we are unable to meet our debt service obligations or comply with our debt covenants, we could be forced to restructure or refinance our indebtedness, seek additional equity capital or sell assets. An inability to effect these measures successfully could result in a declaration of default and an acceleration of some or all of our indebtedness.

Under the indenture for our 10.625% Notes due 2007 and 11.375% Notes due 2012, we may only incur additional debt, subject to certain exceptions, if, after incurrence of such debt, our consolidated leverage ratio (the ratio of debt to EBITDA calculated on a non-consolidated basis based on definitions provided in the same indenture and except under certain circumstances) would be less than 5.5 to 1 prior to December 31, 2003, 5.0 to 1 after December 31, 2003, and prior to December 31, 2004 and 4.5 to 1 thereafter. Because our consolidated leverage ratio presently is in excess of 5.5 to 1, we are currently restricted from incurring any additional debt, subject to certain exceptions, including exceptions for refinancing transactions. In addition, we expect that we will have difficulty meeting our debt payment obligations if we do not continue to receive cash dividends from Smart.

We may not be able to maintain compliance with restrictive covenants and ratios imposed by our indebtedness

Our debt instruments contain restrictive covenants and require us to comply with specified financial ratios and other financial tests calculated in accordance with Philippine GAAP at relevant measurement dates, principally at the end of quarterly periods. Financial statements prepared in conformity with Philippine GAAP differ in some material respects from financial statements prepared in conformity with U.S. GAAP.

The principal factors that can negatively affect our ability to comply with these financial ratios and other financial tests are depreciation of the peso relative to the U.S. dollar, poor operating performance of PLDT and its consolidated subsidiaries, impairment or similar charges in respect of investments or other assets that may be recognized by PLDT and its consolidated subsidiaries, and increases in our interest expenses. As of December 31, 2002, approximately 95% of PLDT's total consolidated long-term debt was denominated in foreign currencies, principally in U.S. dollars, and many of these financial ratios and other tests are negatively affected by any weakening of the peso. The peso declined by approximately 1% against the U.S. dollar to an average of Php51.583 = US\$1.00 in 2002 from an average of Php51.009 = US\$1.00 for the year 2001. At December 31, 2002, the exchange rate was Php53.254 = US\$1.00, equivalent to approximately 3% depreciation of the peso relative to the rate at the end of 2001. Certain of our financial ratios would be adversely affected by impairment or similar charges. In addition, certain of our financial ratios would be adversely affected by increases in interest expense, which may result from factors including issuance of new debt, the refinancing of lower cost indebtedness by higher cost indebtedness, depreciation of the peso, the lowering of PLDT's credit ratings or the credit ratings of the Philippines, an increase in reference interest rates and general market conditions.

PLDT's ability to maintain compliance with financial covenant requirements measured on a non-consolidated basis is principally affected by the performance of our fixed line business, which is predominantly conducted by PLDT. PLDT cannot be assured of the benefit of results generated by Smart and PLDT's other subsidiaries and investees in assisting in complying with non-consolidated covenants or covenants that are calculated without giving effect to the results of PLDT's subsidiaries and investees.

To date, we have maintained compliance with all of our restrictive financial ratios and covenants as measured under Philippine GAAP under our loan agreements and other debt instruments. However, if negative factors adversely affect our financial ratios, we may be unable to maintain compliance with these restrictive ratios and covenants or be unable to incur new debt. During 2001, our performance under certain of these ratios, including our total debt to EBITDA and interest coverage ratios, was close to the permitted thresholds. Under some of our loan agreements, the requirements with respect to our debt to EBITDA ratio on a non-consolidated basis has become more restrictive at the end of the second quarter of 2003 and will continue to become more restrictive in increments thereafter, which will make it more difficult for PLDT to maintain compliance with this ratio in the future. In the future, our performance under certain of our ratios may again fall close to the permitted thresholds. Inability to comply with our restrictive financial ratios and covenants or raise new financing could result in a declaration of default and acceleration of some or all of our indebtedness unless we are able to obtain waivers or amendments from the relevant lenders. The terms of some of our debt instruments have no minimum amount for cross-default.

For more information on the requirements of our loan agreements and other debt instruments and our compliance with them, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Financing Activities Debt Financing Covenants.

*Creditors of our subsidiaries will have superior claims to our subsidiaries' cash flow and assets*

A growing portion of our consolidated revenues and cash flow from operations is derived from our subsidiaries, particularly Smart. Smart and some of our other subsidiaries have significant internal cash requirements for debt service, capital expenditures and operating expenses and so may be financially unable to pay any dividends to PLDT. In addition, some of our subsidiaries are subject to covenants that restrict them from distributing cash to PLDT except under certain circumstances. In particular, Smart is subject to loan covenants that restrict its ability to distribute cash to PLDT. Although Smart received consents under its relevant loans that permitted it to make dividend payments to PLDT in December 2002 and June 2003, we cannot assure you that PLDT will continue to receive dividends or other distributions, or otherwise be able to derive liquidity from Smart or any other subsidiary or associate in the future.

Creditors of our subsidiaries will have prior claims to our subsidiaries' assets and cash flows. We and our creditors will effectively be subordinated to the existing and future indebtedness and other liabilities, including trade payables, of our subsidiaries, except that we may be recognized as a creditor on loans we have made to subsidiaries. If we are recognized as a creditor of a subsidiary, our claim will still be subordinated to any indebtedness secured by assets of the subsidiary and any indebtedness of the subsidiary otherwise deemed senior to indebtedness we hold.

*Our businesses require substantial capital investment, which we may not be able to finance*

Our projects under development and the continued maintenance and improvement of our networks and services, including Smart's projects, networks and services, require substantial ongoing capital investment. Our consolidated capital expenditures in 2001 and 2002 totaled Php30,554 million and Php14,699 million, respectively. Our 2003 budget for consolidated capital expenditures is Php16,000 million, of which approximately Php7,000 million is budgeted to be spent by PLDT and approximately Php9,000 million is budgeted to be spent by Smart. PLDT's capital spending is intended principally to finance the continued build-out of its data and Internet protocol infrastructures and for its data services and the maintenance of its network. Smart's capital spending is focused on expanding and upgrading its GSM network to meet increased demand for cellular services.

Future strategic initiatives could require us to incur significant additional capital expenditures. We plan to finance a portion of our future capital expenditures from external financing sources, which have not yet been fully arranged. We cannot assure you that financing for new projects will be available on terms acceptable to us or at all. If we cannot complete our development programs and other capital projects, our growth, results of operations and financial condition could be materially and adversely affected.

Our ability to refinance our debt and raise new financing to fund our working capital, capital expenditures and other needs depends on many factors beyond our control

In addition to our existing available credit facilities, we may require significant new external financing in order to fund all of our operating, investment, capital expenditures and debt service requirements and to refinance and extend the maturities of our short and medium-term indebtedness. Our ability to arrange for this and other financing and the cost of such financing will be dependent on numerous factors outside of our control, including:

- general economic and capital market conditions, including the peso-to-U.S. dollar exchange rate;
  
- the availability of credit from banks or other lenders;
  
- investor confidence in us;
  
- investor views about the Philippines;

- the continued success of our business;
- our credit ratings and the sovereign credit ratings of the Philippines; and
- provisions of tax and securities laws that may be applicable to our efforts to raise capital.

Any credit rating downgrades may significantly affect the availability and the terms of our prospective financing, including financing costs. In addition, restrictions under our current indebtedness subject us to various financial tests, which could prevent us from incurring additional debt. Inability to arrange such debt could materially and adversely affect our ability to fund our anticipated operating, investment and capital expenditures as well as our anticipated debt service requirements, and could result in defaults and cross defaults under our existing debt, thereby adversely affecting our results of operations and financial condition.

*If the peso depreciates against the U.S. dollar, our financial position could be materially and adversely affected*

Substantially all of our indebtedness and associated interest expense, a substantial portion of our capital expenditures and a portion of our operating expenses are denominated in U.S. dollars and other foreign currencies, but a significant portion of our revenues is denominated in pesos. As of December 31, 2002, 95% of our total consolidated long-term debt was denominated in U.S. dollars and other foreign currencies. A depreciation of the peso against the U.S. dollar increases the amount of our debt obligations and operating and interest expenses in peso terms. In the event that the peso depreciates against the U.S. dollar, we may be unable to generate enough funds through operations (such as by raising our service rates, including through adjustments to rates for local exchange service based on movements in the peso-to-dollar exchange rate) and other means to offset the resulting increase in our obligations in peso terms. Further, these changes could cause us not to be in compliance with the financial covenants imposed by our lenders under certain loan agreements and other indebtedness.

During the last decade, the peso has generally depreciated against foreign currencies. In addition, during this period, the Philippine economy has also, from time to time, experienced periods of concentrated peso devaluation and limited availability of foreign currency. Since June 30, 1997, when the BSP, announced that it would let market forces determine the value of the peso, the peso has experienced a significant decline against the U.S. dollar. It depreciated from Php26.376 = US\$1.00 on June 30, 1997, to Php53.254 = US\$1.00 as of December 31, 2002. The peso declined by approximately 3% against the U.S. dollar to Php53.254 = US\$1.00 as of December 31, 2002 from Php51.69 = US\$1.00 as of December 31, 2001. The peso has also been subject to significant fluctuations. For example, during the first half of 2003, the peso depreciated to a high of Php55.075 on March 12, 2003 and recovered to a low of Php52.021 on May 8, 2003. The peso may again be subject to significant fluctuations and may depreciate due to a range of factors, including:

- political and economic developments affecting the Philippines;
- the volatility of regional currencies, particularly the Japanese yen;
- any interest rate increases by Federal Reserve Bank of the United States;
- higher demand for U.S. dollars by both banks and domestic businesses to service their maturing U.S. dollar obligations; and
- some banks covering their short U.S. dollar positions.

*Our results of operations have been, and may continue to be, adversely affected by lower U.S. dollar revenues caused by declining international termination rates and competition in international long distance service*

The international long distance business was historically our major source of revenue. However, due to competition and the steep decline in international termination rates that are paid to us by foreign telecommunications carriers for termination of international calls on our network, revenues generated from our international long distance business had declined significantly in recent years. These decreases in prices for international long distance services were not fully offset by increases in call traffic volume. For example, on January 1, 2000, we adopted the U.S. FCC benchmark accounting rate of US\$0.38 per minute for inbound international calls, which represented a settlement rate of US\$0.19 per minute for international long distance traffic between the Philippines and the United States. Since then, our termination rates for inbound calls from the United States have continued to decline to levels well below the U.S. FCC benchmark accounting rate. PLDT increased its termination rates with carriers accounting for a substantial portion of its inbound international traffic terminating on its fixed line network to US\$0.12 per minute effective February 1, 2003 and the international inbound traffic volume has decreased by 12% compared to the international inbound traffic volume before the rate increase. Prior to the increase in termination rates, a substantial portion of PLDT's international inbound traffic terminating on its fixed line network was charged an average termination rate of approximately US\$0.08 per minute. Smart likewise implemented an increase in its international termination rates to US\$0.16 per minute effective February 1, 2003 for calls terminating on its cellular network. Moreover, our increased termination rates are the subject of an ongoing proceeding before the United States Federal Communication Commission, or U.S. FCC, brought by WorldCom, Inc., or MCI, and AT&T Corp., or AT&T. See Item 5. Operating and Financial Review and Prospects Other Information U.S. FCC Proceeding on Termination Rates and Item 8. Financial Information Legal Proceedings U.S. FCC Proceeding on Termination Rates for further discussion.

We anticipate that revenues from international communications and information services, including our services, will continue to decline in the future, due primarily to:

- installed and expanding fiber networks and satellite capacities that provide substantially more transmission capacity than may be needed in the short or medium term;
- substantial increases in the transmission capacity of new and existing networks, including those operated by our competitors, due to recent technological advances;
- increased competition from other domestic and international telecommunications providers;
- alternative providers offering Internet telephony and broadband capacity;
- advances in technology; and
- continued uncertainty over the acceptance by certain U.S. carriers of our new termination rates.

We cannot assure you that these declines will not materially and adversely affect our financial performance.

Net settlement payments between PLDT and other foreign telecommunications carriers for origination and termination of international call traffic between the Philippines and other countries have been our predominant source of foreign currency revenues. However, in U.S. dollar terms, these payments have been declining. Continued decline in our foreign currency revenues could increase our exposure to risks from declines in the value of the Philippine peso against the U.S. dollar. We cannot assure you that we will be able to achieve adequate increases in our other revenues to make up for any adverse impact of a further decline in our net settlement payments.

*We face strong competition and may need to increase our marketing expenditures or reduce our rates in order to compete effectively*

We cannot assure you that the number of providers of cellular telecommunication services will not increase or that competition for telecommunication customers will not lead our cellular and fixed line subscribers to switch to other

operators or lead us to increase our marketing expenditures or reduce our rates, resulting in a reduction in our profitability.

The Philippine government has liberalized the Philippine telecommunications industry and opened up the Philippine telecommunications market to new entrants. Including us, there are ten major local exchange carriers, 11 international gateway facility providers and seven cellular mobile telephone system providers in the Philippines, including one, which has not yet commenced operations. Many new entrants into the Philippine telecommunications market have entered into strategic alliances with foreign telecommunications companies, which provide them access to technological and funding support as well as service innovations and marketing strategies. Consequently, we are facing increasing competition in major segments of the telecommunications industry, particularly in the cellular segment and data and other network services segment.

The cellular telecommunications industry in the Philippines has been particularly competitive, as operators have sought to develop and maintain market shares and to attract new subscribers. Our principal cellular competitor, Globe Telecom, Inc., or Globe, acquired another telecommunications provider, Isla Communications Company, Inc., or Islacom, on June 27, 2001, thereby strengthening Globe as a competitor. Further consolidation in the industry could result in more vigorous competition. Digital Telecommunications Philippines, Inc., or Digitel, which was awarded a license to operate cellular telecommunications services in 2000, launched its cellular service, *Sun Cellular*, on March 29, 2003. In addition, the NTC has awarded a license to Bayan Telecommunications Philippines, Inc., or BayanTel, to operate cellular telecommunications services, but BayanTel has not yet commenced operations. The recent entry of Digitel is expected to create additional competition in the industry. In the future, the government may allocate further frequencies and award additional cellular telecommunications licenses, which would further increase competition.

Competitive pressures on cellular rates may affect our cellular revenues and revenue growth. For example, we have not increased our cellular rates to reflect fluctuations in the peso-to-U.S. dollar exchange rate since November 1998 as a result of such competitive pressures. In addition, our prepaid GSM subscribers can, using their existing handsets, switch to one of our competitors by having their handsets unlocked from our service for a fee and purchasing a new SIM card from the desired operator. We cannot assure you that these rate pressures and loss of customers will not have a material adverse effect on our financial performance.

If we are unable to install and maintain telecommunications facilities and equipment in a timely manner, we may not be able to keep up with our principal competitors, which may have negative implications for our revenue and profitability

Our business requires the regular installation of new, and the maintenance of existing, telecommunications transmission and other facilities and equipment. The installation and maintenance of these facilities and equipment is subject to risks and uncertainties relating to:

- shortages of equipment, materials and labor;

- work stoppages and labor disputes;
- interruptions resulting from inclement weather and other natural disasters;
- unforeseen engineering, environmental and geological problems; and
- unanticipated cost increases.

Any of these factors could give rise to delays or cost overruns in the installation of new facilities or equipment or could prevent us from properly maintaining the equipment used in our networks, and could have a material adverse effect on our results of operations and financial condition.

*Rapid changes in telecommunications technology may adversely affect the economics of our existing businesses and the value of our assets, increase our required capital expenditures and create new competition*

The telecommunications sector has been characterized recently by rapid technological changes. We cannot assure you that these developments will not result in competition from providers of new services or the need to make substantial capital expenditures to upgrade our facilities. For example, if third-generation, or 3G, cellular services were introduced in the Philippines, we would likely incur significant expenses if we were to roll out those services.

Our future success will depend, in part, on our ability to anticipate or adapt to such changes and to offer services that meet customer demands on a competitive and timely basis. We cannot assure you that we will be able to obtain new technologies on a timely basis or on satisfactory terms or implement them in an appropriate or effective manner. The development and introduction of new technologies by us or our competitors may cause significant portions of our existing assets to become obsolete and suffer an impairment in value earlier than their anticipated useful lives and require us to accelerate their depreciation. In 2001, we recognized impairment charges in respect of Smart's analog assets and Smart's unamortized intangible asset relating to analog subscriber lists. Piltel recognized impairment losses in respect of its AMPS/CDMA and Executive Order, or E.O. No. 109 assets in 2001 and 2002.

*The cellular telecommunications industry may not continue to grow or may grow at a slower rate*



A significant portion of our consolidated revenues is currently derived from the cellular telecommunications industry. As a result, we depend on the continued development and growth of the cellular telecommunications industry. Growth of the cellular communications market depends on many factors beyond our control, including the continued introduction of new and enhanced cellular devices and consumer preferences. Any economic, technological or other developments resulting in a reduction in demand for cellular services may harm our business.

*Our businesses depend on the reliability of our network infrastructure, which is subject to physical, technological and other risks*

The development and operation of telecommunications networks are subject to physical, technological and other risks, which may cause interruptions in service or reduced capacity for customers. These risks include:

- physical damage;
  
- power loss;
  
- capacity limitation;
  
- software defects; and
  
- breaches of security by computer viruses, break-ins or otherwise.

The occurrence of any of these risks could have a material adverse effect on our ability to provide services to customers, and could have a material adverse effect on our business.

Piltel has experienced financial difficulties and we cannot assure you that it will be able to discharge any of its debts or other obligations, including its debts or other obligations owed to us and our affiliates

Piltel has experienced significant financial difficulties in recent years. It has restructured substantially all of its debts in accordance with its debt restructuring plan, which was signed on June 4, 2001. Under the terms of such debt restructuring plan, PLDT issued a Letter of Support for the benefit of Piltel and its creditors under which PLDT has

agreed to cover any funding shortfalls of Piltel up to a maximum amount of US\$150 million, of which approximately US\$50 million remained undrawn as of December 31, 2002. In June and October 2002, more creditors of Piltel agreed to participate in its restructuring plan on the same terms. As of December 31, 2002, total restructured long-term debt of Piltel amounted to Php21,630 million, with maturities of up to June 14, 2016. Piltel is currently in the process of restructuring certain other debts. However, we cannot assure you that Piltel will be able to restructure or otherwise pay the claims relating to its unstructured debt or that Piltel will have sufficient cash flow to meet its debt service and other payment obligations, including its payment obligations to us. As of December 31, 2002, Piltel owed PLDT and Smart Php258 million and Php1,027 million, respectively, in respect of their respective facilities sharing and other agreements with Piltel. Until all amounts owed to creditors participating in the debt restructuring plan have been paid or discharged, PLDT will not be permitted to demand or receive any payment, redemption, or distribution in respect of any present and future liability owed by Piltel to PLDT or any affiliate of PLDT, subject to specified exceptions. These liabilities include amounts owed on Piltel preferred shares owned by PLDT and other financial indebtedness owed by Piltel to PLDT or any affiliate of PLDT, but exclude payments due in respect of transactions having arm's-length terms or in which the pricing is based on market terms. These severe long-term restrictions significantly impair Piltel's ability to transfer funds to PLDT.

Moreover, Piltel may not be able to restructure or otherwise pay the claims relating to its unstructured debt. As of December 31, 2002, Piltel had an aggregate principal amount of Php451 million of unstructured debt. Piltel does not intend to make any payments in respect of this debt unless and until it reaches a restructuring agreement with the creditors holding the obligations. If Piltel's non-participating creditors take forceful measures to enforce their claims, it is possible that Piltel would be required to submit itself to a court-supervised rehabilitation proceeding or an involuntary insolvency proceeding seeking liquidation. All of Piltel's creditors that participated in the debt restructuring agreed in connection with the debt restructuring that they would submit Piltel to a rehabilitation proceeding in those circumstances and petition for the adoption of a plan of rehabilitation that includes the financial terms of the debt restructuring plan. However, the laws and procedures governing a rehabilitation proceeding in the Philippine courts remain untested in significant respects. We cannot assure you that a rehabilitation plan, which incorporates the financial terms of the debt restructuring, would be adopted promptly or at all. Even if such a rehabilitation plan were adopted, we cannot assure you that Piltel will prove to be viable thereafter and that it will be able to meet its obligations, including its obligations owed to us or our affiliates.

A significant number of PLDT's shares are held by two separate shareholders, which may not act in the interests of other shareholders or stakeholders in PLDT

Affiliates of First Pacific directly or indirectly own approximately 31.4% of PLDT's common stock as of March 31, 2003. This is the largest block of PLDT's common stock that is directly or indirectly under common ownership. NTT Communications owns 14.9% of PLDT's common stock as of March 31, 2003 and has contractual veto rights over a number of major decisions and transactions that PLDT could make or enter into, including:

- capital expenditures in excess of US\$50 million;

- any investments, if the aggregate amount of new investments for the previous 12 months is greater than US\$100 million, determined on a rolling monthly basis;
- any investments in a specific investee, if the cumulative value of all investments made by PLDT in that investee is greater than US\$10 million in the case of an existing investee and US\$50 million in the case of a new investee;
- issuance of common stock or stock that is convertible into common stock;
- new business activities other than those we currently engage in;
- merger or consolidation; and
- the provision of financial support to Piltel in excess of that remaining available under the PLDT Letter of Support.

First Pacific and NTT Communications have also entered into a shareholders' agreement relating to PLDT. As a result of this agreement and their respective stockholdings, First Pacific and its affiliates and/or NTT Communications are able to influence our actions and corporate governance, including:

- elections of PLDT's directors; and
- approval of major corporate actions, which require the vote of common stockholders.

First Pacific and its affiliates and/or NTT Communications may exercise control over these decisions and transactions in a manner that could be contrary to your interests.

If First Pacific sells its interest in PLDT, the transaction may result in an event of default

On June 5, 2002, First Pacific announced that on June 4, 2002, it had entered into a Memorandum of Agreement, or MOA, with the Gokongwei Group and JG Summit Holdings, Inc. (the Gokongwei Group) in relation to First Pacific's existing interests in PLDT and Bonifacio Land Corporation. The MOA contemplated that upon satisfaction of certain conditions precedent, First Pacific would inject its existing 24.4% economic interest in PLDT into an entity in which the Gokongwei Group would purchase a two-thirds controlling interest. On October 2, 2002, First Pacific announced that the Gokongwei Group had terminated the MOA.

First Pacific has accepted the termination of the MOA by the Gokongwei Group. Accordingly, First Pacific has indicated that the transaction contemplated by the MOA will no longer proceed. First Pacific also stated in its announcement that it continues to review its strategic options in relation to its Philippine investments. On April 2, 2003, First Pacific announced that it is finalizing a business plan that will build on Indofood and PLDT as its core assets. Indofood, the food arm of First Pacific, is the leading processed-foods group in Indonesia.

If First Pacific or NTT Communications sells all or a portion of its equity interest in PLDT, in certain circumstances, such sale may give rise to an obligation for us to make an offer to purchase or prepay our outstanding debt under our 10.625% Notes due 2007 and our 11.375% Notes due 2012, our US\$145 million multicurrency term loan facility, our JPY9,760 million loan agreement with Japan Bank for International Cooperation, or JBIC and our JPY5,615 million term loan, and may result in a default under all of Smart's loan agreements. As of June 30, 2003, Php28,382 million (excluding the second tranche of the US\$145 million multicurrency term loan facility to be drawn in December 2003 and the JPY5,615 million term loan signed on June 11, 2003) in principal amount of PLDT's indebtedness is directly subject to a change in control offer to purchase or prepay requirement and Php22,891 million in principal amount of Smart's indebtedness is subject to an event of default in the event of a change in control of PLDT. If we fail to complete a required change in control offer to purchase or prepay the affected debts, all of our debt could become immediately due and payable as a result of various cross-default provisions. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Financing Activities Debt Financing Covenants.

The outcome of the proceeding at the U.S. FCC is uncertain and could materially affect our ability to engage in business in the United States and our results of operations

After lengthy negotiations commencing in May 2002 with carriers around the world, PLDT increased its termination rates with carriers accounting for a substantial portion of its international traffic terminating on its fixed line network to US\$0.12 per minute effective February 1, 2003 for international long distance calls terminating on its fixed line network. Prior to the increase in termination rates, a substantial portion of PLDT's international inbound traffic terminating on its fixed line network was charged an average termination rate of approximately US\$0.08 per minute. Despite numerous extensions by PLDT of PLDT's agreements on termination charges with AT&T and MCI to facilitate continued negotiation over termination rates, AT&T and MCI failed to reach an agreement with PLDT on a termination rate and thus, effective February 1, 2003, PLDT ceased terminating traffic from MCI and AT&T. Smart likewise implemented an increase in its termination rates to US\$0.16 per minute effective February 1, 2003 for calls terminating on Smart's cellular network. On February 7, 2003, AT&T and MCI filed separate petitions with the U.S. FCC requesting the U.S. FCC to take action to protect U.S. international carriers and U.S. consumers from alleged whipsawing behaviour occurring on the U.S.-Philippine route. In response to the petitions and notwithstanding significant objection from PLDT and other Philippine international carriers, on March 10, 2003 the International Bureau of the U.S. FCC issued an Order directing all facilities-based carriers subject to U.S. FCC jurisdiction to

suspend payments for termination services to PLDT, Smart and other Philippine carriers until such time as the U.S. FCC issues a public notice that AT&T's circuits on the U.S.-Philippine route are fully restored. The Order also removed the Philippines from the list of U.S. international routes approved for the provision of International Simple Resale. In response to the Order of the International Bureau of the U.S. FCC, on March 12, 2003 the NTC issued a Memorandum Order directing all affected Philippine carriers, including us, not to accept terminating traffic via direct circuits from certain U.S. facilities-based carriers, including AT&T and MCI, if we are not being paid for it. On April 9, 2003, we filed with the U.S. FCC an application for review of the International Bureau's March 10, 2003 Order. See Item 5. Operating and Financial Review and Prospects Other Information U.S. FCC Proceeding on Termination Rates and Item 8. Financial Information Legal Proceedings U.S. FCC Proceeding on Termination Rates for a detailed discussion of the history and procedural process of the U.S. FCC proceeding.

Although we believe that, based upon the applicable legal principles and facts, the March 10, 2003 Order was incorrect and should be overturned upon appeal, we cannot assure you that the March 10, 2003 Order will not remain in effect. It is also possible that the U.S. FCC could take further actions in light of allegations or complaints that have been made or may in the future be made by AT&T, MCI, or other US facilities-based carriers. The U.S. FCC may have the authority in this regard to prohibit the transmission of all telecommunication traffic originating in the United States and destined for the Philippines, although we believe it unlikely that the U.S. FCC would take such action. To date, subsequent to the March 10, 2003 Order, our revenues derived from international long distance calls have not been materially adversely affected by the actions taken by the International Bureau of the U.S. FCC and the NTC because most of the traffic originating in the United States are being re-routed through circuits of third parties in other countries or otherwise not subject to this order. We can provide no assurance that over a longer period of time our international long distance revenues will not be materially adversely affected by the March 10, 2003 Order. In addition, we can provide no assurances that the U.S. FCC will not take other actions that may materially adversely affect our business in the United States or our revenues derived from our international long distance service.

*PLDT's franchise may be revoked if we are unsuccessful in legal proceedings, which are pending*

The Constitution of the Philippines requires that at least 60% of the capital of a corporation operating a public utility in the Philippines be owned by Philippine citizens. In 1990, the then-Solicitor General of the Philippines instituted legal proceedings seeking to revoke PLDT's franchise on various grounds, including violation of this requirement. We believe that these proceedings are without merit. In 1991, the Philippine Congress extended the term of PLDT's franchise until 2028 and broadened PLDT's franchise authority. The Congress granted this amended franchise to PLDT despite these pending legal proceedings and despite the opposition of the Solicitor General. The Solicitor General has not taken any further action to pursue or continue the proceedings on this case. The parties filed their last pleadings in 1992 and since then the case has remained inactive. Consequently, under a court order dated January 20, 1999, the case has been archived, though the case can potentially be revived by action of either PLDT or the Solicitor General's office. It is normal practice for Philippine courts to archive cases that remain inactive for a long period of time. We are not aware of any court notice for the resumption of the proceedings in this case.

Our business is significantly affected by governmental laws and regulations, including regulations in respect of our franchises and rates

We operate our business under franchises, each of which is subject to amendment, termination or repeal by the Philippine Congress. Additionally, PLDT operates pursuant to various provisional authorities and certificates of public convenience and necessity, or CPCNs, which are granted by the NTC and expire between now and 2028. Some of PLDT's CPCNs and provisional authorities have already expired. However, PLDT filed applications for extension of these CPCNs and provisional authorities prior to their respective expiration dates and is therefore entitled to continue to conduct its business under its existing CPCNs and provisional authorities pending the NTC's decisions on these extensions. Smart also operates its cellular, international long distance, national long distance and global mobile personal communications via satellite services pursuant to CPCNs, which will expire upon the expiration of its franchise. Smart's franchise is due to expire on March 27, 2017, 25 years after the date on which its current franchise was granted. Smart operates international private leased circuits under a provisional authority, which expired on May 6, 2003. Smart applied for an extension of this provisional authority prior to its expiration. Because PLDT and Smart filed the applications for extension on a timely basis, we expect that these extensions will be granted. However, we cannot assure you that the NTC will grant these extensions. If a CPCN has not been issued, the NTC may permit an operator to provide services pursuant to a provisional authority. Provisional authorities are typically granted for a period of 18 months. The Philippine Revised Administrative Code of 1987 provides that if the grantee of a license or permit, such as a CPCN or provisional authority, has made timely and sufficient application for the extension thereof, the existing CPCN or provisional authority will not expire until the application is finally decided upon by the administrative agency concerned. However, we cannot assure you that our franchises, CPCNs and provisional authorities will be renewed. For a description of our licenses, see Item 4. Information on the Company Licenses and Regulation.

The NTC also regulates the rates we are permitted to charge for services that have not yet been deregulated, such as local exchange services. We cannot assure you that the NTC will not impose additional obligations on us that could lead to the revocation of our licenses if not adhered to and/or reduction in our operating revenues or profitability. In addition, the NTC could adopt changes to the regulations governing our interconnection with other telecommunications companies or the rates and terms upon which we provide services to our customers that could have a material and adverse effect on our results of operations.

*The NTC may implement proposed changes in billing requirements for cellular operators, which may have negative implications for our revenues and profitability*

On June 16, 2000, the NTC issued Memorandum Circular No. 13-6-2000 proposing that cellular operators, including Smart and Piltel, be required, among other things:

- to bill their subscribers for cellular calls on a six-second pulse basis instead of the current per minute basis;
- not to bill calls directed to recorded voice messages; and
- to extend the expiration date of prepaid cards from the current two months to two years.

Although Philippine cellular operators obtained a preliminary injunction restraining the implementation of the Memorandum Circular, on October 9, 2001, the Court of Appeals annulled the preliminary injunction and dismissed the cellular operators' complaint against the NTC. On January 10, 2002, the Court of Appeals denied the cellular operators' motion to reconsider its earlier ruling. On February 22, 2002, Smart and Piltel filed a Petition for Review by Certiorari with the Supreme Court to annul and reverse the decision of the Court of Appeals. Pending the decision of the Supreme Court on the matter, the NTC cannot implement the billing and other requirements proposed in the Memorandum Circular. We cannot assure you that the NTC will not seek to implement the billing and other requirements proposed in the Memorandum Circular if the case is eventually decided against the cellular operators. If the measures proposed are implemented, Smart and Piltel's operating revenues could be materially and adversely affected.

We may be subject to significant local business and franchise taxes if we are unsuccessful in legal proceedings, which are pending

We are currently facing various lawsuits for local business and franchise taxes assessed by different local government units, as described under Item 8. Financial Information Legal Proceedings Taxation Local Business and Franchise Taxes." Generally, each province may impose local franchise tax at a rate of up to 0.5% of the gross annual receipts received or realized within that province. Cities within each province may also impose annual franchise taxes on gross annual receipts received or realized in those cities, at a rate that may not exceed the provincial franchise tax rate by more than 50%. In one case, involving the City of Davao, the Supreme Court has ruled that we are not exempt from payment of local business and franchise taxes. On March 25, 2003, the Supreme Court denied our motion for reconsideration and affirmed the local franchise tax assessment of Davao City in the amount of approximately Php3.7 million. Although such a decision would constitute a precedent, this will not automatically result in the termination of the other pending local franchise tax cases, with the courts rendering decisions adverse to us. While the courts in these cases are expected to adhere to this Supreme Court decision, each court would have to make its own determination based on the evidence introduced by the parties and the factual circumstances of each case. We cannot assure you that other local government units will not file lawsuits against us or otherwise claim amounts owed in respect of business and franchise taxes. If the courts rule against us, we would be liable for these taxes, including interest and penalties, for past periods to the extent these taxes are assessed within five years from the date they were due and for future periods.

As of December 31, 2002, the aggregate amount claimed by the plaintiffs in these lawsuits was Php4,524 million with respect to PLDT, Php313 million with respect to Smart, and Php4.5 million with respect to Piltel. In addition, we have received assessments for local business and franchise taxes in the aggregate amount of Php24 million, all of which are under administrative protest. We believe that in the event these lawsuits and protests were decided against us, in many cases, we would not be liable for the full amounts claimed by the local governments because these amounts (1) were computed based on the gross annual receipts received or realized not only from within the related province or city for the related period but also from gross annual receipts received or realized from other provinces or cities and (2) include assessments for periods occurring more than five years before the respective lawsuits were filed. Accordingly, in the event these lawsuits are decided against us, we believe that our potential liability is likely to be significantly lower than the amounts claimed by the plaintiffs.

If we continue to implement our manpower reduction program, PLDT's labor relationship with its rank-and-file employees' union may deteriorate and result in labor unrest, which could materially adversely affect our operations and financial condition.

Over the past several years, we have been implementing a manpower reduction program to reduce the cost base of PLDT's fixed line business, which has faced significant changes in technology, increasing competition, and shifting market preferences to cellular use. We have been implementing the manpower reduction program under the New Labor Code and in compliance with all other relevant labor laws and regulations. We currently expect that by the end of 2003 PLDT's headcount will be reduced to approximately 10,500 employees, from 11,777 employees as of March 31, 2003.

As part of our manpower reduction program, 322 employees that were providing our regional operator services, where call volumes have significantly declined, were terminated effective December 31, 2002. After a series of failed reconciliation meetings between representatives of PLDT and our rank-and-file employees' union, the union staged a 14-day strike beginning on December 23, 2002. The strike ended on January 6, 2003 by virtue of a return-to-work order issued by the Secretary of Department of Labor and Employment, or DOLE. Moreover, the DOLE Secretary, in the same order, certified the labor dispute to the National Labor Relations Commission, or NLRC, for compulsory arbitration. The NLRC has yet to schedule arbitration proceedings on the union's complaint against PLDT.

If we continue implementing our manpower reduction program, which calls for more reductions in the number of rank-and-file employees of our fixed line business, our relationship with our rank-and-file employees' union may deteriorate. The union may decide to stage strikes, work stoppages, lockouts or other labor unrest against PLDT, which may disrupt our business operations. In addition, the Collective Bargaining Agreement with our rank-and-file employees' union will expire on November 8, 2003. If our relationship with the rank-and-file employees' union deteriorates as a result of the continued implementation of our manpower reduction program, we may not be able to enter into a new Collective Bargaining Agreement on the same or similar terms as before. As a result, our business operations and financial condition may be adversely affected.

Alleged health risks of wireless communications devices could lead to decreased wireless communications use, increased difficulty in obtaining sites for base stations or potential litigation.

We are aware of allegations that there may be health risks associated with the effects of radio waves emitted from transmitter masts and wireless handsets. While there is currently no substantiated link between radio waves and health issues, the actual or perceived health risks of wireless communications devices could adversely affect our wireless activities through a reduction in customers, reduced usage per customer, or increased difficulty in obtaining sites for transmitters and exposure to potential litigation or other liabilities.

### ***Risks Relating to the Philippines***



*Our business may be affected by political or social instability in the Philippines*

Our results of operations and financial performance and condition may be influenced by the general political situation in, and the state of the economy of, the Philippines. In February 1986, a peaceful military and civilian uprising ended the 21-year rule of President Ferdinand Marcos and installed Corazon Aquino as President of the Philippines. Between 1986 and 1989, there were several *coup d'état* attempts against the Aquino administration, none of which was successful. Political and economic conditions in the Philippines were generally stable during the 1990's following the election of Fidel V. Ramos as President in 1992. However, during 2000, his successor President Joseph Estrada was subject to allegations of corruption, culminating in impeachment proceedings, mass public protests in the Metropolitan Manila area, withdrawal of the support of the military, and his stepping down from office. Then Vice President, Gloria Macapagal-Arroyo, was sworn in as President on January 20, 2001. On April 25, 2001, Estrada was arrested on a non-bailable charge of plunder that resulted in public protests by his supporters on May 1, 2001. In response, President Macapagal-Arroyo declared a week-long "state of rebellion." On May 14, 2001, the Philippines held legislative elections, following which President Macapagal-Arroyo's coalition won a majority of the seats in the Senate. On May 10, 2004, the Philippines will hold presidential elections as well as elections for members of the Senate and Congress.

In the past three years, an increasing number of kidnapping, criminal and terrorist activities have occurred in Mindanao principally led by the extremist "Abu Sayyaf" group, which reportedly has ties to the Al-Qaeda terrorist network. In recent months, there have been a series of bombing incidents in key cities in Mindanao, including Davao City. The armed conflict between the Philippine military and the communist Moro Islamic Liberation Front also continues in Mindanao. As a result of these terrorist activities, the Armed Forces of the Philippines and the United States military are engaged in joint military activities in Mindanao.

In November 2001, members of rebel groups damaged three of Smart's cell sites located in Central Luzon and one of our relay stations, including some radio facilities, in southern Mindanao in response to our failure to pay revolutionary taxes demanded by these groups. In October 2002, a group of unidentified armed men inflicted minor damage on Smart's cell site in Bicol.

We cannot assure you that political events or terrorist activities will not again result in major public protest or the involvement of the military in politics. Any political instability in the future may have a negative effect on our results of operations and financial condition. We cannot assure you that the political environment in the Philippines will be stable or that the current or any future government will adopt economic policies conducive to sustained economic growth or which do not impact adversely on the current regulatory environment for telecommunications or other companies.

Our results of operations may be negatively affected by slow or negative growth rates and economic instability in the Philippines and in Asia

In the past, the Philippines has experienced periods of slow or negative growth, high inflation, significant devaluation of the peso, imposition of exchange controls, debt restructuring and electricity shortages and blackouts.

From mid-1997 to 1999, the economies of a number of Asian countries experienced significant downturns. The regional economic turbulence affected the Philippine economy in a number of ways, including the depreciation of the peso, increases in interest rates, increases in unemployment and inflation, increased volatility and a decline in prices in the domestic stock market, the downgrading of the Philippines' local currency rating and the ratings outlook for the Philippine banking sector and the reduction of foreign currency reserves.

In 2002, the Philippine government incurred a fiscal deficit of Php212,000 million, which represented approximately 5.3% of the 2002 nominal gross domestic product, or GDP, largely due to weak tax collection. The fiscal deficit for 2003 is expected to reach Php202,000 million. As of April 2003, the fiscal deficit was approximately Php65,500 million. On April 24, 2003, Standard & Poor's announced a lowering of the credit rating of the Philippines to BBB from BBB+ mainly as a result of long-term fiscal deficit concerns. This, in turn, has resulted in the depreciation of the peso against the U.S. dollar and the volatility of the prices of shares traded on the domestic stock market as well as prices of Philippine sovereign and corporate bonds.

In the second half of 2000 and the first half of 2001, the political developments relating to the allegations of corruption in the Estrada administration as well as economic events, for example, the growing government fiscal deficit and a global increase in oil prices, have resulted in increased concerns about the political and economic stability in the Philippines. This, in turn, has resulted in the depreciation of the peso against the U.S. dollar and the volatility of the prices of shares traded on the domestic stock market.

We cannot assure you that these factors will not affect our results of operations in a materially adverse manner.

*If foreign exchange controls were to be imposed, our ability to meet our foreign currency payment obligations could be adversely affected*

Approval from or registration with the BSP for the issuance and guarantee of foreign currency denominated borrowings is not required in order to make our foreign currency payment obligations legally valid and binding. However, receiving this approval and registration will enable a borrower to access the banking system to obtain foreign currency to service its debt obligations rather than using other sources of foreign currency, for example, foreign currency revenue streams.

The Philippine government has, in the past, instituted restrictions on the conversion of pesos into foreign currency and the use of foreign exchange received by Philippine companies to pay foreign currency-denominated obligations. The Monetary Board of the BSP has statutory authority, with the approval of the President of the Philippines, during a foreign exchange crisis or in times of national emergency, to:

- suspend temporarily or restrict sales of foreign exchange;
- require licensing of foreign exchange transactions; or
- require the delivery of foreign exchange to the BSP or its designee banks.

We cannot assure you that foreign exchange controls will not be imposed in the future. If imposed, these restrictions could materially adversely affect our ability to obtain foreign currency to service our foreign currency obligations.

*The occurrence of natural catastrophes may materially disrupt our operations*

The Philippines has experienced a number of major natural catastrophes over the years including typhoons, volcanic eruptions and earthquakes that may materially disrupt and adversely affect our business operations. We cannot assure you that the insurance coverage we maintain for these risks will adequately compensate us for all damage and economic losses resulting from natural catastrophes.

Item 7. Information on the Company

**Overview**

We are the leading national telecommunications service provider in the Philippines. Through our three principal business groups—fixed line, wireless, and information and communications technology—we offer a wide range of telecommunications services to over 11 million subscribers in the Philippines, on the nation's most extensive fiber optic backbone and fixed line, cellular and satellite networks.

We are the leading fixed line provider in the Philippines with approximately 66% of the total reported fixed lines in service nationwide as of March 31, 2003. Smart is the leading cellular service provider in the country, with approximately 45% of total reported cellular subscribers as of March 31, 2003. Piltel had approximately 12% of total reported cellular subscribers as of March 31, 2003. We have interests in the information and communications technology sectors, including *Vitro*™, an Internet data center, two call centers, namely Parlance and Vocativ, and Infocom, one of the leading ISPs in the Philippines.

Our common shares are listed on the Philippine Stock Exchange and our American Depositary Shares are listed on the New York Stock Exchange and the Pacific Exchange. We had a market capitalization of approximately Php95,647 million (US\$1,787 million) as of June 30, 2003, representing one of the largest market capitalizations among Philippine-listed companies. For the year ended December 31, 2002, we had consolidated revenues, net loss and EBITDA of Php95,540 million (US\$1,794 million), Php4,477 million (US\$84 million) and Php29,443 million (US\$553 million), respectively. See footnote 5 to the selected financial data table in Item 3. Key Information Selected Financial Data for a quantitative reconciliation of EBITDA on a consolidated basis to income (loss) before minority interest in net income (losses) of consolidated subsidiaries.

Our principal executive offices are located at the Ramon Cojuangco Building, Makati Avenue, Makati City, Philippines and our telephone number is (632) 816-8024. Our website address is [www.pldt.com.ph](http://www.pldt.com.ph). The contents of our website are not a part of this annual report.

## Historical Background and Development

PLDT was incorporated under the old Corporation Law of the Philippines (Act 1459, as amended) on November 28, 1928, following the merger of four telephone companies under common U.S. ownership. Under the amended Articles of Incorporation, the term of PLDT is limited to 2028. In 1967, General Telephone and Electronics Corporation (a major stockholder since PLDT's incorporation) sold its effective control of PLDT to a consortium of Filipino businessmen. In 1981, in furtherance of the then-existing policy of the Philippine Government to integrate the Philippine telecommunications industry, PLDT purchased substantially all of the assets and liabilities of Republic Telephone Company, which at that time was the second largest telephone company in the Philippines. During 1998, First Pacific, through its Philippine and other affiliates, acquired a significant interest in PLDT. On March 24, 2000, NTT Communications became PLDT's strategic partner with a 15% economic and voting interest in the issued common capital stock of PLDT. Simultaneous with NTT Communications' investment in PLDT, we acquired 100% of Smart.

PLDT's original franchise, which was granted in 1928, was last amended in 1991 to extend PLDT's franchise until 2028. The amended franchise (Republic Act No. 7082), which became effective on August 24, 1991, also broadened PLDT's franchise to permit PLDT to provide virtually every type of telecommunications service. PLDT's franchise covers the business of providing basic and enhanced telecommunications services in and between the provinces, cities and municipalities in the Philippines and between the Philippines and other countries and territories including mobile, cellular, wired or wireless telecommunications system, fiber optics, multi-channel transmission distribution systems and their value-added services such as but not limited to transmission of voice, data, facsimile, control signals, audio

and video, information services bureau and all other telecommunications systems technologies, as are at present available or can be made available through technical advances or innovations in the future. See Item 8. Financial Information Legal Proceedings Quo Warranto Action for information regarding legal proceedings initiated by the Solicitor General with respect to PLDT's franchise.

PLDT has made significant investments for the upgrade and expansion of its fixed line business in the mid- to late-90's when the Philippine government liberalized the telecommunications industry. Presently, PLDT has the most extensive fixed line access network in the country supported by a 5,400-kilometer domestic fiber optic backbone and digital microwave backbone. Since 2000, PLDT's capital expenditures have been focused on the expansion of its transmission and data network capacities as well as the maintenance of its network and other computerization and support projects. In addition, Smart has implemented an extensive deployment program for its GSM network since the launch of its GSM service in 1999 to meet the growing demand for GSM cellular service. As of the first quarter of 2003, Smart's digital network consists of 29 switching centers and 2,953 base stations covering 829 cities and municipalities.

On a consolidated basis, capital expenditures amounted to Php27,109 million, Php30,554 million and Php14,699 million in 2000, 2001 and 2002, respectively. Of these amounts, Php11,520 million, Php9,685 million and Php6,932 million were attributable to PLDT, while Php14,672 million, Php18,990 million and Php6,319 million were spent by Smart for 2000, 2001 and 2002, respectively. The remaining balance of Php917 million, Php1,879 million, and Php1,448 million were spent by our other subsidiaries, principally ePLDT, in 2000, 2001, 2002, respectively.

## Organization

Our two largest stockholders are First Pacific, a Hong Kong-based investment and management company engaged in consumer, telecommunications and property businesses, which, through its Philippine and other affiliates, beneficially owns 31.4% of our common stock, and NTT Communications, a wholly-owned subsidiary of Nippon Telegraph and Telephone Corporation of Japan, which beneficially owns 14.9% of our common stock.

PLDT and the following subsidiaries were all incorporated in the Philippines, except for PLDT Global, which was incorporated in the British Virgin Islands:

Name of Investee	Principal Activity	Percentage of Ownership		
		2000	2001	2002
<b>Fixed Line</b>				
Clark Telecom	Telecommunications services	100.0	100.0	100.0
Subic Telecom	Telecommunications services	60.0	100.0	100.0
Smart-NTT Multimedia, Inc.	Data and network services	100.0	100.0	100.0
PLDT Global and subsidiaries	Telecommunications services		100.0	100.0

MaraTel	Telecommunications services	92.3	97.5
<b>Wireless</b>			
Smart and subsidiaries	Cellular mobile services	100.0	100.0 100.0
Telesat	Satellite communications services	94.4	94.4 94.4
ACeS Philippines	Satellite phone services	88.5	88.5 88.5
Mabuhay Satellite	Satellite communications services	67.0	67.0 67.0
Piltel and subsidiaries	Cellular mobile and telecommunications services	57.6	45.3 45.3
<b>Information and Communications Technology</b>			
ePLDT and subsidiaries	Information and communications infrastructure for internet-based services, e-commerce, call centers and IT-related services	100.0	100.0 100.0

### ***Fixed Line***

We are the leading fixed line operator in the Philippines and the only company providing fixed line telecommunications service throughout the country. Our fixed line business group offers local exchange, international long distance, national long distance, data and other network, and miscellaneous services. As of March 31, 2003, we had fixed lines in service of approximately 2.1 million, which remained relatively unchanged as compared to December 31, 2002. Revenues from our fixed line services accounted for 51% of our consolidated operating revenues for the year ended December 31, 2002.

We have a 5,400-kilometer long digital fiber optic backbone, which is supported by an extensive digital microwave backbone. Our fixed line network reaches all of the major cities and municipalities in the Philippines, with a concentration in the Metropolitan Manila area. Our network offers the country's most extensive connections to international networks through three international gateway switching exchanges, satellite systems and various regional submarine cable systems in which we have interests.

With a view to increasing fixed line revenues, we have recently introduced several new fixed line services, including *Telesulit*, a prepaid fixed line service, as well as new data and other network services, such as *Shops.work*, a network solution that allows electronic linking of retail stores; *Brains*, an integrated data network solutions package; and *Hype*, a two-way fixed line texting service.

### ***Wireless***

We provide cellular, satellite, VSAT and other services through our wireless business segment. Revenues from our wireless services accounted for 48% of our consolidated operating revenues for the year ended December 31, 2002.

We provide our cellular services through Smart and Piltel. Piltel offers cellular services using Smart's GSM network under a revenue sharing agreement, acting principally as a reseller of Smart's digital GSM capacity under its own branding and pricing strategy for voice and text messaging services. Our cellular services accounted for about 99% of our wireless business revenues in the year ended December 31, 2002. Smart is the leading cellular service provider in the Philippines, with approximately 7.4 million subscribers as of March 31, 2003, an increase of 8% from 6.8 million subscribers as of December 31, 2002, representing a market share of 45%. Piltel had approximately 2 million subscribers as of March 31, 2003, an increase of 12% from 1.8 million as of December 31, 2002, representing a market share of 12%. In the year ended December 31, 2002, the combined number of Smart's and Piltel's subscriber increased by 2.2 million, representing 58% of all cellular subscribers added by Philippines cellular operators in that period. In the three months ended March 31, 2003, Smart added 564,000 subscribers and Piltel added 205,000 subscribers. Since 2000, the aggregate number of Smart's and Piltel's cellular subscribers has outnumbered our fixed line subscribers. As of March 31, 2003, the combined subscribers of Smart and Piltel outnumbered our fixed line subscribers by more than 4 to 1. As of March 31, 2003, Smart and Piltel had the largest and third largest cellular subscriber bases, respectively, in the Philippines.

Smart's and Piltel's cellular subscriber gains were predominantly attributable to their prepaid GSM services, which Smart introduced in September 1999 and Piltel introduced in April 2000. Approximately 98% of Smart's and Piltel's combined subscribers were prepaid as of March 31, 2003. The predominance of prepaid service reflects one of the distinguishing characteristics of the Philippine cellular market. The growth in our prepaid service has enabled us to increase and broaden our subscriber base rapidly while controlling credit risk and reducing billing and administrative costs on a per-subscriber basis.

Cellular revenues are derived mainly from various voice and data services and sales of handsets and phone kits. Usage revenues, which comprise all voice and SMS and text-related services, contributed 67% of total cellular revenues in 2002 while the balance of 33% is generated from handset and phone kit sales associated with new subscriber activations.

Our cellular subscriber growth has also been driven by SMS, a text messaging service on GSM networks, which was introduced in 1999. SMS is extremely popular in the Philippines, particularly on the prepaid platform, as it provides a convenient and inexpensive alternative to voice and e-mail based communications. SMS has contributed significantly to the continued growth of our cellular data service revenues. During 2002, our SMS system handled 19,558 million outbound messages, an increase of 39% compared to 14,055 million outbound messages handled during 2001. During the first quarter of 2003, the volume of outbound messages handled by our SMS system was 6,069 million, a 35% increase over the 4,481 million outbound messages handled during the same period in 2002.

As of March 31, 2003, Smart's digital GSM network had 29 switching centers and 2,953 base stations covering 829 cities and municipalities, up from 2,777 base stations as of December 31, 2002, which covered 807 cities and municipalities. Piltel's prepaid GSM service, *Talk 'N Text*, is also supported on this network.

### ***Information and Communications Technology***

We conduct our information and communications technology businesses through our wholly owned subsidiary ePLDT, which was incorporated in August 2000 and commenced commercial operations in February 2001. ePLDT is a broad based integrated information and communications technology company, focusing on infrastructure and solutions for Internet applications, Internet protocol based solutions and multimedia content delivery. ePLDT's principal activities are:

- the operation of an Internet data center under the brand name *Vitro* ;
- two wholly owned call centers, Vocativ and Parlance; and
- Infocom, an ISP.

ePLDT has also invested in a number of other e-commerce and Internet-related businesses, as described in Business Information and Communications Technology Infrastructure and Services Other Investments below.

As a new business, revenues from our information and communications technology services accounted for less than 1% of our consolidated operating revenues in 2002.

### **Strengths**

We believe our business is characterized by the following competitive strengths:

- *Recognized Brands*. PLDT and Smart are strong and widely recognized brand names in the Philippines. We have built the PLDT brand name for over 70 years as the leading telecommunications provider in the Philippines. Smart is recognized in the Philippines as an innovative provider of high-quality cellular services. Piltel's *Talk 'N Text* brand, which is provided using Smart's GSM network, has also gained significant recognition.



- *Leading Market Shares.* With over 11 million subscribers as of March 31, 2003, we have the leading market position in both the fixed line and cellular markets in the Philippines. ePLDT's subsidiary, Infocom, is one of the leading ISPs in the Philippines.
- *Diversified Product Mix.* We have reduced our dependence on our long distance business, which accounted for approximately 20% of our consolidated operating revenues in 2002, compared to 25% in 2001 and 38% in 2000. Our wireless business has become a significant revenue contributor, accounting for 48%, 41% and 26% of our total operating revenues in 2002, 2001 and 2000, respectively. We currently generate the balance of our operating revenues from a range of products, including local exchange services, and data and other network-based services.
- *Advanced Integrated Network.* With one of the most advanced and extensive telecommunications networks in the Philippines, we are able to offer a wide array of communications services. We are enhancing the capabilities of our fixed line and wireless networks to allow us to better exploit this competitive strength and achieve higher levels of network efficiency in providing voice and data services.
- *Innovative Products and Services.* We have successfully introduced a number of innovative and award-winning cellular products and services, including *Smart zedä*, *Smart Money*, *PureTxt 100*, *addict mobile* and *SmartLoad*. We have likewise launched new fixed line services, including *Telesulit*, a prepaid fixed line service; *Hype*, a two-way fixed line texting service; and data and other network services such as *Brains*, a data network solutions package, and *Shops.work*, a network solution that allows electronic linking of retail stores.
- *Strong Strategic Relationship.* We have an important strategic relationship with NTT Communications. The technological support, international experience and management expertise made available to us through this strategic relationship enhance our market leadership and ability to provide and cross-sell a more complete range of products and services.

## Strategy

The key elements of our business strategy are:

- *Build on our leading positions in the fixed line and cellular businesses.* We plan to build on our position as the leading provider of fixed line service in the Philippines by continuing to launch new products and services to increase subscriber value and utilization of our existing facilities and equipment at reduced cost. We plan to build on our position as the leading wireless service provider in the Philippines by continuing to introduce new products and services to increase our subscribers' use of our network for both voice and data, as well as

their reliance on our services. We also plan to further increase the capacity and expand the geographic reach of our cellular network as well as to improve our service quality and indoor coverage.

- *Capitalize on our strength as an integrated provider of telecommunications services.* We offer the broadest range of telecommunications services among all operators in the Philippines. We plan to capitalize on this position to maximize revenue opportunities by bundling and cross-selling our products and services between voice and data and fixed line and cellular. We are also lowering our costs by integrating the operations of our different businesses.
- *Strengthen our leading position in the data transmission market.* Recognizing the significant growth potential of data and other network services, including Internet-based services, and their increasing importance to PLDT's overall business strategy, we are emphasizing the development of our data and network business segment to address the needs of large corporations, small and medium-sized enterprises and retail customers. We have launched a variety of products and services, including digital leased lines, frame relay and other packet-based data services. We are progressively introducing asymmetric digital subscriber line, or ADSL, technology to our network.
- *Strengthen our financial position.* We are engaged in a number of initiatives to strengthen our financial position. We are working to increase our cash flow available for debt reduction by containing our operating costs, reducing capital expenditures and capping investments in subsidiaries. In December 2002 and June 2003, Smart paid cash dividends to PLDT. We will continue to seek dividend payments from Smart to supplement PLDT's cash flows available for debt reduction.

## **Business**

### **Fixed Line**

We provide local exchange, international long distance, national long distance, data and other network and miscellaneous services under our fixed line business segment.

#### *Local Exchange Service*

#### *Overview*

Our local exchange service, which consists of our basic voice telephony business, is provided primarily through PLDT. On August 31, 2000, Smart transferred its fixed line business to PLDT.

The following table summarizes key measures of PLDT's local exchange service segment as of and for the years ended December 31, 2000, 2001 and 2002:

	<b>Years Ended December 31,</b>		
	<b>2000</b>	<b>2001</b>	<b>2002</b>
Number of PLDT local exchange lines in service	1,915,985	2,075,109	2,092,539
Growth rate	9%	8%	1%
Number of PLDT employees	13,285	12,915	12,131
Number of local exchange lines in service per employee	144	161	172
Consolidated local exchange revenues (in millions)	Php18,739	Php21,470	Php23,390
Growth rate		15%	9%
Local exchange revenues as a percentage of total operating revenues	30%	27%	24%

We also provide local exchange services through Clark Telecom, Subic Telecom, MaraTel and Piltel. Together, these subsidiaries account for approximately 1% of our total fixed lines in service.

We regularly introduce new products and services in an effort to increase our number of subscribers, improve our churn management efforts and minimize our credit risk exposure. Since 1999, PLDT has launched prepaid fixed line services under the brand names *Teletipid* and *Telesulit*, introduced additional value-added services, such as *Caller ID* and *conference calling*, and implemented initiatives aimed at increasing subscription in areas where we have excess capacity and reduced our installation fees, as described below under Rates.

Launched in August 2000, *Teletipid* is the Philippines' first prepaid fixed line service. Initially intended as an affordable alternative telephone service for consumers under difficult economic conditions, *Teletipid* now forms an important part of PLDT's overall churn and credit risk exposure management and subscriber retention strategy. In February 2002, PLDT launched a premium variant to *Teletipid* under the brand name *Telesulit*. As of December 31, 2002, we had 121,054 active *Teletipid* subscribers and 121,973 active *Telesulit* subscribers, which together represented 12% of our total fixed lines in service. For more information on *Teletipid* and *Telesulit*, see Item 5. Operating and Financial Review and Prospects Results of Operations 2002 Compared to 2001 Consolidated Operating Revenues Fixed Line Local Exchange Service and Results of Operations 2001 Compared to 2000 Consolidated Operating Revenues Fixed Line Local Exchange Service.

As of March 31, 2003, PLDT had 2,087,237 fixed lines in service, of which 116,874 were active *Teletipid* subscribers and 134,411 were active *Telesulit* subscribers. The combined *Teletipid* and *Telesulit* subscribers represented 12% of

our total fixed lines in service.

To attract new fixed line subscribers and retain existing ones, PLDT has introduced various value-added services such as *Caller ID*. *Caller ID* allows subscribers to identify callers by telephone number, and is now bundled at special rates with other value-added phone services, such as *call waiting*, *call forwarding*, *3-party conference calling* and *speed calling*.

#### *Rates*

*General.* As of December 31, 2002, basic monthly charges for PLDT's local exchange service in the Metropolitan Manila area were Php634 for a single-party residential line and Php1,321 for a single business line. Monthly charges vary according to the type of customer (business or residential) and location, with charges for urban customers generally being higher than those for rural/provincial customers. Service connection charges are currently Php895 for residential customers and Php1,330 for business customers. These one-time charges are uniform throughout the country. Other than basic monthly charges, we do not charge our postpaid subscribers for local calls.

PLDT adjusts its monthly local exchange service rates according to changes in the peso-to-U.S. dollar exchange rate. Under the authorization granted to us by the NTC, PLDT is permitted to increase and are required to decrease these rates by 1% for every Php0.10 change in the exchange rate relative to a base exchange rate of Php11 to US\$1. During 2002, PLDT implemented 13 upward and six downward adjustments in our monthly local exchange service rates.

PLDT's *Teletipid* and *Telesulit* customers do not pay a basic monthly charge but are charged on usage. Initially, the rate for local calls charged to our *Teletipid* customers was Php0.50 per minute but was increased to Php1.00 per minute, effective May 1, 2002. The rate for local calls charged to our *Telesulit* customers was also increased from an initial rate of Php0.75 per minute to Php1.00 per minute, effective February 1, 2003. The international and national long distance rates PLDT charges to its *Teletipid* and *Telesulit* customers are similar to the rates it charges its postpaid customers. For a description of these rates, see "International Long Distance Service Rates" and "National Long Distance Service Rates." *Teletipid* phone kits are sold for Php1,700 per unit, inclusive of Php300 worth of pre-stored call credits, while *Telesulit* phone kits are sold for Php1,900 per unit, inclusive of Php500 worth of pre-stored call credits.

Effective January 1, 2003, calls originating from cellular subscribers are charged a termination rate of Php2.50 per minute, an increase from the previous rate of Php2.00 per minute, which will further increase to Php3.00 per minute effective January 1, 2004.

#### *International Long Distance Service*

*Overview*

Our international long distance service consists of voice and packet-based voice services that go through our international gateway facilities. We also generate international long distance revenues through access charges paid to us by other Philippine telecommunications carriers for incoming international voice calls that terminate to our local exchange network. Our subsidiary, Subic Telecom, also provides international long distance services through its own international gateway facility. Our packet-based voice services are transmitted over our existing traditional circuits, the voice over Internet protocol, or VOIP, the network of a consortium of dominant carriers in Asia, and the asynchronous transfer mode, or ATM, Internet protocol global backbone of our wholly-owned subsidiary, PLDT Global.

The following table shows certain information about our international long distance business as of and for the years ended December 31, 2000, 2001 and 2002:

	<b>Years Ended December 31,</b>		
	<b>2000</b>	<b>2001</b>	<b>2002</b>
Total PLDT call volumes (million minutes)(1)	2,378	2,814	2,576
Growth rate	103%	18%	(8%)
Inbound call volumes (million minutes)	2,237	2,648	2,409
Growth rate	115%	18%	(9%)
Outbound call volumes (million minutes)	141	165	167
Growth rate	5%	17%	1%
Inbound-outbound call ratio	15.8:1	16.0:1	14.4:1
Consolidated international long distance revenues (in millions)	Php13,226	Php11,544	Php10,957
Growth rate		(13%)	(5%)
International long distance revenues as a percentage of total operating revenues	21%	15%	11%

(1) Call volumes for the years ended December 31, 2000 and 2001 have been restated to conform with our 2002 financial statement presentation which includes interconnection traffic.

International long distance service historically was our major source of revenue. However, due to the steep decline in inbound termination rates and collection rates and intense competition, revenues derived from our international long distance service have been declining through the end of 2002. We adopted a two-pronged initiative in early 2000 with respect to inbound international service to try to address this issue. First, we lowered our termination rates at that time to market level to recapture market share from our competitors. Second, we intensified our efforts to identify and

contain operators that use illegal bypass route calls to the Philippines through more effective monitoring of our international trunks and leased lines. International simple resale operation occurs when a company rents an international leased line from a Philippine international gateway operator, aggregates traffic outside the Philippines and carries and terminates this traffic at the public switch telephone network in the Philippines. International simple resale can be used to bypass the local access charge system and is illegal in the Philippines.

Since 2001, we have become more selective in accepting incoming traffic from some carriers, particularly second and third tier international carriers. In addition, we adopted a policy in 2001 requiring prepayment from certain second and third tier international carriers as a prerequisite for accepting their incoming traffic. For a description of this policy, see Item 5. Operating and Financial Review and Prospects Results of Operations 2002 Compared to 2001 Consolidated Operating Revenues Fixed Line International Long Distance Service."

We are also pursuing a number of other initiatives to further strengthen our inbound business. We earn incremental revenues from foreign carriers by using our fiber optic submarine cable capacity to offer least cost call routing and regional hubbing. We also provide "carrier's carrier service" to new and emerging domestic and foreign service providers, including transit service that enables carriers to complete calls to countries to which they do not have a direct connection, and Internet telephony. We have formed PLDT Global to establish our presence in several countries in North America, Europe and Asia. Through arrangements with local carriers in these countries, we aggregate inbound call traffic to the Philippines at our points of presence and, using our capacity in submarine cable systems connected to each point of presence, transmit calls to our network. We believe this strategy will help us mitigate the effect of rapidly declining accounting and settlement rates for inbound traffic, maximize the use of our existing international facilities, collect inbound international traffic at their sources and develop alternative sources of revenues such as carrying traffic without routing through the Philippines.

To stimulate call volume growth and prevent further erosion in our share of outbound international call traffic, we have introduced a number of marketing initiatives, including substantial cuts in international direct dialing rates, innovative pricing packages for large accounts and loyalty programs for some customers.

The table below sets forth the net settlement amounts for international calls handled by PLDT, by country, for the years ended December 31, 2000, 2001 and 2002:

	<b>Net Settlement</b>		
	<b>Years Ended</b>		
	<b>December 31,</b>		
	<b>2000</b>	<b>2001</b>	<b>2002</b>
	<b>(in millions)</b>		
United States	US\$107	US\$82	US\$68
Japan	22	23	16
Australia	9	18	5

Saudi Arabia	12	7	5
Canada	15	10	7
Hong Kong	5	7	3
Taiwan	1	3	6
Singapore	1	1	1
Others	30	49	75
Total	US\$202	US\$200	US\$186

### *Rates*

We adopted the U.S. FCC benchmark accounting rate of US\$0.38 per minute for inbound international calls on January 1, 2000, which represented a settlement rate of US\$0.19 per minute for international long distance traffic between the Philippines and the United States. Adopting the U.S. FCC benchmark accounting rate one year ahead of the target date of January 1, 2001 allowed us pricing flexibility for inbound call traffic. This pricing flexibility enabled us to compete more effectively in the U.S.-Philippine telecommunications market. Our termination rates for inbound calls from the United States have continued to decline through the end of 2002 to levels below the U.S. FCC benchmark accounting rate. Termination rates for inbound calls from other countries have also been declining generally. As of December 31, 2002, a substantial portion of PLDT's international inbound traffic terminating on its fixed line network was charged an average termination rate of approximately US\$0.08 per minute. PLDT increased termination rates with carriers accounting for a substantial portion of its international inbound traffic terminating on its fixed line network to US\$0.12 per minute effective February 1, 2003.

On March 10, 2003, the International Bureau of the U.S. FCC issued an Order on petitions filed separately by AT&T and MCI requiring all U.S. carriers providing direct facilities-based service on the U.S.-Philippines route to suspend payments for termination services to Philippine carriers, including PLDT, Smart and Subic Telecom, until such time as the U.S. FCC issues a public notice that AT&T's circuits on the U.S.-Philippine route are fully restored. The Order also removed the Philippines from the list of U.S.- international routes approved for the provision of International Simple Resale. In response to the Order of the International Bureau of the U.S. FCC, the NTC issued a Memorandum Order dated March 12, 2003, directing all affected Philippine carriers (1) not to accept terminating traffic via direct circuits from U.S. facilities-based carriers who do not pay Philippine carriers for services rendered; and (2) to take all measures necessary to collect payments for services rendered in order to preserve the viability, efficiency, sustained growth and development and continued competitiveness of the Philippine telecommunications industry. On April 9, 2003, we filed with the U.S. FCC an application for review of the International Bureau's March 10, 2003 Order. Our revenues derived from international long distance calls have not been materially adversely affected by the Order of the International Bureau of the U.S. FCC because most of the facilities-based traffic originating in the United States is being re-routed through circuits of third parties not subject to the Order. See Item 3. Key Information Risk Factors Risks Relating to Us Our results of operations have been, and may continue to be, adversely affected by lower U.S. dollar revenues caused by declining international termination rates and competition in international long distance service, Item 5. Operating and Financial Review and Prospects Other Information U.S. FCC Proceeding on Termination Rates, Item 8. Financial Information Legal Proceedings U.S. FCC Proceeding on Termination Rates and Note 28 to our financial statements in Item 18 for further discussion.

Effective February 2001, PLDT reduced its IDD rates for retail customers from US\$0.49 per minute for off-peak hours and US\$0.69 per minute for peak hours to a flat rate for retail customers of US\$0.40 per minute applicable to all call destinations at any time and any day of the week. Additionally, in November 2001, PLDT introduced Budget Card, a prepaid call card offering a reduced IDD rate of US\$0.24 per minute for calls to the United States, Canada and Hawaii. Budget Cards are sold in a denomination of Php200, which must be used within 24 hours of activation.

### *National Long Distance Service*

#### *Overview*

Our national long distance services are provided primarily through PLDT. This service consists of voice services for calls made by our fixed line customers outside of their local service areas within the Philippines and access charges paid to us by other telecommunications carriers for calls carried through our backbone network and/or terminating to our fixed line customers.

The following table shows our national long distance call volumes and revenues as of and for the years ended December 31, 2000, 2001 and 2002:

	Years Ended December 31,		
	2000	2001	2002
Total PLDT call volumes (million minutes)	3,255	2,756	2,145
Growth rate	15%	(15%)	(22%)
Consolidated national long distance revenues (in millions)	Php10,453	Php8,367	Php8,191
Growth rate		(20%)	(2%)
National long distance revenue as a percentage of total operating revenues	17%	10%	9%

Cellular substitution and the widespread availability and growing popularity of alternative, more economical, non-voice means of communications, particularly e-mail and cellular text messaging, have negatively affected our national long distance call volumes. The integration of some of our local exchanges into a single local calling area effective August 2000, as mandated 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 are treated as local calls.



The technological changes we made from analog to digital switches has enabled us to increase data speed over our telephone lines and to shift customers from operator-assisted long distance service to lower-cost direct dialing service. As a result, a substantial number of our national long distance calls have been direct-dialed calls. Operator-assisted calls are charged based on a minimum of three minutes plus operator charges, while direct-dialed calls are charged on a less costly per minute basis.

In 2001, we launched *PLDT Premium Phone Services*, which allow customers to choose from a range of service applications, such as appointment-booking services for select embassies (including, among others, the U.S. and Australian embassies in the Philippines), spiritual and love counseling, joining television-based game shows, celebrity chatting, downloading and sending of ringtones and logos, televoting, job postings, and myMusic, a music entertainment line to various popular artists. PLDT charges a minimum of Php10 per minute for these premium phone services.

### *Rates*

Rates for national long distance calls are based on time, distance and type of service, such as whether the call is operator-assisted or direct-dialed. In the latter part of 2001, PLDT simplified its rates for calls to fixed line subscribers and for those terminating to cellular subscribers resulting in an overall rate increase. For calls terminating to fixed line subscribers, the applicable rates from January to November 1, 2001 ranged from Php3.00 to Php5.00 per minute, depending on distance and time of call. In line with its move towards rate simplification, PLDT simplified these rates to a flat rate of Php4.50 per minute effective November 2, 2001. At the same time, PLDT simplified its rates for calls terminating to cellular subscribers from a range of Php10.00 to Php16.00 per minute to a uniform rate of Php13.75 per minute. Effective March 1, 2003, PLDT increased the rate for calls terminating to other local exchange carriers from a flat rate of Php4.50 per minute to Php5.00 per minute. Through rate simplification, we aim to simplify our tariff structure in order to enhance the competitiveness of our products and services and increase our operating efficiencies.

In 2001, PLDT entered into new interconnection agreements with local exchange carriers and cellular operators. In May 2001, PLDT entered into a new interconnection arrangement with the majority of other local exchange carriers, pursuant to which the originating carrier pays (1) a hauling charge of Php0.50 per minute for short-haul traffic or Php1.25 per minute for long-haul traffic to the carrier owning the backbone network and (2) an access charge of Php1.00 per minute to the terminating carrier. In addition, effective January 2002, access charges being paid by PLDT to cellular operators were reduced to Php4.50 per minute from Php6.50 per minute it paid for the period from July to December 2001. Prior to July 2001, PLDT was paying access charges ranging from a low of Php7.69 per minute to a high of Php10.94 per minute for calls terminating to cellular subscribers, depending on whether the calls were local or long distance. We adopted simplified pricing plans and amended our interconnection agreements with cellular operators with a view to maximizing revenues of our national long distance service. PLDT still maintains revenue-sharing arrangements with a few other local exchange carriers, whereby charges are generally apportioned 30% for the originating entity, 40% for the backbone owner and the remaining 30% for the terminating entity. For more information on these interconnection arrangements, see Item 5. Operating and Financial Review and Prospects Results of Operations 2002 Compared to 2001 Consolidated Operating Revenues Fixed Line National Long Distance Service."

*Data and Other Network Services*

Recognizing the growth potential of data and other network services, including Internet-based services, and in light of their importance to our business strategy, we have been putting considerable emphasis on this service segment. In 2002 and 2001, this segment registered the highest percentage growth in revenues among our fixed line services.

The upgrading of our network in recent years through the completion of our domestic fiber optic backbone has enabled us to offer a growing range of value-added and broadband services. With this and other technological upgrades, our infrastructure is being developed from a traditional voice facility to a new packet-switched and Internet-based network that allows faster transmission of voice, video and data. Data services we currently provide include:

- traditional bandwidth service    high-speed point-to-point domestic and international digital leased line services;
  
- broadband/packet-based/Internet protocol-based services    frame relay, ATM, Internet protocol virtual private network, or IP-VPN, digital subscriber line, or DSL, Internet gateway and wholesale digital signal level 3, or DS3; and
  
- other packet-based switching services    Datapac and integrated services digital network, or ISDN.

The foregoing services are used for the following:

- domestic and international communication;
  
- broadband data transmission services that transmit data over a range of frequencies and/or bandwidth into several narrower bands;
  
- Internet exchange services that provide ISPs with a primary connection to the global Internet to exchange local traffic generated within the Philippines;

- private networking services that use the public Internet as a backbone for private interconnection between different locations;
- switch-based services, provided through a fixed bandwidth transmission facility, that allow establishment of a dedicated connection for the duration of the call; and
- international packet-based services, provided through bilateral arrangements and global alliances that integrate voice, video and data.

We continue to broaden our service offerings with the launch of new services and expansion or enhancement of some of the existing ones.

In March 2001, PLDT launched Remote Access Service, offering customers in the Philippines outsourced dial-up access to their local area networks and head offices from remote locations using our servers. PLDT has installed remote access servers at our local central offices located in 17 key cities throughout the Philippines.

In April 2001, PLDT launched IP-VPN, a networking service incorporating multi-protocol label switching. This switching technology assigns a label to each packet of data before it is sent through the public Internet. The label contains information such as destination, precedence and VPN membership designed to prevent access to information by persons outside their virtual private network. In June 2001, we expanded the coverage of our IP-VPN service by making it available throughout Southeast Asia through ACASIA, a joint venture telecommunications company owned by PLDT, Singapore Telecom, Telekom Malaysia, Jabatan Telecom Brunei, CAT of Thailand and PT Indosat.

In 2001, PLDT substantially increased the capacity of our *I-Gate* network by 110 megabits per second to 155 megabits per second to meet increased demand for broadband Internet access. *I-Gate* is our Internet gateway service that provides high-speed access to the global Internet. With the activation in December 2001 of the Asia Pacific Cable Network 2, of which PLDT is a part owner, we have further increased *I-Gate's* capacity to 290 megabits per second as of October 31, 2002. By the end of 2002, we increased *I-Gate's* capacity by 155 megabits per second, making it the biggest terrestrial Internet connection in the Philippines.

In the second half of 2001, PLDT accelerated the deployment of our DSL infrastructure to meet the growing demand for high-speed and dedicated Internet access. DSL is a broadband service that allows high-speed data transmission over ordinary (copper) telephone lines. PLDT's DSL service is now available in Metro Manila and other key cities in the Philippines under the brand names *PLDT DSL* for corporate customers and *myDSL* for retail customers.

In May 2002, PLDT launched a pay-per-use dial-up Internet service under the brand name *PLDT Vibe*, which is available on a postpaid or prepaid basis to PLDT's fixed line subscribers. Charges for this service are Php0.25 per minute for off-peak hours, which are from 10:01 p.m. to 6:00 a.m., and Php0.50 per minute for peak hours, which are from 6:01 a.m. to 10:00 p.m. With the launch of *PLDT Vibe*, PLDT now offers two residential Internet service packages targeting separate markets - *PLDT Vibe* for light to medium Internet users and *myDSL* broadband for heavy Internet users. As of December 31, 2002, the number of PLDT's postpaid fixed line subscribers that signed up for *PLDT Vibe* was 60,878, while the number of subscribers to *PLDT DSL* and *myDSL* broadband service reached 10,896. As of March 31, 2003, the number of PLDT's postpaid fixed line subscribers that signed up for *PLDT Vibe* was 72,263 while the number of subscribers to *PLDT DSL* and *myDSL* broadband service rose to 12,869 as of March 31, 2003.

In August 2002, PLDT launched *Shops.work*, a network solution that allows the electronic linking of retail stores providing, among others, sales and inventory reports, up-to-date and real-time monitoring of sales and inventory, and on-line access to head offices.

In March 2003, PLDT launched a number of data services, namely: *Continuum*, *iView* and *Encompass*, all under the *Brains* umbrella. *Brains Continuum* provides customers the ability to recover from service interruptions and offers network diversity, facility and hosting services in partnership with ePLDT. *Brains iView* enables customers to monitor the performance of their network, track bandwidth utilization patterns and identify the source of network problems. *Brains Encompass* provides a broad range of services for the customers' managed networking needs, be it a wide area network or local area network.

In April 2003, PLDT introduced a full two-way fixed line text messaging service under the brand name *Hype*, which allows subscribers to send and receive text messages to and from landline and mobile phones, and is capable of international text messaging. *Hype* also allows subscribers to join TV network-based and new PLDT-initiated texting services.

## **Wireless**

We provide cellular and satellite, VSAT and other services through our wireless business segment.

### *Cellular Service*

#### *Overview*

Our cellular business, which we provide through Smart and Piltel, is focused on providing products and services using our digital GSM network, including products and services based on SMS technology, such as *Smart zed* and *Smart Money*. Piltel's GSM prepaid service, *Talk 'N Text*, is also supported on Smart's GSM network.

The following table summarizes key measures of our cellular business as of and for the years ended December 31, 2000, 2001 and 2002:

	<b>Years Ended December 31,</b>		
	<b>2000</b>	<b>2001</b>	<b>2002</b>
Cellular subscriber base	3,515,293	6,368,850	8,599,306
Smart	2,858,479	4,893,844	6,825,686
GSM	2,331,005	4,641,666	6,825,686
Prepaid	2,263,322	4,569,616	6,649,038
Postpaid	67,683	72,050	176,648
Analog/ETACS (1)	527,474	252,178	
Prepaid(2)	282,529	87,429	
Postpaid	244,945	164,749	
Piltel	656,814	1,475,006	1,773,620
GSM Prepaid(3)	368,578	1,329,326	1,773,620
Analog/CDMA(1)	288,236	145,680	
Prepaid	200,042	76,473	
Postpaid	88,194	69,207	
Growth rate of cellular subscribers	137%	81%	35%
Smart	179%	71%	39%
GSM	1,119%	99%	47%
Analog/ETACS	(37%)	(52%)	(100%)
Piltel	44%	125%	20%
GSM Prepaid(3)	100%	261%	33%
Analog/CDMA	(37%)	49%	(100%)
Cellular revenues (in millions)	Php15,576	Php31,627	Php45,375
Service (4)	11,840	20,157	30,599
Handset sales(5)	3,736	11,470	14,776
Percentage of cellular revenues to total operating revenues	25%	40%	47%

(1) In December 2002, Smart closed down its analog/ETACS network. In 2001 and 2002, Piltel recognized impairment losses in respect of its AMPS/CDMA network.

(2) Prior to October 2000, Smart's prepaid analog subscribers were classified as inactive if they had not reloaded for at least three months. In October 2000, Smart changed its disconnection policy with respect to prepaid analog subscribers, eliminating the "inactive" classification and adopting the same disconnection periods applicable to its prepaid GSM subscribers.

(3) *Represents Talk 'N Text, a prepaid GSM service provided by Piltel using Smart's GSM network. Piltel's GSM revenue is net of service fees payable to Smart for using Smart's GSM network. Piltel does not offer postpaid GSM service.*

(4) *Refers to GSM and analog voice and data revenues.*

(5) *Includes revenue from handset sales.*

*Service Plans.* We market nationwide cellular communications services under the brand names *Smart Buddy*, *Smart Gold*, *addict mobile* and *Talk 'N Text*.

*Smart Buddy* is a prepaid service while *Smart Gold* and *addict mobile* are postpaid services. These three services are provided through Smart's digital GSM network. Of Smart's total cellular subscribers as of December 31, 2002, 97% were *Smart Buddy* prepaid subscribers and 3% were *Smart Gold* postpaid subscribers. *addict mobile* was introduced in April 2003. *Talk 'N Text* is a prepaid service provided using Smart's GSM network marketed by Piltel pursuant to a facilities service agreement between Smart and Piltel. Before Smart decommissioned its analog enhanced total access communications system, or ETACS, network in December 2002, it had also offered analog prepaid and postpaid services under the brand names *BillCrusher* and *PriceBuster*, respectively. Prior to 2002, Piltel had also offered analog prepaid and postpaid services under the brand names *Phone Pal* and *Mobiline*, respectively.

As of December 31, 2002 and March 31, 2003, Smart's and Piltel's combined cellular subscribers reached 8,599,306 and 9,368,513, respectively. As a result, the aggregate of Smart's and Piltel's cellular subscribers has outnumbered our fixed line subscribers since 2000. As of December 31, 2002, the combined subscribers of Smart and Piltel outnumbered our fixed line subscribers by more than 4 to 1. As of December 31, 2002, Smart had 6,825,686 subscribers, of which 6,649,038 were *Smart Buddy* prepaid subscribers and 176,648 were *Smart Gold* postpaid subscribers. Smart's prepaid and postpaid subscribers increased to 7,176,196 and 213,611, respectively, for a total of 7,389,807 subscribers, as of March 31, 2003. As of December 31, 2002 and March 31, 2003, Piltel's *Talk 'N Text* subscribers reached 1,773,620 and 1,978,706, respectively. Piltel does not offer postpaid GSM service.

*SMS and Other Value-added Services.* Our cellular subscriber growth has been driven by SMS, a text messaging service on GSM networks, which was introduced in 1999. SMS is extremely popular in the Philippines, particularly on the prepaid platform, as it provides a convenient and cost-efficient alternative to voice and e-mail based communications. Strong volume growth in SMS contributed significantly to our cellular revenue growth in 2002. The total volume of outbound messages handled by our SMS system during 2002 increased by 39% to 19,558 million from 14,055 million outbound messages handled during 2001. During the first quarter of 2003, our SMS system handled 6,070 million outbound messages, a 35% increase over the 4,481 million outbound messages handled during the same period in 2002.

Our value-added services are primarily based on SMS technology. We offer value-added services such as voice mail, information-on-demand, which is a service that allows subscribers to order information from our content providers whenever desired, mobile banking and *TextMail*, which is a service that allows subscribers to send and receive text messages through their personal computers, and location-based services. Since 2000, we have launched the following major value-added cellular services:

- *Smart zed*, a partnership with international cellular operator Sonera zed Ltd. of Finland, enables subscribers to personalize their information requirements not only as to the types of information required but also when the information is required. Sonera zed Ltd. has introduced a single platform that provides access to local and global information through SMS or wireless application protocol;
- *Mobile Banking*, launched in collaboration with various banks, allows subscribers to execute banking transactions, such as balance inquiries and transfers, over their mobile telephones; and
- *Smart Money*, launched in conjunction with MasterCard, enables subscribers to pay for their purchases by transferring money from their bank accounts to their *Smart Money* cards as well as reload their prepaid cards electronically.

Value added services offered through *Talk 'N Text* include group text messaging, or *Team TEXT*, balance inquiry via text, cell-to-cell instant reload that enables subscribers to reload their accounts through their handsets, and information-on-demand through the *zed* service.

Smart and Piltel have a number of interactive activities, such as text games and chat services, developed on their own platforms.

*Smart Money* was cited as the "Best Product Innovation" by MasterCard International and the "Most Innovative GSM Wireless Service for Customers" at the 3rd GSM World Congress held in Cannes, France, in March 2001.

Due to the high level of SMS usage, we believe that the Philippine market is well-suited for text-based informational and e-commerce services. Our current approach is to continue maximizing our GSM, or 2G, services. We also offer General Packet Radio Service, or GPRS or 2.5G, to service increased demand for bandwidth-intensive applications. GPRS allows data transfer at an average speed of up to 115 kilobits per second. In addition, we are in the process of upgrading our network to Enhanced Data rates for GSM Evolution, or EDGE. EDGE is a technology that would

further increase the speed and data capability of our GSM network.

#### *Rates*

*Smart Buddy* and Piltel's *Talk 'N Text* prepaid cards are sold in denominations of Php300, Php500 and Php1,000, which include 33, 83 and 250 free SMS text messages, respectively. The stored value of a prepaid card remains valid for a period of two months from the time a subscriber activates the card. On May 11, 2003, *Smart Buddy* and *Talk 'N Text* launched *SmartLoad*, an over-the-air electronic loading facility designed to make reloading of air time credits more convenient for, and accessible to *Smart Buddy* and *Talk 'N Text* subscribers. These over-the-air reloads, which have both voice and text functions, are packaged in smaller denominations of Php30, Php60 and Php115, but have shorter validity periods of 3 days, 6 days and 12 days, respectively. We had also previously offered *PureTxt 100*, a Php100-denominated prepaid card offering a text-only service designed as an alternative for *Smart Buddy* and *Talk 'N Text* subscribers who may have temporarily been unable to afford the Php300-denominated card. *PureTxt 100* cards came with a free allocation of ten text messages and were valid for one month. Like *PureTxt 100*, we believe that *SmartLoad* will encourage subscribers to stay within our network, instead of churning and re-subscribing at a later time. We have ceased the production and sale of *PureTxt 100* cards in anticipation that our *PureTxt* subscribers will eventually avail of *SmartLoad*.

The peak hour air time rate for *Smart Buddy* subscribers is Php8.00 per minute, while the off-peak hour air time rate is Php4.00 per minute. Charges for national direct dial services for *Smart Buddy* subscribers are as follows: for calls within the same island Php11.00 per minute for peak hours and Php7.00 per minute for off-peak hours, for calls between Luzon and Visayas and between Visayas and Mindanao Php12.00 per minute for peak hours and Php8.00 per minute for off-peak hours, and for calls between Luzon and Mindanao Php13.00 per minute for peak hours and Php9.00 per minute for off-peak hours. As described under Item 5. Operating and Financial Review and Prospects Results of Operations 2001 Compared to 2000 Consolidated Operating Revenues Wireless Cellular Service on September 15, 2001 and January 1, 2002, Smart reduced its free text message allocations to subscribers by a total two-thirds of the previous free text message allocations.

*Talk 'N Text* subscribers are charged Php6.50 per minute for local and cell-to-cell calls and for national direct dial services, a peak-hour rate of Php12.00 per minute and an off-peak hour rate of Php8.00 per minute, regardless of destination.

Prior to January 1, 2002, *Smart Gold* offered the following monthly air time plans: Php600, Php1,200, Php1,800, Php3,000 and Php4,000. Subscribers who enrolled in these plans prior to January 1, 2002 remained on these plans following introduction of the plans described below.

*Smart Gold* subscribers may choose from any of the subscription plans set forth in the table below:



<b>Plan</b>	<b>Free SMS Text Messages(1)</b>	<b>Free Air time (in minutes)</b>	<b>Monthly Service Fee (in pesos)(2)</b>	<b>Rate for SMS Text Messages (pesos per message)</b>	<b>Smart to Smart Call Rate (Peak/Off Peak) (pesos per minute)(3)</b>	<b>Smart to Fixed Line/Other Cellular Local Call Rate (Peak/Off Peak) (pesos per minute)(4)</b>	<b>NDD Rate (Peak/Off Peak) (pesos per minute)(5)</b>	<b>NDD Rate (Peak/Off Peak) (pesos per minute)(6)</b>
Gold Rave	500	20	500	1.00	7.50/3.00	8.00/4.00	11.00/7.00	9.50/5.00
Gold Standard	225	85	600	1.00	7.00/3.00	7.50/4.00	10.50/7.00	9.00/5.00
Gold Pick	350	100	800	1.00	7.00/3.00	7.50/4.00	10.50/7.00	9.00/5.00
Gold Choice	390	235	1,335	0.50	6.50/2.00	7.00/4.00	10.00/6.00	8.50/4.00
Gold Select	500	390	1,995	0.50	5.00/2.00	6.50/4.00	9.50/6.00	7.00/4.00
Gold Premium	800	600	2,665	0.50	4.00/2.00	5.00/4.00	8.00/6.00	6.00/4.00
Gold Elite	650	750	3,500	0.50	4.00/2.00	5.00/4.00	8.00/7.00	6.00/4.00

(1) Applies only to point-to-point text messages sent within Smart's network and does not apply to SMS-based value-added services.

(2) The monthly service fees may be applied to any local, international long distance or national long distance call, or any text, Smart zedä, voice mail or international roaming service.

(3) Air time rates for local calls made to other Smart GSM subscribers.

(4) Air time rates for local calls made to fixed lines and cellular subscribers of other carriers.

(5) For Visayas, Mindanao and Luzon, excluding radius covering Bulacan, Cavite, Laguna-San Pedro and Rizal.

(6) For radius covering Bulacan, Cavite, Laguna-San Pedro and Rizal.

On April 17, 2003, Smart began offering the following postpaid plans under the *addict mobile* brand.

Plan	Addict Credits (in pesos)	Free Air time (in minutes)	Monthly Service Fee (in pesos)	Rate for SMS Text Messages (pesos per message)	Smart to Smart Call Rate (Peak/Off Peak) (pesos per minute)	Smart to Fixed Line/Other Cellular Local Call Rate (Peak/Off Peak) (pesos per minute)	NDD Rate (Peak/Off Peak) (pesos per minute)	NDD Rate (Peak/Off Peak) (pesos per minute)
addict 500	500	20	500	1.00	7.50/3.00	8.00/4.00	11.00/7.00	9.50/5.00
addict 600	300	85	600	1.00	7.00/3.00	7.50/4.00	10.50/7.00	9.00/5.00
addict 800	450	100	800	1.00	7.00/3.00	7.50/4.00	10.50/7.00	9.00/5.00
addict 1335	550	235	1,335	0.50	6.50/2.00	7.00/4.00	10.00/6.00	8.50/4.00
addict 1995	700	390	1,995	0.50	5.00/2.00	6.50/4.00	9.50/6.00	7.00/4.00
addict 2665	850	600	2,665	0.50	4.00/2.00	5.00/4.00	8.00/6.00	6.00/4.00
addict 3500	950	750	3,500	0.50	4.00/2.00	5.00/4.00	8.00/7.00	6.00/4.00

Smart is permitted to adjust its cellular air time and national direct dial rates according to changes in the peso-to-U.S. dollar exchange rate. Under the authorization granted to Smart by the NTC, Smart is permitted to increase and is required to decrease its air time and national direct dial rates by 1% for every Php0.25 change in the exchange rate relative to a base rate of Php24.726 = US\$1.00. However, Smart has not implemented any foreign currency adjustments to its rates since November 4, 1998 because of the concern that increased rates may result in decreased usage by its subscribers.

*Smart Buddy*, *Smart Gold* and *addict mobile* subscribers pay an international direct dialing rate of US\$0.40 per minute. This rate applies to 200 destinations, including the United States, Hong Kong, Japan, Singapore, the United Kingdom and the United Arab Emirates. Smart charges US\$0.98 for 27 other destinations such as Afghanistan and Cuba and US\$2.18 for another ten destinations such as East Timor and the Falkland Islands. Talk N Text subscribers pay an international direct dialing rate of US\$0.40 per minute to all 237 destinations.

Charges for point-to-point text messages beyond the allotted free text messages are as follows:

- for *Smart Buddy* and *Talk 'N Text* subscribers, Php1.00 per message; and
- for *Smart Gold* and *addict mobile* subscribers, Php0.50 or Php1.00 per message, depending on air time plan, as listed in the table above.

Smart and Talk 'N Text subscribers pay for SMS-based value-added services, as follows:

- Php15.00 per message for international text for *Smart Buddy* and *Talk 'N Text* subscribers and Php10.00 per message for international text for *Smart Gold* and *addict mobile* subscribers;
- Php2.50 per message for e-text and information-on-demand services, such as news, stock and entertainment updates;
- Php15.00 for downloading ringtones and logos; and
- Php2.50 per *Mobile Banking* and *Smart Money* transaction, such as balance inquiry and fund transfer.

For multimedia messaging service, or MMS, and wireless application protocol, or WAP, services, the charges are as follows:

- Php5.00 per person-to-person MMS still and animated images;
- Php15.00 per download of pictures, greeting cards, polyphonic ring tones and traffic shots;
- Php2.50 per transaction when surfing on the Smart WAP portal; and

Except for *Mobile Banking* and *Smart Money*, which it does not offer, *Talk 'N Text* charges the same rates for value-added services as those charged by Smart. For voice mail retrieval, *Smart Buddy*, *Smart Gold* and *addict mobile* subscribers are charged Php8.00 per minute during peak hours and Php4.00 per minute during off-peak hours. For voice mail retrieval, *Talk 'N Text* subscribers are charged a flat rate of Php4.00 per minute.

In addition to enjoying the same tariffs as *Smart Gold* subscribers, *addict mobile* subscribers are allowed to apply their allocated free credits on their choice of data and value-added services.

We sell our cellular services primarily through a network of independent dealers that generally have their own retail networks, direct sales forces and sub-dealers. These dealers include major distributors of cellular handsets. We currently have six dealers that carry out distribution throughout the Philippines. On December 1, 2002, Smart purchased the assets of Telecommunications Specialists, Inc., or TSI, a major dealer that used to account for more than half of our sales of prepaid air time cards, and integrated TSI's employees following the acquisition. Account managers from our dealer sales force manage our dealer network and regularly update these dealers on our upcoming marketing strategies, promotional campaigns and product development. In addition, subscribers may reload their prepaid cards electronically using their handsets through *Smart Money* or over-the-air through *SmartLoad*.

For prepaid services, Smart and Piltel pay commissions to dealers for both prepaid phone kits and air time cards sold. Beginning August 1, 2002, Smart and Piltel reduced the maximum commission to dealers for prepaid phone kit sales from a range of Php1,000 to Php1,300 per unit sold paid in the form of prepaid call and text cards (depending on the volume purchased) to Php800 in cash per prepaid phone kit sold. An additional 1% rebate is given on cash purchases. Air time cards are sold to dealers at volume discounts determined by the value of the cards purchased by the dealers. Air time cards cannot be returned or refunded and normally expire within 6 to 12 months after release from the Smart and Piltel warehouse. For postpaid services, Smart pays dealer commissions based on the air time plan sold.

### *Satellite and VSAT*

#### *Overview*

We currently provide satellite and VSAT services through Mabuhay Satellite and Telesat. ACeS Philippines, our satellite phone service provider, started to roll out fixed satellite terminals in the last quarter of 2001 and started commercial operations on January 1, 2002.

#### *Mabuhay Satellite*

We currently own 67% of Mabuhay Satellite, which is engaged in the control and operation of the Agila II satellite. Agila II, which is the Philippines' first communications satellite, commenced commercial operations in January 1998. Mabuhay Satellite leases satellite space segments in both the C and Ku bands on the Agila II. Through the Agila II, Mabuhay Satellite also offers Internet backbone access, video and data broadcasting, and bandwidth-on-demand, facilitating communication links between telecommunications, broadcast and other public utility companies operating in the Asia-Pacific region.

See Item 5. Operating and Financial Review and Prospects Critical Accounting Policies Investments and Note 9 to our financial statements in Item 18 for a discussion of the re-measurement of our investment account in Mabuhay Satellite.

#### *Telesat*

We currently own 94.4% of Telesat, which operates a nationwide communications satellite network using VSAT technology. Telesat offers voice, facsimile and data transmission services throughout the Philippines, including areas that are underserved or unserved by local fixed line operators.

Using VSAT technology, we also provide the following services:

- point-to-multipoint data transmission services, usually for intercompany communication for corporate customers;
- private point-to-point service; and
- connectivity for the cell sites of our wireless network in outlying locations.

We lease transponder capacity on the Agila II to provide VSAT services.

#### *ACeS Philippines*

PLDT and Piltel currently own 88.5% and 11.5% , respectively, of ACeS Philippines, which commenced commercial operation on January 1, 2002 and operates telecommunications gateway equipment for fixed satellite phone services. ACeS Philippines owns approximately 20.23% of ACeS International Limited, or AIL, which aims to develop and implement a satellite-based communications system to provide services to users in the Asia-Pacific region through the Garuda I satellite. ACeS International Limited has entered into interconnection agreements and roaming service agreements with PLDT and other major telecommunications operators that will allow ACeS Philippines subscribers to access GSM terrestrial cellular systems in addition to the ACeS Philippines system.

In 2001, we made impairment provisions in respect of our investment in AIL and ground station equipment of ACeS Philippines in relation to the business of AIL, as described in Item 5. Operating and Financial Review and Prospects Critical Accounting Policies Impairment of Long-Lived Assets and Note 9 to our financial statements in Item 18 for a further discussion.

### *Revenue*

Our satellite and VSAT service revenues consist of:

- lease payments from the rental of Mabuhay Satellite's C-band and Ku-band transponders;
- revenues generated from Telesat's nationwide satellite network; and
- revenues generated from ACeS Philippines satellite phone service.

### *Rates*

Mabuhay Satellite leases its transponders to third parties at annual rates of US\$1.4 million and US\$0.8 million for its C-band and Ku-band transponders, respectively. Telesat provides its VSAT services on a cost plus mark-up basis. ACeS Philippines mobile subscribers are charged Php13.84 per minute for local and cell-to-cell calls and for national direct dial services while residential subscribers are charged a peak-hour rate of Php13.00 per minute and off-peak hour rate of Php8.00 per minute for domestic calls regardless of destination. For ACeS Philippines public calling offices, callers are charged Php4.50 and Php7.00 per minute for calls terminating on fixed line and cellular networks, respectively. Rates for international long distance calls depend on the country of termination, ranging from US\$0.35 per minute for frequently called countries to US\$0.85 per minute for less frequently called countries.

## Information and Communications Technology

We conduct our information and communication technology businesses through our wholly-owned subsidiary, ePLDT, which was incorporated in August 2000 and commenced commercial operations in February 2001. ePLDT is a broad based integrated information and communications technology company, focusing on infrastructure and solutions for Internet applications, Internet protocol based solutions and multimedia content delivery. ePLDT's principal business activities are:

- the operation of an Internet data center under the brand name *Vitro* ;
- two wholly-owned call centers, namely Vocativ and Parlance; and
- Infocom, an ISP.

ePLDT has also invested in a number of other e-commerce and Internet-related businesses, as described in Infrastructures and Services Other Investments below.

As a new business, revenues from our information and communications technology services accounted for less than 1% of our consolidated operating revenues in 2002.

### *Infrastructures and Services*

#### *Data Center*

ePLDT's *Vitro* is one of the Philippines' first Internet data centers. The Philippine Board of Investments granted *Vitro* pioneer status, which entitles us to tax and other governmental incentives. *Vitro* is a CISCO-certified co-location service provider. *Vitro* provides co-location, web and 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 Internet protocol security services, as well as firewall and managed firewall services.

*Internet Service*

In December 2001, we transferred to ePLDT our 99.6% interest in Infocom, one of the country's leading ISPs. Infocom offers consumer prepaid Internet access under the name *WarpSpeed* and postpaid Internet access; dedicated dial-up and multi-user dial-up corporate leased lines; broadband Internet access through DSL and cable; and website consulting, development and hosting.

*Call Centers*

ePLDT is focused on developing its call center services business, which capitalizes on our network resources and the availability of English-speaking labor in the Philippines. The call center service business is being undertaken through the following subsidiaries of ePLDT:

- Parlance, a wholly-owned subsidiary of ePLDT, which operates a dedicated call center facility capable of accommodating 520 seats. Pursuant to a guaranteed three-year contract with one of the largest direct-to-home satellite service providers in the United States, Parlance operates and manages the facility exclusively for its client to provide customer support and billing services. Parlance commenced commercial operations in June 2002;
- Vocativ, a wholly-owned subsidiary of ePLDT, which operates a call center facility capable of accommodating 500 seats, which can be expanded to 750 seats. Pursuant to a ten-year supplier-purchaser agreement with a global provider of customer relationship management services, Vocativ operates and manages the call center facility exclusively for this provider's clients. Vocativ commenced commercial operations in April 2002; and

ePLDT sold its entire interest in Contact World on June 30, 2003. Contact World, a joint venture with Salmat Pty Limited of Australia, was 51%-owned by ePLDT. .

*Other Investments*

ePLDT also has investments in several other Internet-related businesses, including:



- 100% interest in mySecureSign, Inc., which issues VeriSign digital certificates in the Philippines for e-commerce transactions;
- 100%-owned subsidiary, iPlus Intelligent Network, Inc., which provides IT helpdesk/contact center solutions;
- 20.5% interest in BayanTrade Dotcom, Inc., a business-to-business exchange established together with six of the Philippines' leading conglomerates;
- debt securities convertible into a 40% interest in Netopia, a leading branded chain of Internet cafes in the Philippines; and
- 22.5% interest in convertible securities of Stradcom International Holdings, the parent company of Stradcom Corporation, which has an existing concession agreement with the Philippine government for the modernization of the Philippine Land Transportation Office, including the computerization of driver's license issuance, vehicle registration and traffic adjudication systems.

In addition, we hold convertible notes issued by Unilink Communications Corporation, or Unilink, which owns 100% of the shares of The Philippine Home Cable Holdings, Inc. or Home Cable, the Philippines' second largest cable television operator by subscriber number. The notes are convertible into shares of Unilink and/or exchangeable for shares of Home Cable. However, because Philippine law currently prohibits direct or indirect foreign ownership of equity in broadcast companies, we cannot convert or exchange our convertible notes into Unilink or Home Cable equity. We have contributed our convertible notes of Unilink to PLDT's Beneficial Trust Fund in 2003. Mediaquest Holdings, Inc., a company wholly-owned by the beneficial trust fund of PLDT's employees, owns all of the shares of Unilink. Unilink has pledged all of its shares in Home Cable to a group of lenders as security for a loan of Home Cable. Home Cable defaulted on the payment of principal and interest due on December 6, 2001 under this loan and is currently engaged in efforts to restructure its debt. On April 10, 2002, the loan agent, at the request of a majority of the lenders, delivered a notice to Home Cable declaring an event of default and accelerating the loan. Consequently, the lenders are entitled to foreclose on or sell the collateral granted as security for the loan, including Unilink's shares in Home Cable. In the event that Home Cable's lenders were to foreclose on Unilink's Home Cable shares, the lenders would be entitled to the proceeds from the sale thereof, or, if such shares were not sold, to the shares, and Unilink would be subrogated to the lenders' claims against Home Cable. As of the filing of this annual report, Home Cable is still in negotiations with its lenders to restructure its debt. As of December 31, 2001, we provided for an impairment charge against our investment in the Unilink convertible notes amounting to Php2,052 million due to an other than temporary decline in value.

On July 18, 2001, we entered into a master consolidation agreement pursuant to which a newly incorporated company, Beyond Cable, Inc., would hold all interests in Sky Cable and Home Cable. Completion of the transaction is subject to certain conditions, including obtaining consents of lenders of Sky Cable and Home Cable. Upon completion of the transaction, the Benpres Group, which currently holds the interests in Sky Cable, would hold a 66.5% interest in

Beyond Cable and Mediaquest would hold the remainder. In connection with this transaction, PLDT's Beneficial Trust Fund is expected to assign the convertible notes in Unilink and our interests in convertible loans to Mediaquest.

## Fixed Line Network Infrastructure

### *Domestic*

Our domestic telephone network includes installed telephones and other equipment on customers' premises, local access lines connecting customers to exchanges, referred to as "outside plant," inter-office lines connecting exchanges, and long distance transmission equipment.

The following table gives some basic measures of the development of our domestic telephone network as of December 31, 2000, 2001 and 2002:

	<b>As of December 31,</b>		
	<b>2000</b>	<b>2001</b>	<b>2002</b>
Number of central office exchanges	186	187	183
PLDT fixed lines in service	1,915,985	2,075,109	2,092,539
PLDT employees per 10,000 local exchanges in service	69	62	58

Since the end of 1999, substantially all of our nationwide network has been upgraded from analog to digital exchanges. This shift to digital technology has enabled us to realize savings in network costs, upgrade our network to handle non-voice communications, and offer value-added and enhanced services such as fixed line text messaging.

In November 1998, we completed our domestic fiber optic backbone, the country's first telecommunications network using fiber optics in delivering voice, video, data, and other broadband and multimedia services nationwide. Constructed at a total cost of US\$188 million, our fiber optic network employs synchronous digital hierarchy technology to improve network performance and reduce operating costs. Our network is composed of in-land and submarine cable installations and is configured in six self-healing rings and an extension link, allowing route delivery even in the event of link failures. It has an initial transmission speed of 2.5 gigabits per second and is connected directly to five existing international submarine cable systems.

In July 2000, we inaugurated our domestic fiber optic network facilities in Cebu City, the second largest city in the Philippines. The new facilities enable us to offer a broader range of products and services to meet the growing

telecommunications needs of Cebu-based businesses.

On August 7, 2000, we inaugurated *CS PLDT*, a cable ship which we lease from NTT World Engineering Marine Corporation pursuant to a five year Chartered Arrangement Maintenance Contract. Under the contract, NTT World Engineering Marine Corporation uses *CS PLDT* primarily to maintain the 2,400 kilometers of submarine cable comprising the submerged portion of our domestic fiber optic network.

In 2001, we activated a second fiber pair on our existing fiber cable and installed dense wavelength division multiplexing technology in certain portions of the network. The new system serves the areas of Luzon, Visayas and Mindanao and also serves the international node connecting the Philippines to the Asia-Pacific Cable Network 2. The second pair provides an extra 10 gigabits per second of capacity, or the equivalent of 120,000 voice circuits. Nortel Networks supplied us with a suite of optical Internet solutions, including a 10-gigabit per second dense wavelength division multiplexing solution based on Nortel Networks OPTera Long Haul 1600 Optical Line System.

In 2002, we increased our transmission and data network capacities and sold to Smart certain assets comprising a portion of our digital fiber optic cable loops from Luzon to Mindanao and certain related equipment.

### *International*

We provide international network services using our three international gateway switching exchanges and our extensive international network passing mainly through submarine fiber optic cable systems. As of December 31, 2002, our international long distance facilities allow our subscribers to reach 229 countries/territories worldwide, of which 50 countries/territories have direct circuits with PLDT.

The table below shows the submarine cable systems in which we have interests and the countries or territories they link:

<b><u>Cable System</u></b>	<b><u>Countries Being Linked</u></b>
G-P-T	Guam, the Philippines and Taiwan
B-M-P	Brunei, Malaysia and the Philippines
G-P	Guam and the Philippines
B-S	Brunei and Singapore
Hawaii-4/Transpacific-3	Guam, Japan, Hawaii and the U.S. Mainland
Asia-Pacific Cable Network 2	Philippines, Hong Kong, Japan, Korea, Malaysia, Singapore and Taiwan
Asia-Pacific Cable Network	Korea, Japan, Hong Kong, Taiwan, Australia, the Philippines, Singapore, Indonesia and Thailand

Transpacific Cable No. 5	Guam, Japan, Hawaii and the U.S. Mainland
Transpacific Cable No. 4	Japan, Canada, and the U.S. Mainland
KN-KK	Kuantan and Kota Kinabalu in Malaysia
Southeast Asia-Middle East	34 other countries in Europe, Africa, the Middle East, the Indian
Western Europe No. 3	subcontinent, Southeast Asia and North Asia
HONTAI-2	Hong Kong and Taiwan
Asia Pacific	Hong Kong, Japan, Singapore, Malaysia and Taiwan
PacRim West	Guam and Australia
M-T	Malaysia and Thailand
Hawaii-5	Hawaii and the U.S. Mainland
C-J	China and Japan
North Pacific	Japan, Alaska and the U.S. Mainland
H-J-K	Hong Kong, Japan and Korea
SEA-ME-WE-2	13 countries in South East Asia, the Middle East and Western Europe including Singapore, Indonesia, India, Saudi Arabia, Egypt, Italy, Turkey and France

In April 2000, we and 24 other telecommunications administrations signed a construction and maintenance agreement for Asia-Pacific Cable Network 2, a 19,000-kilometer long submarine cable that commenced commercial operations in late 2001 and links the Philippines to China, Hong Kong, Japan, Korea, Malaysia, Singapore and Taiwan. Under the agreement, Asia-Pacific Cable Network 2 is required to deploy dense wavelength division multiplexing technology that will initially allow transmission of 40 gigabits per second of protected traffic. This initial capacity is expected to be upgraded in the future to reach a maximum of 2.56 terabits per second.

## Wireless Network Infrastructure

### *Cellular*

Through Smart, we operate a digital GSM network, which consists of 29 mobile switching centers with a capacity for 10.7 million subscribers and 12 messaging centers capable of processing 239 million messages per day. To meet the growing demand for cellular services, Smart has implemented an extensive deployment program for its GSM network. In the first quarter of 2003, Smart added 176 base stations to its nationwide cellular network, bringing Smart's total GSM base stations in operation to 2,953. Smart previously operated an analog/ETACS network, which it closed down in December 2002. Piltel's cell sites decreased to six as of March 31, 2003 from 36 as of December 31, 2002 as it ceased to offer its analog/CDMA service at the end of 2002.

Smart and Piltel have been co-locating their cell sites where their base stations are installed. As of March 31, 2003, 19 of Smart's mobile switching centers and 59 of Smart's cell sites are housed in our complexes while 150 cell sites are co-located on Piltel properties. These operational synergies have allowed Smart to reduce switch installation time from three months to five weeks.

In December 2002, Smart acquired certain assets comprising a portion of PLDT's digital fiber optic cable loops from Luzon to Mindanao and certain related equipment.

We are in the process of upgrading our network to EDGE technology to further increase the speed and data capability of our GSM network.

#### *Satellite and VSAT*

Mabuhay Satellite controls and operates the Agila II satellite, which has 30 C-band transponders and 24 Ku-band transponders covering the Asia-Pacific region, the Indian subcontinent and Hawaii. Of the 54 transponders, four C-band transponders are owned by Loral Cyberstar, Inc. of the United States and PSN of Indonesia while six have restricted usage. Through Agila II, Mabuhay Satellite offers Internet service, video and data broadcasting, and bandwidth-on-demand, facilitating communication links between telecommunications, broadcast and other public utility companies operating in the Asia-Pacific region. In December 2000, Agila II joined the U.S. FCC's "Permitted Space Station" list, which permits U.S. owned and operated earth stations in Hawaii to access Agila II for transpacific telecommunications, data, video and Internet-over-satellite traffic and vice versa.

Telesat operates a national communications satellite network using VSAT technology to provide voice, facsimile, video and data transmission services to areas in the country that are still underserved or unserved by local telephone operators. Telesat leases transponder capacity from Agila II to provide VSAT services such as multipoint-to-multipoint and point-to-multipoint data transmission services, private point-to-point service, and connectivity for the cell sites of our cellular network in outlying locations.

ACeS Philippines manages, controls and operates its own satellite gateway and other ground infrastructure, including a 13-meter feeder-link C-band earth station, beam congruency antenna and equipment that serves as the primary interface between the ACeS Philippines system and other telecommunications networks. It uses the Garuda I satellite to provide digital voice services to ACeS Philippines mobile and fixed terminal users within the Asian service area.

#### *Interconnection Agreements*

Since the issuance of E.O. No. 59 in 1993, which requires non-discriminatory interconnection of Philippine carriers' networks, we have entered into bilateral interconnection arrangements with other Philippine fixed line and cellular carriers. On April 6, 2001, July 2, 2001 and July 10, 2001, PLDT signed separate amended interconnection agreements with PAPTELCO, Smart and Globe, respectively.

Prior to July 2001, Smart and Globe received and paid interconnection fees of Php1.00 per minute for calls originating from and terminating to each other's cellular network. Effective July 1, 2001, these fees were increased to Php3.00 per minute and further increased to Php4.50 per minute, effective January 1, 2002.

On July 10, 2001, March 10, 2003, and April 4, 2003, Smart signed interconnection agreements with Digitel covering fixed line, cellular and SMS, respectively. Effective June 1, 2003, calls originating from Smart and terminating to Digitel's fixed line network are charged Php2.50 per minute, an increase from the previous charge of Php2.00 per minute. For calls originating from Smart and terminating on Digitel's cellular network and for calls originating from Digitel and terminating on Smart's cellular network, the charge is Php4.50 per minute. For SMS originating from Smart and terminating on Digitel's cellular network and for SMS originating from Digitel and terminating on Smart's cellular network, the charge is Php0.35 per message.

For local calls originating from PLDT and terminating on the cellular networks of Smart and Globe, Smart and Globe charge PLDT a rate of Php4.50 per minute effective January 1, 2002. Effective January 1, 2004, calls terminating to cellular subscribers originating from fixed line subscribers will be charged a termination rate of Php4.00 per minute, a decrease from the previous rate of Php4.50 per minute. From July 1, 2001 to December 31, 2001, Smart and Globe charged PLDT Php6.50 per minute. Prior to July 1, 2001, PLDT retained an origination charge of Php2.00 on every call terminating to the network of Smart or Globe. The new arrangement also applies to national long distance calls originating from PLDT and terminating to the cellular network of either Smart or Globe. Under the new agreement, there will be no distinction between access charges for local calls and national long distance calls.

Effective January 1, 2003, local access for cellular operators which terminate calls to PLDT's fixed line network increased from Php2.00 per minute to Php2.50 per minute which will further increase to Php3.00 per minute effective January 1, 2004.

Under a separate agreement between PLDT and PAPTELCO, PLDT is the transit facility provider between Smart and Globe and PAPTELCO. Transit traffic is an accommodation by PLDT to Smart, Globe and PAPTELCO members where PAPTELCO members have no direct interconnection with either Smart or Globe.

## **Licenses and Regulation**

Telecommunications services in the Philippines are provided as a public service and are governed by specific regulations and laws. The principal laws governing the telecommunications industry are the 1936 Commonwealth Act No. 146, as amended, referred to as the Public Service Act, and the Public Telecommunications Policy Act. The Public Service Act seeks to protect the public against unreasonable charges and poor, inefficient service by public utilities and seeks to prevent ruinous competition. The Public Telecommunications Policy Act sets forth the current telecommunications policy objectives of the Philippine government. It also seeks to develop and maintain a viable,

efficient, reliable and universal telecommunications infrastructure, which ensures that telecommunications services are available in unserved or under-served areas, and sets out the functions, powers and responsibilities of the NTC.

The government agency charged with the administration of laws governing the telecommunications industry is the NTC. The NTC is a collegial body composed of a commissioner and two deputy commissioners who are appointed by the Philippine President. It is an agency attached to the Department of Transportation and Communications and as such is subject to its supervision. In the exercise of its quasi-judicial function, however, the decisions of the NTC cannot be reviewed by the Department of Transportation and Communications and may only be appealed to the Court of Appeals or, ultimately, the Supreme Court.

PLDT, Smart and Piltel provide telecommunications services pursuant to legislative franchises, which expire, in the case of PLDT, 25 years from November 28, 2003, in the case of Smart, 25 years from March 27, 1992 or the date its current franchise was granted, and, in the case of Piltel, 25 years from May 14, 1994. A franchise holder is required to obtain operating authority from the NTC to provide specific telecommunications services. These approvals may take the form of a CPCN or, while an application for a CPCN is pending, a provisional authority to operate.

PLDT operates its business pursuant to a number of provisional authorities and CPCNs, the terms of which expire at various times between now and 2028. PLDT's CPCNs to provide services to most of the Metropolitan Manila area, Davao and other Philippine cities expire in 2003. Although some of PLDT's CPCNs and provisional authorities have already expired, PLDT filed timely applications for extension of these CPCNs and provisional authorities prior to their respective expiration dates and is therefore entitled to continue to conduct its business under its existing CPCNs and provisional authorities pending the NTC's decision on these extensions. The Philippine Revised Administrative Code of 1987 provides that if the grantee of a license or permit, such as a CPCN or provisional authority, has made timely and sufficient application for the extension thereof, the existing CPCN or provisional authority will not expire until the application is finally decided upon by the administrative agency concerned. PLDT expects that the NTC will grant these extensions; however, we cannot assure you that this will occur. The period of validity of some of PLDT's CPCNs that will expire on November 28, 2003, co-terminus with the term of its previous franchise under Republic Act No. 6146, has been extended further by the NTC to November 28, 2028, co-terminus with PLDT's current franchise under Republic Act No. 7082. Motions to extend the period of validity of the other CPCNs to November 28, 2028 are now pending with the NTC. See Item 3. Key Information Risk Factors Risks Relating to Us Our business is significantly affected by governmental laws and regulations, including regulations in respect of our franchises and rates.

Smart operates its cellular, international long distance and national long distance services pursuant to CPCNs, the terms of which will expire upon the expiration of its franchise. On August 26, 2002, Smart was granted a CPCN to install, operate and maintain nationwide global mobile personal communications via satellite which shall also expire upon the expiration of its franchise. Smart's provisional authority to establish, install, maintain, lease and operate an international private leased circuit expired on May 6, 2003. Smart filed for an extension of this provisional authority prior to its expiration. On July 22, 2002, Smart was granted a CPCN to operate cellular mobile telephone system and international gateway facility. Piltel holds a CPCN to provide a nationwide cellular telephone service, which expires in August 2012.

The following table sets forth the spectrum system, licensed frequency and bandwidth of Smart and Piltel:

	<b>Carrier Spectrum System</b>	<b>Frequency Assignment</b>	<b>Bandwidth</b>
Smart	ETACS/GSM 900	897.5905/942.6-950 Mhz	7.5 Mhz
	GSM 1800	1725-1730/1820-1825 Mhz	5.0 Mhz
		1730-1732.5/1825-1827.5 Mhz	2.5 Mhz
		1735-1740/1830-1835 Mhz	5.0 Mhz
		1745-1750/1840-1845 Mhz	5.0 Mhz
Piltel	AMPS/CDMA	825-835/845-846.5 Mhz	11.5 Mhz

Operators of international gateway facilities and cellular telephone operators, pursuant to E.O. No. 109, are required to install a minimum number of local exchange lines. Of these new lines, operators are required to install one rural exchange line for every 10 urban exchange lines installed. Smart and Piltel were required to install 700,000 and 400,000 lines, respectively, and each has received a certificate of compliance from the NTC.

PLDT, Smart and Piltel are required to pay various permit, regulation and supervision fees to the NTC. PLDT, Smart and Piltel are currently engaged in disputes with the NTC over some of the assessed fees. For more information on the disputes involving PLDT, see Item 8. Financial Information Legal Proceedings NTC Fees."

In a letter dated January 17, 2002, the NTC requested that Smart pay the following fees in respect of its CPCNs and provisional authorities:

<b>Case No.</b>	<b>Fee</b>
92-303	Php3,750,000
93-482	62,510,950
94-220	878,830
96-248	6,815,500
Total	Php73,955,280

On May 27, 1998, Smart filed an Urgent Ex Parte Motion and Manifestation regarding the permit fee assessed by the NTC for CPCN 93-482. Smart contended that the fee should have been calculated on the basis of the actual local exchange carrier project cost, and that therefore the fee should be Php70 million. Although the NTC has not yet resolved this issue, Smart has already paid Php50 million in respect of this assessment as of the date of filing this annual report.



Piltel has also been assessed by the NTC for deficiency supervision and regulation fees. Based on the latest computation of deficiency supervision and regulation fees received from the NTC, which is dated as of September 30, 2002, the total amount assessed on Piltel stands at Php639.7 million, including penalty fees amounting to Php274.9 million. Piltel has protested the assessments in good faith. Piltel continues to make payments for amounts, which it believes is properly due to the NTC. On September 30, 2002, Piltel made a payment to the NTC under protest in the amount of Php9.1 million.

In order to diversify the ownership base of public utilities, the Public Telecommunications Policy Act requires a telecommunications entity with regulated types of services to make a public offering through the stock exchanges of at least 30% of its aggregate common stock by the later of the following:

- the fifth anniversary of the date the law became effective; and
- the fifth anniversary of the date of the entity's commencement of commercial operations.

PLDT and Piltel have complied with this requirement. Smart believes that it has ten years from the commencement of its operations, or until August 2004, to conduct a public offering because the Philippine government has granted franchises to other telecommunications companies requiring a public offering within ten years from the later of their commencement of operations or the date on which the franchise was granted. Because the Public Telecommunications Policy Act (Republic Act No. 7925) provides that any advantage granted under existing franchises automatically becomes part of previously granted telecommunications franchises, Smart believes that it is also entitled to this ten year period. PLDT currently contemplates to cause Smart to conduct a public offering based on market conditions and in accordance with applicable rules and regulations of the Philippine Stock Exchange.

The Philippine Congress is currently considering five bills, each of which, if passed by Congress and enacted into law, would impose a 7% or 10% tax on the gross receipts of cellular operators. The proposed taxes would apply to both cellular call and data revenues and prohibit cellular operators from imposing additional charges or fees to compensate for the imposition of the proposed taxes.

## **Competition**

The enactment of the Public Telecommunications Policy Act (Republic Act No. 7925) of the Philippines in March 1995 consolidated the government's various policy issuances governing the telecommunications industry and reaffirmed, among other things, the policy of liberalizing the industry and opening up the telecommunications market to new entrants. Including us, there are 10 major local exchange carriers, 11 international gateway facility providers, and seven cellular service providers in the country, including one, which has not yet commenced operations. Many new entrants into the Philippine telecommunications market have entered into strategic alliances with foreign

telecommunications companies, which provide them access to technological and funding support as well as service innovations and marketing strategies. Consequently, we are facing increasing competition in major segments of the telecommunications industry, particularly in the cellular segment and data and other network services segment.

#### *Local Exchange Service*

The concerted nationwide local exchange line build-out by new entrants in recent years, as mandated by the Philippine government, significantly increased the number of fixed lines in service in the country and resulted in wider access to basic telephone service. The growth of the fixed line market has considerably weakened due to the surge in demand for cellular services and the general sluggishness of the national economy. Nevertheless, we have sustained our leading position in the fixed line market on account of PLDT's extensive network in key cities nationwide. In most areas, we face one or two competitors. Our principal competitors in the local exchange market are Digitel, BayanTel and Globe.

Over the past couple of years, however, competition among local exchange operators has reduced as certain operators have faced financial difficulties or have shifted strategic focus away from the fixed line business to cellular services. On the other hand, we are facing increasing competition from cellular operators mainly due to substitution of cellular services for fixed line services.

#### *International Long Distance Service*

Including us, there are 11 international gateway facility operators in the country. While we have so far been able to maintain a leadership position in this highly competitive segment of the industry, in recent years, our market share has reduced largely as a result of (1) competition from other international gateway facility operators and international simple resale operators, (2) an increase in inbound and outbound international long distance calls terminating to and originating from a growing number of cellular subscribers, and (3) the popularity of alternative and cheaper means of long distance communications, such as SMS, e-mail and Internet telephony, further heightening the competition.

With respect to inbound calls into the Philippines, we compete with other service providers primarily through pricing. For example, we adopted the U.S. FCC benchmark accounting rate of US\$0.38 per minute for inbound international calls, which represented a settlement rate of US\$0.19 per minute, one year ahead of the target date of January 1, 2001, and reduced our average termination rates progressively through 2002. This provided us with increased flexibility to terminate more U.S. traffic into the Philippines, minimize unauthorized traffic termination through international simple resale operations and recover traffic lost due to bypass routings. We have also established points of presence in key cities overseas to capture traffic at its source, maximize the use of our international facilities and develop alternative sources of revenue. Effective February 1, 2003, after lengthy negotiations with approximately 100 telecommunications operators around the world, we increased the termination rate with carriers accounting for a substantial portion of our international inbound traffic terminating on its fixed line network to US\$0.12 per minute. Prior to the increase in termination rates, a substantial portion of PLDT's international inbound traffic terminating on

its fixed line network was charged an average termination rate of approximately US\$0.08 per minute. In addition, Smart implemented an increase in its international termination rates to US\$0.16 per minute effective February 1, 2003 for calls terminating on its cellular network. As of May 31, 2003, most of the other major international gateway operators in the Philippines have also independently negotiated increases in their average termination rates. It is still too early to determine, whether we will subsequently experience significant price competition at termination rates substantially below US\$0.12 per minute.

With respect to outbound calls from the Philippines, we compete for market share through our local exchange and cellular businesses, which are the origination points of outbound international calls. We have also introduced a number of marketing initiatives to stimulate growth of outbound call volumes, including tariff reductions and volume discounts for large corporate subscribers.

#### *National Long Distance Service*

Since 2000, our national long distance service business has been negatively impacted by the growing number of cellular subscribers in the Philippines and the widespread availability and growing popularity of alternative economical non-voice methods of communication, particularly SMS and e-mail.

While national long distance call volumes have been declining, we have remained a leading provider of national long distance service in the Philippines due to our significant subscriber base and ownership of the Philippines' most extensive domestic fiber optic network. In order to mitigate the decline of our national long distance revenues, we have amended the interconnection agreements between ourselves and other cellular operators to provide the fixed line business more equitable access charge arrangements for calls between fixed line and cellular subscribers.

#### *Data and Other Network Services*

Another rapidly growing segment of the industry is the market for data and other network services, including Internet-based services, spurred by the significant growth of the Internet and e-commerce. Our principal competitors in this area are BayanTel, Globe and Eastern Telecommunications. The principal bases of competition in the data services market are price, customer service and quality of service and network redundancy.

#### *Cellular Service*

Competition in the cellular business has intensified with the introduction by competitors of affordably priced handsets offering a range of new functions and features, new and improved plans for postpaid subscribers, reduced rates per minute and aggressive marketing and promotional strategies. Our principal competitor in this area is Globe, which acquired Isiacom in June 2001. The principal bases of competition are price, including handset cost, quality of service, network reliability, geographic coverage and attractiveness of packaged services.

Cellular operators are also competing actively against each other in launching innovative products and value-added services. The growing range of cellular products and services now include text messaging, multi-media messaging, voice mail, text mail, international roaming, information-on-demand, mobile banking, e-commerce, mobile data and cellular Internet access.

Consistent with industry practice and our churn management efforts, we "lock" the handsets we sell to our subscribers, rendering them incompatible with SIM cards issued by our competitors. However, our subscribers may have their handsets "unlocked" by unauthorized parties, for a nominal fee, and purchase new SIM cards from competing operators. "Unlocking" does not involve significant cost. In addition, switching to another cellular operator would result in a change of the subscriber's cellular telephone number.

We expect competition to increase in the future as new competitors enter the cellular telecommunications market. On March 29, 2003, Digitel launched its cellular service under the brand name *Sun Cellular*. Moreover, in January 2002, the Supreme Court reinstated BayanTel's license to provide cellular telecommunications service.

## **Environmental Matters**

We have not been subject to any material fines or legal or regulatory action involving non-compliance with environmental regulations of the Philippines. We are not aware that we are not in compliance in any material respect with relevant environmental protection regulations.

## **Intellectual Property Rights**

We do not own any material intellectual property rights apart from our brand names and logos. We are not dependent on patents, licenses or other intellectual property, which are material to our business or results of operations, other than licenses to use the software that accompanies most of our equipment purchases.

## **Properties**

PLDT owns four office buildings located in Makati City and owns and operates 183 exchanges nationwide, of which 61 are located in the Metropolitan Manila area. The remaining 122 exchanges are located in small cities and municipalities outside Metropolitan Manila area. We also own radio transmitting and receiving equipment used for international and domestic communications.

As of December 31, 2002, our principal properties, excluding property under construction, consisted of the following, based on book value:

- 55% consisted of cable and wire facilities, including our domestic fiber optic network, subscriber cable facilities, inter-office trunking and toll cable facilities and cellular facilities;
- 29% consisted of central office equipment, including three international gateway facilities, seven pure national toll exchanges and 16 combined local and toll exchanges;
- 7% consisted of land and improvements and buildings, which we acquired to house our telecommunications equipment;
- 2% consisted of information origination and termination equipment, including, pay telephones and radio equipment installed for customers use, as well as cables and wires installed within customers' premises; and
- 7% consisted of other work equipment.

For more information on these properties, see Note 8 to our financial statements in Item 18. These properties are located in areas being served by our exchanges. In our opinion, these properties are in good condition, except for ordinary wear and tear, and are adequately insured.

The majority of our connecting lines are above or under public streets and properties owned by others.

PLDT's properties are free from any mortgage, charge, pledge, lien or encumbrance. Except for the properties covered by chattel mortgages in favor of Nordbanken AB and ABN Amro Bank AB to secure an outstanding loan of US\$2,517 million, which was fully paid in January 2003, all properties of Smart are also free from any mortgage,

pledge, lien or encumbrance. Substantial properties of Piltel and Mabuhay Satellite are subject to liens.

PLDT has various long-term lease contracts for periods ranging from two to ten years covering certain offices, warehouses, telecommunications equipment locations and various office equipment. For more information on these lease arrangements, see Note 23 to our financial statements in Item 18.

For 2003, on a non-consolidated basis, PLDT's budgeted capital expenditures of Php7,000 million will be partially financed by committed long-term debt facilities supported by various export credit agencies. As of December 31, 2002, PLDT had a total of approximately Php1,531 million undrawn balances available under committed long-term debt facilities. In addition, we have put in place long-term debt facilities during the first half of 2003, which will also finance in part PLDT's budgeted capital expenditures for 2003.

## Item 8. Operating and Financial Review and Prospects

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*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our audited consolidated financial statements (and the related notes) as of December 31, 2001 and 2002 and for the years ended December 31, 2000, 2001 and 2002 included elsewhere in this report. This discussion contains forward-looking statements that reflect our current views with respect to future events and our future financial performance. These statements involve risks and uncertainties, and our actual results may differ materially from those anticipated in these forward-looking statements as a result of particular factors such as those set forth under "Risk Factors" and "Forward-Looking Statements" and Item 3. Key Information "Risk Factors" and elsewhere in this report. Our audited consolidated financial statements, and the financial information discussed below, have been prepared in accordance with U.S. GAAP. For convenience, certain peso financial information in the following discussions has been translated to U.S. dollars at the exchange rate at December 31, 2002 of Php53.254 = US\$1.00, as quoted through the Philippine Dealing System.*

*Prior to 2002, our financial statements included in our Annual Report on Form 20-F filed with the U.S. Securities and Exchange Commission were prepared in accordance with Philippine GAAP. Philippine GAAP varies in certain significant respects from U.S. GAAP. A description of the significant differences between U.S. GAAP and Philippine GAAP and a quantitative reconciliation of such differences in the net income and shareholders' equity to U.S. GAAP was disclosed in a note to our previously filed financial statements. In connection with the preparation of our consolidated balance sheets as of December 31, 2002 and 2001, and the related statements of income, changes in stockholders' equity and cash flows for the years ended December 31, 2002, 2001, and 2000 in accordance with U.S. GAAP, we identified differences in the U.S. GAAP amounts previously disclosed for 2001 and 2000. Please see Note 4 to our consolidated financial statements included herein for a discussion of such differences.*

## Overview

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

- *Fixed Line* fixed line telecommunications services primarily provided through PLDT. We also provide fixed line services through PLDT's subsidiaries Clark Telecom, Subic Telecom and MaraTel, which together account for approximately 1% of our total fixed lines in service, and PLDT Global;
- *Wireless* wireless telecommunications services provided through our cellular service providers, namely Smart and Piltel, and satellite operators, namely Mabuhay Satellite, ACeS Philippines and Telesat; 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, Internet access services provided by ePLDT's subsidiary Infocom, and e-commerce, call centers and IT-related services provided by other subsidiaries and associates of ePLDT, as described in Item 4. Information on the Company Business Information and Communications Technology Infrastructure and Services Other Investments .

## **Fixed Line**

Our fixed line business provides local exchange service, international and national long distance services and data and other network services, and miscellaneous services. Historically, our fixed line business was the primary source of our consolidated operating revenues. In 2002, our fixed line business accounted for 51% of our consolidated operating revenues, compared to 58% in 2001 and 73% in 2000.

*Local Exchange Service.* Local exchange service remains one of our major revenue drivers. In 2002, local exchange service contributed 24% of our consolidated operating revenues compared to 27% in 2001 and 30% in 2000. Local exchange revenues have remained relatively stable largely as a result of service rate increases implemented pursuant to the currency adjustment mechanism allowed by the NTC. Under this mechanism, we are authorized to increase and, if we have increased service rates, required to decrease, our monthly recurring local exchange service rates by 1% for every Php0.10 change in the peso-to-dollar exchange rate relative to a base rate of Php11.00 = US\$1.00. Increased local exchange revenues also reflect a higher average number of fixed lines in service. Since 2000, however, there has been a shift in subscriber preference from postpaid to prepaid fixed line service. As of December 31, 2002, prepaid subscribers accounted for 12% of PLDT's fixed lines in service.

*International Long Distance Service.* Historically, international long distance service was our primary revenue source. However, international long distance revenues have been declining in both absolute terms and as a percentage of gross revenues due to the reduction of international termination rates reduced calling rates and increased competition. We

have initiated a number of marketing and other initiatives in an effort to prevent further erosion of our market share and revenue base. In 2002, international long distance services accounted for 11% of our consolidated operating revenues, compared to 15% in 2001 and 21% in 2000. Effective February 1, 2003, PLDT increased its average termination rates with carriers accounting for a substantial portion of its international traffic terminating on its fixed line network to US\$0.12 per minute. Prior to the increase, a substantial portion of PLDT's international inbound traffic terminating on its fixed line network was charged an average termination rate of approximately US\$0.08 per minute. See Other Information U.S. FCC Proceeding on Termination Rates and Item 8. Financial Information Legal Proceedings U.S. FCC Proceeding on Termination Rates.

*National Long Distance Service.* National long distance service revenues have been declining since 2000 in both absolute terms and as a percentage of our consolidated operating revenues due to a drop in call volumes and an increase in the proportion of calls subject to revenue sharing with other carriers. Our national long distance business has been negatively impacted by the increasing number of cellular subscribers, as well as the widespread availability and popularity of alternative economical non-voice methods of communication, particularly SMS and e-mail. In 2002, national long distance services accounted for 9% of our consolidated operating revenues, compared to 10% in 2001 and 17% in 2000. Beginning 2001, we adopted simplified pricing plans and amended our interconnection agreements between ourselves and cellular operators with a view to maximizing revenues of our national long distance service.

*Data and Other Network Services.* Data and other network services is the only major segment of our fixed line business that registered revenue growth in 2002. Recognizing the growth potential of this service segment and considering its importance to our business strategy, we have put considerable emphasis on the development of new packet-switched, data-capable and Internet-based networks. In 2002 and 2001, data and other network services remained unchanged at approximately 6% of our consolidated operating revenues. In 2000, data and other network services accounted for 5% of our consolidated operating revenues.

## **Wireless**

Our wireless business segment offers cellular service as well as satellite, VSAT and other services. Our wireless service revenues have increased considerably since 2000 mainly as a result of the continued strong growth in revenues generated from Smart's cellular service. In 2002, revenues from our wireless business represented 48% of our consolidated operating revenues, compared to 41% in 2001 and 26% in 2000.

### **Cellular Service**

Since 2000, our cellular service, which we provide through Smart and Piltel, has been the principal revenue source of our wireless service segment and has increased its contribution to our consolidated revenues from 40% in 2001 to 47% in 2002. Cellular revenues have increased, from Php31,627 million in 2001 to Php45,375 million in 2002.



Smart launched its GSM in September 1999 after having offered analog services since 1994. Since the launch of its GSM service, Smart's GSM subscriber base has grown to approximately 6.8 million as of December 31, 2002. Smart also supports Piltel's prepaid GSM service, *Talk N Text*, on its GSM network. Since the launch of *Talk N Text* in April 2000, Piltel has seen its GSM subscriber base grow to approximately 1.8 million as of December 31, 2002. As a result, the aggregate of Smart's and Piltel's cellular subscribers has outnumbered our fixed line subscribers since 2000. As of December 31, 2002, the combined subscribers of Smart and Piltel outnumbered our fixed line subscribers by more than 4 to 1. As of December 31, 2002, Smart and Piltel had the largest and third largest cellular subscriber bases in the Philippines, respectively, with prepaid subscribers accounting for 98% of Smart's and Piltel's combined subscriber base. The number of Smart's and Piltel's analog subscribers had declined significantly, reflecting the Philippine cellular users' preference for digital networks, which are capable of providing a broader range of value-added services, such as SMS.

Cellular revenues are derived mainly from various voice and data services and sales of handsets. Usage revenues comprise all voice and SMS and text-related services, while revenues from handset sales are associated with new subscriber activations.

In 2002, monthly churn rates for Smart's prepaid services averaged approximately 3.2% while monthly churn rates for Smart's postpaid services averaged approximately 1.8%. In 2002, monthly churn rates for Piltel's *Talk N Text* averaged at 5.7%. We believe that the principal factors affecting subscriber churn are economic conditions in the Philippines, network quality and technological advances that necessitated the upgrading of SIM cards.

For an explanation of how we calculate churn and the factors affecting our churn rates in the years ended December 31, 2002 and 2001, see "Results of Operations 2002 Compared to 2001 Consolidated Operating Revenues Wireless Cellular Service" and "2001 Compared to 2000 Consolidated Operating Revenues Wireless Cellular Service," respectively.

#### Satellite, VSAT and Other Services

Our revenues from satellite and VSAT services consist mainly of rentals received for the lease of Mabuhay Satellite's transponders and Telesat's VSAT facilities to other companies. ACeS Philippines, our satellite phone service provider, started to roll out fixed satellite terminals in the last quarter of 2001 and commenced commercial operations on January 1, 2002.

#### Information and Communications Technology

We conduct our information and communications technology businesses through our wholly owned subsidiary ePLDT, which was incorporated in August 2000 and started commercial operations in February 2001. ePLDT's

principal business activities are:

- the operation of an Internet data center under the brand name *Vitro*™;
- two wholly-owned call centers, Vocativ and Parlance; and
- Infocom, an ISP.

PLDT transferred Infocom to ePLDT on December 1, 2001. Through *Vitro*™, we provide co-location services, server hosting, hardware and software maintenance services, website development and maintenance services, webcasting and web hosting. *Vitro*™ began commercial operations in the first half of 2001. ePLDT has also focused on developing its call center services business, which we expect will account for a significant portion of ePLDT's operating revenues and capital expenditures in the near future. Both Vocativ and Parlance commenced their operations in 2002.

In addition, ePLDT has interests in the Philippines' only digital certificate issuer, a business-to-business exchange established together with five Philippine conglomerates, Internet cafes and a company with an existing build-own-and-operate agreement with the Philippine government for the computerization of the nationwide operations of the Philippine Land Transportation Office.

### **Critical Accounting Policies**

Our consolidated financial statements are prepared in accordance with U.S. GAAP, which requires management to make estimates and assumptions that affect amounts reported in our financial statements and related notes. In preparing these financial statements, we have made our best estimates and judgments of certain amounts, giving due consideration to materiality.

We believe the following represent our critical accounting policies under U.S. GAAP. The impact and any associated risks relating to these policies in our business operations are discussed elsewhere in this section where such policies affect our reported and expected financial results.

#### *Revenue Recognition*

Revenue for services is stated at amounts invoiced to customers and excludes value-added tax. We provide fixed-line communication services, mobile communication services, and information and communications technology services. We provide such services to business, residential, payphone and mobile customers. Revenue, which excludes value-added tax, represents the value of fixed consideration that has been received or is receivable. Revenue is recognized when there is evidence of an arrangement, collectibility is reasonably assured, and the delivery of the product or service has occurred. In certain circumstances, revenue is split into separately identifiable components and recognized when the related components are delivered in order to reflect the substance of the transaction. The value of components is determined using verifiable objective evidence. We do not provide our customers with the right to a refund.

#### *Products and services*

##### *Subscriptions*

We provide telephone and data communication services under postpaid and prepaid payment arrangements. Revenue includes fees for installation and activation. Installation and activation-related fees and the corresponding costs are deferred and recognized over the expected period of the customer relationship period of 7 years and 3 years for fixed line and cellular service, respectively. Costs incurred on first time installations that form an integral part of the network are capitalized and depreciated over the life of the network. All installation and activation costs are expensed as incurred. Postpaid service arrangements include subscription fees, typically fixed monthly fees, which are recognized over the subscription period on a pro rata basis.

##### *Airtime, traffic and value-added services*

Prepaid service revenue collected in advance is deferred and recognized based on the earlier of actual usage or upon expiration of the usage period. Payphone service revenue is recognized when the service is provided. Interconnection revenue for call termination, call transit, and network usage are recognized in the period the traffic occurs. Revenue related to local, long distance, network-to-network, roaming and international call connection services are recognized when the call is placed or the connection provided, net of amounts payable to other telecommunication carriers for terminating calls in their territories. Revenue related to products and value-added services is recognized upon delivery of the product or service.

##### *Equipment sales*

Sales of communication equipment are recognized upon delivery to the customer.

*Directory services*

Revenue related to published directory services is recognized on a pro rata basis over the period in which the publication expires, which is generally 12 months. Telephone-based directory service revenue is recognized when the service is provided.

*Others*

Interest is recognized on a time proportion basis taking into account the principal amount outstanding and the effective interest rate.

*Incentives*

We record an insignificant amount of commission expense based on the number of new subscriber connections initiated by certain dealers. All other cash incentives provided to dealers and customers are recorded as a reduction to revenue. Product based incentives provided to dealers and customers as part of a transaction are accounted for as multiple element arrangements and recognized when earned.

*Impairment of Long-Lived Assets*

U.S. GAAP requires that an impairment review be performed when certain impairment indicators are present. The impairment review first compares the future undiscounted cash flows expected to be generated from the continued use and ultimate disposition of the assets with the book value of the assets. If these cash flows are not sufficient to recover the book value of the assets, an impairment charge is recognized based on the comparison between the discounted value of these cash flows and the book value of the assets. In addition, our projections for future cash flows are generally less during periods of reduced cash flow. As a result, an impairment charge is more likely to occur during a period when our operating results are already otherwise depressed.

Purchase accounting requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair market values of the assets and liabilities purchased. Our business acquisitions typically result in goodwill, which affected our results of operations for the amount of future period amortization expense. However, we no longer amortize goodwill under U.S. GAAP effective January 1, 2002. Instead, goodwill is subject to a periodic impairment test. Determining the value of goodwill and future undiscounted cash flows expected to be generated from the continued use and ultimate disposition of such assets requires us to make estimates and assumptions that can materially affect our consolidated financial statements. Future events could cause us to conclude that goodwill

associated with an acquired business is impaired. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

Piltel recognized an asset impairment charge of Php12,938 million in 2001 and Php11,596 million in 2002 relating to its AMPS/CDMA and E.O. 109 assets. The revenues generated from these services could no longer support the cost of operating the network.

Also, Smart carried out an impairment review of its analog assets in June and December 2001 as a result of declining subscriber numbers, decreasing average revenue per user and the general migration of analog subscribers to Smart's GSM services. This resulted to an asset impairment charge of Php3,783 million in 2001 based on the estimated discounted cash flows from continued use and eventual disposition of these assets.

In 2001, Smart wrote-off the unamortized intangible assets (customer list) amounting to Php2,077 million relating to analog customers.

AIL incurred recurring significant losses, has a working capital deficiency and only began providing services to customers in 2001 and therefore has a limited operating history. In addition, the National Service Providers, including ACeS Philippines had not been able to generate the amount of revenues originally expected as the growth in subscriber numbers had been significantly lower than budgeted. These factors raised substantial doubt about AIL's ability to continue as a going-concern. On this basis, we made impairment provisions in respect of our investment in AIL and ground station equipment of ACeS Philippines in relation to the business of AIL in 2001.

Total impairment charges amounted to Php3,579 million consisting of full write-down of the following: (1) carrying value of our investment in AIL of Php1,614 million; (2) net book value of ground station equipment of Php1,614 million; (3) aggregate capitalized interest, net of depreciation, of Php73 million recorded during the periods that construction of the Asia Cellular Satellite System was in process, under the equity basis of accounting; and (4) shares of our losses in AIL amounting to Php921 million. Related other comprehensive income of Php1,801 million, will be credited to retained earnings, upon disposal of investment.

PLDT's total investments in convertible notes of Unilink amounted to Php2,052 million as of December 31, 2000. These notes are convertible into shares of common stock of Unilink or Home Cable at the option of the holder, when the law limiting the ownership of cable television systems to Philippine citizens or corporations, which are currently 100% owned by Philippine citizens, is eventually changed. Unilink is a Philippine corporation owning all the outstanding common shares of Home Cable, which is also a Philippine corporation licensed to own, maintain and operate a cable television system in the Philippines.

All of Unilink's shares in Home Cable have been pledged to a group of lenders as security for a loan of Home Cable. On December 6, 2001, Home Cable defaulted on the principal and interest payments in respect of certain of its obligations. On April 10, 2002, the loan agent, at the request of the lenders, delivered a notice to Home Cable declaring an event of default and accelerating the loan. Consequently, the lenders are entitled to foreclose on or sell the collateral granted as security for the loan, including Unilink's share in Home Cable. In the event that Home Cable's lenders were to foreclose on Unilink's Home Cable shares, the lenders would be entitled to the proceeds from the sale thereof or, if such shares were not sold, to the shares, and Unilink would be subrogated to the lenders' claims against Home Cable. Home Cable is currently engaged in negotiations with the lenders to restructure its debt.

On the basis of Home Cable's default on certain of its obligations, the uncertainty surrounding the negotiations with its creditors and equity holders, and its financial condition, we provided for a full permanent decline in value of our investment totaling Php2,052 million in 2001. Accordingly, we made the necessary adjustment in respect to our pension cost of Php170 million to cover for the consequent decline in value of our beneficial trust fund's investment in Home Cable.

Our investment in Mabuhay Satellite reflects the designation of its functional currency to be U.S. dollar as provided under FAS 52. Mabuhay Satellite's revenues are all in U.S. dollars and the cost of Mabuhay satellite system, which accounts for around 90% of its assets, was paid for in U.S. dollars and was funded by U.S. dollar-denominated debt to the extent of 70% of the original cost. A re-measurement of our investment account in Mabuhay Satellite's functional currency had to be made since in the previous years, we accounted for our investment on the basis of Mabuhay Satellite using the Philippine peso as its functional currency. The cumulative translation adjustment related to this amounted to Php1,031 million, Php946 million and Php870 million in 2002, 2001 and 2000.

The preparation of these estimated future cash flows involves significant judgment and estimations. While we believe that our assumptions are appropriate and reasonable, significant changes in our assumptions may materially affect our assessment of recoverable values and may lead to future additional impairment changes under U.S. GAAP.

#### *Estimating Allowances for Doubtful Accounts*

We estimate the allowance for doubtful accounts related to our trade receivables based on two methods. The amounts calculated using each of these methods are combined to determine the total amount we reserve. First, we evaluate specific accounts, mostly of foreign administrators and fixed line subscribers, or, where we have information that certain customers may be unable to meet their financial obligations. In these cases, we use judgment, based on the best available facts and circumstances, including but not limited to, the length of our relationship with the customer and the customer's current credit status based on third party credit reports and known market factors, to record specific reserves for customers against amounts due to reduce our receivables to amounts that we expect to collect. These specific reserves are re-evaluated and adjusted as additional information is received that impacts the amounts estimated. Second, a general provision is established as a certain percentage of operating revenues. This percentage is based on historical collection, write-off experience, current economic trends and changes in our customer payment terms. The amount and timing of recorded expenses for any period would differ if we made different judgments or utilized different estimates.

An increase in our allowance for doubtful accounts would increase our recorded operating expenses and decrease our current assets. Provision for doubtful accounts amounted to Php2,904 million in 2000, Php3,168 million in 2001 and Php4,209 million in 2002. The provision for doubtful accounts represented 5% of our consolidated operating revenues for the years ended December 31, 2000 and 4% for the years ended 2001 and 2002. The allowance for doubtful accounts as of December 31, 2001 and 2002 amounted to Php6,888 million and, Php9,942 million, respectively. We have not set aside any allowances for the receivables owed by U.S. carriers in connection with the termination payments due for international long distance, which was US\$19 million as of March 31, 2003, of which US\$8 million was owed to PLDT, US\$8 million to Smart and US\$3 million to Subic Telecom. See Other Information U.S. FCC Proceeding on Termination Rates and Item 8. Financial Information Legal Proceedings U.S. FCC Proceeding on Termination Rates. While we believe that these amounts can be recovered from these U.S. carriers, the ongoing disputes with these U.S. carriers may increase the risk that the amounts may not be recoverable and may require an increase in the level of provision.

### *Acquisitions and Intangible Assets*

Acquisitions have generally been accounted for as purchases. Accordingly, the acquisition of Smart was accounted for using the purchase method of accounting. The excess of the total acquisition cost over the fair value of the net assets acquired was Php28,192 million. Based on management's review and estimate, Php5,900 million was allocated to the value of customers acquired. This excess, net of Php2,077 million pertaining to the value of customers under the analog service written-off, was initially amortized on a straight-line basis over its estimated useful life of five years. Effective January 1, 2002, amortization of goodwill was no longer allowed under U.S. GAAP, which instead requires the test of goodwill impairment at least annually. Purchase accounting requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair market values of the assets and liabilities purchased. See Impairment of Long-Lived Assets above.

### *Foreign Exchange Revaluation Losses*

When we incur unhedged foreign currency-denominated liabilities arising directly from the acquisition of property, plant and equipment invoiced in a foreign currency, such as U.S. dollar-denominated loans to finance equipment purchases, foreign exchange losses on those liabilities are charged or credited to operations in the current period. In recent years, the Philippine peso has depreciated significantly against the U.S. dollar, resulting in substantial foreign exchange losses, and has resulted in our incurring a net loss for certain periods.

### *Investments*

The various interests that we hold in companies are accounted for under three methods: consolidation, the equity method and the cost method. The applicable accounting method is generally determined based on our voting interest

in a company. Majority-owned companies are consolidated, 20% to 50% owned companies are accounted for using the equity method and our investments in companies over which no significant influence is exercised or in cases where our investments are temporary, the investments are stated at cost.

*Pension Cost*

The determination of our obligation and cost for pension and other retirement benefits is dependent on our selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 19 to our financial statements in Item 18, and include among others, discount rates, expected returns on plan assets and rates of compensation increase. In accordance with U.S. GAAP, actual results that differ from our assumptions are accumulated and amortized over future periods and therefore, generally affect our recognized expense and recorded obligation in such future periods. While we believe that our assumptions are reasonable and appropriate, significant differences in our actual experience or significant changes in our assumptions may materially affect our pension and other retirement obligations.

*Legal Contingencies*

We are currently involved in various legal proceedings. Our estimate of the probable costs for the resolution of these claims has been developed in consultation with outside counsel handling our defense in these matters and is based upon an analysis of potential results. We do not believe these proceedings will have a material adverse effect on our consolidated financial position. It is possible, however, that future results of operations could be materially affected by changes in our estimates or in the effectiveness of our strategies relating to these proceedings. See Item 8. Financial Information Legal Proceedings.

**Results of Operations**

The following table shows the contribution by each of our business segments to our consolidated operating revenues, operating expenses and net operating income (loss) for each of the years ended December 31, 2000, 2001 and 2002. 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.

	<b>Years Ended December 31,</b>					
	<b>2000</b>	<b>% (1)</b>	<b>2001</b>	<b>% (1)</b>	<b>2002</b>	<b>% (1)</b>
	<b>(in millions)</b>					
<b>Operating Revenues</b>						
Fixed line	Php45,352	73	Php46,270	58	Php48,541	51



Wireless	16,358	26	32,389	41	46,058	48
Information and communications technology	239	1	469	1	941	1
	61,949	100	79,128	100	95,540	100
<b>Operating Expenses</b>						
Fixed line	30,273	67	31,965	69	36,015	74
Wireless	19,919	122	49,981	154	43,180	94
Information and communications technology	312	130	1,118	238	1,452	154
	50,504	319	83,070	461	80,647	322
<b>Net Operating Income (Loss)</b>						
Fixed line	15,079	33	14,305	31	12,526	26
Wireless	(3,562)	(22)	(17,598)	(54)	2,878	6
Information and communications technology	(72)	(30)	(648)	(138)	(511)	(54)
	Php11,445	19	Php(3,942)	(161)	Php14,893	22

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

## 2002 Compared to 2001

### Consolidated Operating Revenues

Our consolidated operating revenues grew by Php16,412 million, or 21%, to Php95,540 million in 2002 from Php79,128 million in 2001 largely as a result of the continued strong performance of our wireless segment, particularly our cellular business. Our cellular revenues contributed Php45,375 million in revenues for 2002, an increase of 43% over its revenue contribution of Php31,627 million for 2001. Our cellular revenues accounted for 47% of our consolidated operating revenues in 2002, compared to 40% in 2001.

The following table shows the break-down of our total consolidated operating revenues for the years ended December 31, 2001 and 2002 by business segment:

	<b>Years Ended December 31,</b>			
	<b>2001</b>	<b>%</b>	<b>2002</b>	<b>%</b>
	<b>(pesos in millions)</b>			
Fixed line services	Php46,270	58	Php48,541	51
Wireless services	32,389	41	46,058	48
Information and communications technology services	469	1	941	1
Total	Php79,128	100	Php95,540	100

***Fixed Line***

Our fixed line business provides local exchange service, international and national long distance services, data and other network services, and miscellaneous services. In 2002, this business segment generated total revenues of Php48,541 million, increasing by Php2,271 million, or 5%, from Php46,270 million in 2001. The increase was due to higher local exchange and data and other network service revenues which more than offset declines in our long distance service revenues. As a percentage of our consolidated operating revenues, fixed line revenues, however decreased in 2002 to 51% from 58% in 2001 due principally to the continued strong growth of our wireless business.

The following table summarizes our consolidated operating revenues from our fixed line business for the years ended December 31, 2001 and 2002 by service segment:

	<b>Years Ended December 31,</b>			
	<b>2001</b>	<b>%</b>	<b>2002</b>	<b>%</b>
	<b>(in millions)</b>			
Fixed line services:				
Local exchange	Php21,470	46	Php23,390	48
International long distance	11,544	24	10,957	23
National long distance	8,367	18	8,191	17
Data and other network	4,776	10	5,480	11
Miscellaneous	113	2	523	1
Total	Php46,270	100	Php48,541	100

***Local Exchange Service***

Our local exchange service revenues consist of:

- flat monthly fees for our postpaid service;
  
- amortization of 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;
  
- call revenues generated from payphones and coin-operated phones; and
  
- charges for special features, including bundled value-added services such as *call waiting*, *call forwarding*, *3-party conference calling* and *Caller ID*.

The following table summarizes key measures of our local exchange service business segment as of and for the years ended December 31, 2001 and 2002:

	<b>Years Ended December 31,</b>	
	<b>2001</b>	<b>2002</b>
Consolidated local exchange revenues (in millions)	Php21,470	Php23,390
Number of fixed lines in service		
PLDT Group	2,174,082	2,188,612
PLDT(1)	2,075,109	2,092,539
Number of PLDT employees	12,915	12,131
Number of PLDT fixed lines in service per PLDT employee	161	172

(1) *Approximately 93% and 88% were postpaid fixed line subscribers as of December 31, 2001 and 2002, respectively.*

Revenues from our local exchange service increased by Php1,920 million, or 9%, to Php23,390 million in 2002 from Php21,470 million in 2001. The increase was primarily due to the combined effects of (1) currency-related adjustments in our monthly local service rates and (2) increased subscription to our bundled value-added services. Partially offsetting the impact of these factors was the shift in subscriber preference from postpaid to prepaid services, which generate lower average revenue per subscriber. The percentage contribution of local exchange revenues to our total fixed line revenues increased to 48% in 2002 from 46% in 2001.

Gross additions to PLDT's fixed lines in service in 2002 totaled 523,014, a 22% increase from the gross additions of 427,349 in 2001. On a net basis, however, PLDT's fixed line additions decreased by 89% to 17,430 in 2002 from 159,124 in 2001. While fixed line additions totaled 98,525 for PLDT's prepaid fixed line services, particularly *Teletipid* and *Telesulit*, PLDT's postpaid fixed lines in service declined by 81,095 in 2002.

As of December 31, 2002, PLDT's postpaid fixed line subscribers totaled 1,849,512. These subscribers accounted for approximately 88% of PLDT's total fixed lines in service as of December 31, 2002.

Launched in 2000, *Teletipid* was initially intended as an affordable alternative telephone service for consumers under difficult economic conditions. In 2001, *Teletipid* eventually became part of PLDT's overall churn and credit risk exposure management and subscriber retention efforts. *Teletipid* phone kits, each containing Php300 worth of pre-stored call credits, are sold for Php1,700 per unit. Prior to May 1, 2002, *Teletipid* subscribers were charged based on usage at a rate of Php0.50 per minute for local calls and at the same rates applicable to postpaid fixed line subscribers for national and international long distance calls. Effective May 1, 2002, the local call rate was increased to Php1.00 per minute, but the rates for national and international long distance calls remained unchanged.

In February 2002, PLDT launched a premium variant to *Teletipid* under the brand name *Telesulit*. *Telesulit* phone kits, each containing Php500 worth of pre-stored call credits, are sold for Php1,900 per unit. Effective February 1, 2003, the local call rate for *Telesulit* was increased to Php1.00 per minute from Php0.75 per minute, while the national and international long distance rates are the same as those applicable to *Teletipid* and postpaid fixed line subscribers. A *Teletipid* subscriber migrating to *Telesulit* will be able to retain the same telephone number.

As of December 31, 2002, PLDT's active prepaid fixed line subscribers totaled 243,027, of which 121,054 were *Teletipid* subscribers and 121,973 were *Telesulit* subscribers. These subscribers accounted for approximately 12% of PLDT's total fixed lines in service.

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 Php300 in the case of *Teletipid* and Php500 in the case of *Telesulit*. Reloads are valid for two months. A prepaid fixed line subscriber is disconnected if that subscriber does not reload within four months for *Teletipid* and within one month for *Telesulit* after the expiry of the last reload. All sales of prepaid *Teletipid* and *Telesulit* cards, whether through dealers or through PLDT's business offices, are non-refundable.

Pursuant to a currency exchange rate adjustment mechanism authorized by 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 = US\$1.00. In 2002, we implemented 13 upward adjustments and six downward adjustments in our monthly local service rates, compared to four upward adjustments and ten downward adjustments in 2001. The average peso-to-dollar rate in 2002 was Php51.583 = US\$1.00, compared to the average of Php51.009 = US\$1.00 in 2001. This change in the average peso-to-dollar rate translated to a peso depreciation of 1.2%, which resulted in a 1.1% average net increase in our monthly local service rates in 2002.

To attract new fixed line subscribers and retain existing ones, PLDT has introduced additional value-added products and services such as *Caller ID* and *txt 135*. *Caller ID* allows subscribers to identify callers by telephone number, and it is now bundled at special rates with other value-added phone services, such as *call waiting*, *call forwarding*, *3-party conference calling* and *speed calling*. *txt 135* allows one-way text messaging from PLDT fixed lines to Smart and Piltel GSM handsets and is capable of international text messaging.

The ratio of PLDT fixed lines in service per PLDT employee improved from 161 at December 31, 2001 to 172 at December 31, 2002. This improvement is a result of the net increase in PLDT's fixed lines in service coupled with a reduction of PLDT's workforce. In 2002, employee headcount was reduced by 6% mainly as a result of PLDT's ongoing manpower reduction program, bringing its workforce down to 12,131 at year-end.

#### *International Long Distance Service*

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

- inbound call revenues representing settlements from foreign telecommunications carriers for inbound international calls;
- 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 long distance business for the years ended December 31, 2001 and 2002:

	<b>Years Ended</b>	
	<b>December 31,</b>	
	<b>2001</b>	<b>2002</b>
Consolidated international long distance revenues (in millions)	Php11,544	Php10,957
Inbound	9,075	8,778
Outbound	2,469	2,179
International call volumes (in million minutes, except call ratio)(1)		
PLDT Group(2)	3,276	2,815
Inbound	3,108	2,644
Outbound	168	171
Inbound-outbound call ratio	18.5:1	15.5:1
PLDT	2,814	2,576
Inbound	2,648	2,409
Outbound	166	167
Inbound-outbound call ratio	16.0:1	14.4:1

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(1) Call volumes for the year ended December 31, 2001 have been restated to conform with our 2002 financial statement presentation, which includes interconnection traffic.

(2) Excludes cellular call volumes.

Our consolidated international long distance revenues declined by Php587 million, or 5%, to Php10,957 million in 2002 from Php11,544 million in 2001, primarily as a result of lower inbound call volumes. The percentage contribution of international long distance revenues to our total fixed line revenues also declined in 2002 to 23% from 24% in 2001.

Our revenues from inbound international long distance calls decreased by Php297 million, or 3%, to Php8,778 million in 2002 from Php9,075 million in 2001. The decrease was due mainly to the combined effects of lower call volumes and continued declines in the average international termination rates, partially offset by the positive impact of the depreciation of the average value of the peso relative to the U.S. dollar.

Our inbound international long distance call volumes decreased by 15% to 2,644 million minutes in 2002 from 3,108 million minutes in 2001 due to the following factors:

- increased competition from alternative means of long distance communications, particularly e-mail, international text messaging and Internet telephony;
- more inbound calls terminating directly to cellular subscribers; and
- our policy requiring certain second and third tier international carriers to prepay in order for us to accept their incoming traffic. Although this policy had a negative impact on our inbound international long distance revenues in 2002, we expect that this will help us achieve a more stable revenue base and control uncollectible accounts over the longer term.

The depreciation of the peso increased our inbound international long distance revenues in peso terms because 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 and translated into pesos at the prevailing exchange rates at the time of billing.

Our revenues from outbound international long distance calls declined by Php290 million, or 12%, to Php2,179 million in 2002 from Php2,469 million in 2001. The decline was due primarily to reductions in our average international direct dialing, or IDD, rates brought about by discounts granted to corporate customers and other large accounts and operator-assisted call charges, partially offset by higher outbound call volumes and the positive effect of the depreciation of the average value of the peso against the U.S. dollar.

Effective February 2001, PLDT reduced its IDD rates for retail customers from US\$0.49 per minute for off-peak hours and US\$0.69 per minute for peak hours to a flat rate for retail customers of US\$0.40 per minute applicable to all call destinations at any time and any day of the week. Additionally, in November 2001, PLDT introduced *Budget Card*, a prepaid call card offering a reduced IDD rate of US\$0.24 per minute for calls to the United States, Canada and Hawaii. *Budget Cards* are sold in a denomination of Php200, which must be used within 24 hours of activation.

Our outbound international long distance call volumes grew by 2% to 171 million minutes in 2002 from 168 million minutes in 2001 on account of:

- reduced average IDD rates; and
- various marketing initiatives, including automatic activation of the IDD service for qualified subscribers, innovative pricing packages for corporate accounts and loyalty programs for high-valued customers.

The depreciation of the peso increased our outbound international long distance revenues in peso terms because outbound calls are charged at U.S. dollar rates that are billed to our subscribers in pesos at the prevailing exchange rates at the time of billing.

*National Long Distance Service*

Our national long distance 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 revenues and call volumes for the years ended December 31, 2001 and 2002:

	<b>Years Ended December 31,</b>	
	<b>2001</b>	<b>2002</b>
Consolidated national long distance revenues (in millions)	Php8,367	Php8,191
National long distance call volumes (in million minutes)		
PLDT Group	2,780	2,181



PLDT

2,756 2,145

Our national long distance revenues decreased by Php176 million, or 2%, to Php8,191 million in 2002 from Php8,367 million in 2001 due to the combined effects of the (1) decrease in call volumes resulting mainly from cellular substitution and (2) changes in PLDT's interconnection arrangements with the majority of other local exchange carriers. Accordingly, the percentage contribution of national long distance revenues to our fixed line revenues was down to 17% in 2002 from 18% in 2001.

Our national long distance call volumes decreased by 22% to 2,181 million minutes in 2002 from 2,780 million minutes in 2001. Cellular substitution and the widespread availability and growing popularity of alternative non-voice means of communications, particularly cellular text messaging and e-mail, have negatively affected call volumes.

In the latter part of 2001, PLDT simplified its rates for calls to fixed line subscribers and for those terminating to cellular subscribers resulting in an overall rate increase. For calls terminating to fixed line subscribers, the applicable rates from January to November 1, 2001 ranged from Php3.00 to Php5.00 per minute, depending on distance and time of call. In line with its move towards rate simplification, PLDT simplified these rates to a flat rate of Php4.50 per minute effective November 2, 2001. At the same time, PLDT also simplified its rates for calls terminating to cellular subscribers from a range of Php10.00 to Php16.00 per minute to a uniform rate of Php13.75 per minute. Effective March 1, 2003, the rate for calls terminating to other local exchange carriers increased from a flat rate of Php4.50 per minute to Php5.00 per minute. Through rate simplification, we aim to simplify our tariff structure in order to enhance the competitiveness of our products and services and increase our operating efficiencies. We adopted these simplified pricing plans with a view to maximizing our national long distance revenues.

On May 1, 2001, PLDT entered into a new interconnection arrangement with the majority of other local exchange carriers. Under this arrangement, the originating carrier pays (1) a hauling charge of Php0.50 per minute for short-haul traffic or Php1.25 per minute for long-haul traffic to the carrier owning the backbone network and (2) an access charge of Php1.00 per minute to the terminating carrier. PLDT maintains revenue-sharing arrangements with a few other local exchange carriers, whereby charges are generally apportioned 30% for the originating entity, 40% for the backbone owner and the remaining 30% for the terminating entity.

The decrease in our national long distance revenues in 2002 compared to 2001 was, however, mitigated by the impact of the following:

- changes in interconnection arrangements with cellular operators;
- increase in national direct dialing rates; and

- launch of *PLDT Premium Phone Services*.

PLDT has reached an agreement with cellular operators to reduce the access charges it pays for calls terminating to cellular subscribers. Effective January 2002, PLDT pays access charges of Php4.50 per minute, down from the Php6.50 per minute it paid for the period from July to December 2001. Prior to July 2001, PLDT was paying access charges ranging from a low of Php7.69 per minute to a high of Php10.94 per minute for calls terminating to cellular subscribers, depending on whether the calls were local or long distance.

Launched in 2001, *PLDT Premium Phone Services* allow customers to choose from a range of service applications, such as appointment-booking services for selected embassies (including, among others, the U.S. and Australian embassies in the Philippines), spiritual and love counseling, joining television-based game shows, celebrity chatting, downloading and sending of ring tones and logos, televoting, and job postings. PLDT charges an average of Php10.00 per minute for these premium phone services.

#### *Data and Other Network Services*

While the other major segments of our fixed line business posted lower revenues in 2002 compared to 2001, our data and other network services consistently registered increasing revenue growth. Revenues from these services grew by Php704 million, or 15%, to Php5,480 million in 2002 from Php4,776 million in 2001. The percentage revenue contribution of these services to our fixed line revenues increased to 11% in 2002 from 10% in 2001. We expect that demand for, and therefore revenues generated from, these services will continue to grow in the foreseeable future.

Data and other network services we currently provide include:

- traditional bandwidth services high-speed point-to-point domestic and international digital leased line services;
- broadband/packet-based/Internet-based services frame relay, ATM, IP-VPN, DSL, Internet gateway, and wholesale DS3; and
- other packet-based switching services Datapac and integrated services digital network, or ISDN.

The foregoing services are used for the following:

- domestic and international communication;
- broadband data transmission services that transmit data over a range of frequencies and/or bandwidth into several narrower bands;
- Internet exchange services that provide ISPs with a primary connection to the global Internet to exchange local traffic generated within the Philippines;
- private networking services that use the public Internet as a backbone for private interconnection between different locations;
- switch-based services, provided through a fixed bandwidth transmission facility, that allow establishment of a dedicated connection for the duration of the call; and
- international packet-based services, provided through bilateral arrangements and global alliances that integrate voice, video and data.

Traditional bandwidth services accounted for 57% of the total revenues from PLDT's data and other network services for 2002, broadband/IP-based services accounted for 38%, and other services accounted for the remaining 5%, compared to 67%, 29% and 4%, respectively, for 2001. These percentage changes indicate a shift in data and other network revenues from traditional bandwidth services to broadband/IP-based services. We expect this trend to continue given the growing demand for broadband transmission of voice, data and video due to the continued growth of the Internet, e-commerce and other online services.

In May 2002, PLDT launched a pay-per-use dial-up Internet service under the brand name *PLDT Vibe*, which is available on a postpaid or prepaid basis to PLDT's fixed line subscribers. Charges for this service are Php0.25 per minute for off-peak hours, which are from 10:01 p.m. to 6:00 a.m., and Php0.50 per minute for peak hours, which are from 6:01 a.m. to 10:00 p.m. With the launch of *PLDT Vibe*, PLDT now offers two residential Internet service packages targeting separate markets: *PLDT Vibe* for light to medium Internet users and *myDSL* broadband for heavy Internet users. As of December 31, 2002, the number of PLDT's postpaid fixed line subscribers that signed up for *PLDT Vibe* was 60,878, while the number of subscribers to *PLDT DSL* and *myDSL* broadband services rose to 10,896 and 4,203 at the end of 2002 and 2001, respectively.

In August 2002, PLDT launched *Shops.work*, a network solution that allows the electronic linking of retail stores providing, among others, sales and inventory reports, up-to-date and real-time monitoring of sales and inventory, and on-line access to head offices.

*Miscellaneous*

Miscellaneous revenues are derived mostly from directory advertising and facilities rental. In 2002, these revenues increased by Php410 million, or 363%, to Php523 million from Php113 million in 2001, and accounted for approximately 1% of our fixed line revenues in 2002.

*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 years ended December 31, 2001 and 2002 by service segment:

	<b>Years Ended December 31,</b>			
	<b>2001</b>	<b>%</b>	<b>2002</b>	<b>%</b>
	<b>(pesos in millions)</b>			
Wireless services:				
Cellular services	Php20,157	62	Php30,599	66
Cellular handset sales	11,470	36	14,776	32
Satellite, VSAT and others	762	2	683	1
Total	Php32,389	100	Php46,058	100

Our wireless service revenues increased considerably by Php13,669 million, or 42%, to Php46,058 million in 2002 from Php32,389 million in 2001 mainly as a result of the continued strong growth in revenues generated from Smart's cellular service. Accordingly, as a percentage of our consolidated operating revenues, wireless service revenues rose to 48% in 2002 from 41% in 2001.

*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;
- 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;
- revenues associated with the sale of handsets; and
- other charges, including those for reconnection and migration.

Our cellular service revenues in 2002, increased by Php13,748 million, or 43%, to Php45,375 million from Php31,627 in 2001 as a result of the significant increase in our GSM subscriber base, partially offset by declining usage per subscriber. Cellular service revenues accounted for 47% of our consolidated operating revenues in 2002, compared to 40% in 2001.

We market nationwide cellular communications services through Smart and Piltel under the brand names *Smart Buddy*, *Smart Gold*, *addict mobile*, and *Talk 'N Text*. *Smart Buddy* is a prepaid service while *Smart Gold* and *addict mobile* are postpaid services, all provided through Smart's digital GSM network. *addict mobile* was introduced in April 2003. *Talk 'N Text* is a prepaid service provided using Smart's GSM network marketed by Piltel pursuant to a facilities service agreement between Smart and Piltel. Before Smart decommissioned its analog enhanced total access communications system, or ETACS, network in December 2002, it had also offered analog prepaid and postpaid services under the brand names *BillCrusher* and *PriceBuster*, respectively. Prior to 2002, Piltel had also offered analog prepaid and postpaid services under the brand names *Phone Pal* and *Mobiline*, respectively.

The significant increase in our cellular service revenues in 2002 was largely driven by our large GSM subscriber base coupled with sustained subscriber growth. The table below shows our cellular subscriber base as of December 31, 2001 and 2002:

	<b>Years Ended</b>	
	<b>December 31,</b>	
	<b>2001</b>	<b>2002</b>
Cellular subscribers	6,368,850	8,599,306
Smart	4,893,844	6,825,686
GSM	4,641,666	6,825,686
Prepaid	4,569,616	6,649,038
Postpaid	72,050	176,648
Analog(1)	252,178	
Prepaid	87,429	
Postpaid	164,749	
Piltel(2)	1,475,006	1,773,620
GSM Prepaid	1,329,326	1,773,620
Analog(1)	145,680	
Prepaid	76,473	
Postpaid	69,207	

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(1) Smart closed down its analog/ETACS network in December 2002. Piltel ceased to offer its analog/CDMA prepaid and postpaid services at the end of 2002.

(2) Piltel does not offer postpaid GSM services.

As of December 31, 2002, Smart's prepaid GSM subscriber base grew by 46% to 6,649,038 from 4,569,616 at December 31, 2001, whereas Smart's postpaid GSM subscriber base increased by 145% to 176,648 at December 31, 2002 from 72,050 at December 31, 2001. Of Smart's 6,825,686 GSM subscribers at December 31, 2002, prepaid subscribers accounted for 97%, while postpaid subscribers accounted for the remaining 3%. Piltel's prepaid GSM subscribers reached 1,773,620 as at December 31, 2002, representing a 20% increase from its 1,475,006 subscribers at December 31, 2001.

The following table provides a breakdown of our cellular revenues as of and for the years ended December 31, 2001 and 2002:

**Years Ended  
December 31,  
2001      2002**

Cellular revenues (in millions)	Php31,627	Php45,375
Cellular services(1)	20,157	30,599
Cellular handset sales(2)	11,470	14,776

(1) *Refers to GSM and analog voice and data revenues*

(2) *Includes revenues from handset sales*

Usage revenues from voice and data services, which include all voice traffic and value-added services such as voice mail and international roaming as well as text messaging-related services, increased by Php10,442 million, or 52%, to Php30,599 million in 2002 from Php20,157 million in 2001 due mainly to an increase of our cellular subscriber base, partially offset by a decrease in our revenue per user.

As a result of our increasing GSM subscriber base, volumes for both domestic and international calls increased by 52% in 2002 to 3,252 million minutes from 2,142 million minutes in 2001. Domestic call volumes, which include voice traffic originating from our cellular subscribers and terminating within our cellular network and to other cellular and fixed line networks, increased by 54% to 2,288 million minutes in 2002 from 1,487 million minutes in 2001. In addition, international call volumes, both inbound and outbound, grew significantly to 964 million minutes in 2002 from 655 million minutes in 2001, representing an increase of 47%.

During 2002, our SMS system handled 19,558 million outbound messages, an increase of 39% from the 14,055 million outbound messages handled during 2001. We implemented a two-phase reduction of our free text message allocation to subscribers. The first phase, effective September 15, 2001, reduced the allocation by one-third, while the second phase, effective January 1, 2002, reduced the allocation by another one-third of the original allocation, resulting in a total reduction of two-thirds.

Revenues from our analog services have been declining as analog subscribers have been migrating to GSM service. Smart decommissioned its analog enhanced total access communications system, or ETACS, network in December 2002 while Piltel ceased to offer its analog/CDMA service at the end of 2002.

Prior to July 2001, Smart and Piltel received interconnection fees at an average of Php8.50 per minute for calls originating from fixed line subscribers. Effective July 1, 2001, these fees were reduced to Php6.50 per minute and then further reduced to Php4.50 per minute effective January 1, 2002. Also, prior to July 2001, Smart and Piltel received and paid interconnection fees of Php1.00 per minute for calls originating from/terminating to another cellular operator's network. Effective July 1, 2001, these fees were increased to Php3.00 per minute and then further increased to Php4.50 per minute effective January 1, 2002.

Effective January 1, 2003, the termination rate for calls terminating to fixed line subscribers increased from Php2.00 per minute to Php2.50 per minute, which will further increase to Php3.00 per minute effective January 1, 2004. Effective February 1, 2003, international long distance calls passing through our cellular network facility terminating to cellular subscribers are charged a termination rate of US\$0.16 per minute, an increase from the previous rate of US\$0.12 per minute. Effective January 1, 2004, calls terminating to cellular subscribers originating from fixed line subscribers will be charged a termination rate of Php4.00 per minute, a decrease from the previous rate of Php4.50 per minute.

#### *Handset Revenues*

Our cellular revenues include revenues from the sale of handsets amounting to Php14,776 million, an increase of 29% over the Php11,470 million recorded in 2001. The increase was attributable to higher gross activations in our GSM subscribers.

#### *GSM Churn Rates*

Churn, or the rate at which existing subscribers have their service canceled 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 simple average of the numbers of subscribers at the beginning and at the end of a month, all divided by the number of months in the same period.

A prepaid cellular subscriber is recognized as an active subscriber when that subscriber activates and uses the SIM card in the handset, which already contains Php100 worth of pre-stored air time. Subscribers can then reload by purchasing prepaid call-and-text cards that are sold in denominations of Php300, Php500 and Php1,000 or, in the case of Smart's prepaid subscribers, by purchasing additional air time through their handsets using *Smart Money*. Reloads are valid for two months. A prepaid GSM account is disconnected if the subscriber does not reload within four months after the full usage or expiry of the last reload. As a result, a subscriber would not be recognized in churn for up to four to six months after the subscriber may have stopped using the service to make calls or send messages (although the subscriber may continue to receive calls and messages). These effects may cause our calculated churn rate for a period to be lower than the actual rate at which subscribers are ceasing to use Smart's and Piltel's services, and may contribute to more rapid growth in calculated churn following periods of rapid subscriber growth.



For Smart's prepaid GSM subscribers, the average monthly churn rate for 2002 was 3.2%, compared to 1.8% for 2001. Smart's churn has been influenced by several factors, particularly the slowdown of the Philippine economy, which negatively affected the ability of some subscribers to afford the service. Piltel's *Talk 'N Text* experienced churn for 2002 at an average rate of 5.7%, an increase from 2.7% in 2001.

As part of our initiatives to address the increase in churn rate, we introduced *PureTxt 100* on August 18, 2002. The card was designed as an alternative for *Smart Buddy* and *Talk 'N Text* subscribers who may temporarily be unable to afford the call and text cards with higher denominations. Once a *PureTxt 100* card was loaded, the incoming and outgoing voice-call capabilities of the subscriber were temporarily deactivated until such time that the subscriber reloaded with a call and text card in a denomination of at least Php300. *PureTxt 100* cards came with a free allocation of 10 text messages and were valid for one month.

In May 2003, we introduced *SmartLoad*, an over-the-air electronic loading facility designed to make reloading of air time credits more convenient for and accessible to *Smart Buddy* and *Talk 'N Text* subscribers. These over-the-air reloads, which have both voice and text functions, are packaged in smaller denominations of Php30, Php60 and Php115, but have shorter validity periods of 3 days, 6 days and 12 days, respectively. Like *PureTxt 100*, we believe that *SmartLoad* will encourage subscribers to stay within our cellular network instead of churning and re-subscribing at a later time. We have ceased production of *PureTxt 100* cards in anticipation that our *PureTxt* subscribers will eventually avail of *SmartLoad*.

The average monthly churn rate for Smart's postpaid GSM subscribers in 2002 was 2.3%, compared to 3.3% in 2001. 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 in 2002 amounted to Php683 million, a decrease of Php79 million, or 10%, from Php762 million in 2001.

#### *Information and Communications Technology*

Our information and communications technology business is conducted by ePLDT, a wholly-owned subsidiary of PLDT. ePLDT was formed in August 2000 and started commercial operations in February 2001. ePLDT's principal business activities are the operation of an Internet data center under the brand name *Vitroä*; two wholly-owned call centers, namely Vocativ and Parlance; and Infocom, an ISP. Granted pioneer status as an Internet data center by the Philippine Board of Investments, *Vitroä* 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. ePLDT also operates Infocom, our ISP, which was transferred from PLDT to ePLDT in December 2001 in line with the reorganization of our businesses into three major business segments.

ePLDT is engaged in the call center business through the following subsidiaries:

- Parlance, a 100%-owned call center facility capable of accommodating 520 seats exclusively for one of the largest direct-to-home service providers in the United States for customer support and billing requirements. Parlance commenced commercial operations in June 2002;
- Vocativ, a 100%-owned call center facility capable of accommodating 500 seats exclusively for clients of a global provider of customer relationship management services. Vocativ commenced commercial operations in April 2002; and

ePLDT sold its entire 51% interest in Contact World on June 30, 2003. Contact World, a call center facility capable of accommodating 200 seats, provides services that include customer acquisition, retention and growth, customer care and support, receivables management, help desk and technical support to various companies. Contact World commenced commercial operations in June 2001.

ePLDT has also invested in a number of other e-commerce and Internet-related businesses, as described in Item 4. Information on the Company Business Information and Communications Technology Infrastructure and Services Other Investments.

In 2002, our information and communications technology business generated total revenues of Php941 million, an increase of Php472 million, or 101%, over the Php469 million in 2001. These revenues accounted for less than 1% of our consolidated operating revenues in each of the years 2002 and 2001. *Vitroä* contributed revenues of Php296 million, ePLDT's call center business Php299 million and Infocom Php346 million, representing 31%, 32% and 37%, respectively, of the total revenues from our information and communications technology business in 2002. Infocom's revenue contribution in 2002 represented an increase of Php12 million, or 4%, over its revenue contribution of Php334 million in 2001. Going forward, we expect revenues from our call center business to contribute significantly to our information and communications technology revenues with the full commercial operations of Parlance and Vocativ and the growing demand for call center services.

**Consolidated Operating Expenses**

Our consolidated operating expenses in 2002 decreased by Php8,136 million, or 3%, to Php80,647 million from Php83,070 million in 2001. The decrease was due primarily to lower amortization expenses of goodwill and a lower amount of impairment charges recognized in 2002. As a percentage of our consolidated operating revenues, consolidated operating expenses decreased to 51% in 2002 from 58% in 2001 as a result of an increase in wireless revenues.

The following table shows the break-down of our total consolidated operating expenses for the years ended December 31, 2001 and 2002 by business segment:

	<b>Years Ended December</b>	
	<b>31,</b>	
	<b>2001</b>	<b>2002</b>
	<b>(pesos in millions)</b>	
Fixed line services	Php31,965	Php36,015
Wireless services	49,987	43,180
Information and communications technology services	1,117	1,452
Total	Php83,070	Php80,647

**Fixed Line**

Consolidated operating expenses related to our fixed line business in 2002 totaled Php36,015 million, an increase of Php4,050 million, or 13%, compared to Php31,965 million in 2001.

The following table shows the break-down of our total consolidated fixed line-related operating expenses for the years ended December 31, 2001 and 2002 and the percentage of each expense item to the total:

	<b>Years Ended December</b>	
	<b>31,</b>	
	<b>2001</b>	<b>2002</b>
	<b>(in millions)</b>	
Fixed line services:		
Depreciation and amortization	Php8,820	Php13,902

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Compensation and benefits	7,444	7,723
Provision for doubtful accounts	2,827	3,629
Maintenance	3,252	3,243
Selling and promotions	1,050	2,700
Professional and other service fees	1,008	1,018
Rent	832	970
Taxes and licenses	408	507
Other operating costs	1,676	1,699
Total	Php31,965	Php36,015

Depreciation and amortization charges increased by Php5,081 million, or 58%, to Php13,902 million in 2002 mainly due to higher depreciation of our asset base primarily resulting from additional completed projects.

Compensation and benefits increased by Php279 million, or 4%, to Php7,723 million in 2002 mainly due to Collective Bargaining Agreement related salary increases and partly offset by the impact of PLDT's ongoing manpower reduction program and lower overtime costs.

Provision for doubtful accounts increased by Php802 million, or 28%, to Php3,629 million in 2002 on account of higher provision for anticipated uncollectible accounts from various specifically identified second-tier international telecommunications carriers. To address the receivable issue, PLDT has adopted a prepayment policy as a prerequisite for its acceptance of incoming international traffic from these carriers. Provision for doubtful accounts in 2002 was equivalent to 7% of its operating revenues, compared to 6% in 2001.

Maintenance expenses decreased by Php9 million to Php3,243 million primarily due to lower maintenance costs for PLDT's outside and inside plant facilities. The reduction in maintenance costs for these facilities was partially offset by higher electricity expense that resulted from increased power consumption coupled with increased power rates.

Selling and promotion expenses increased by Php1,650 million, or 157%, to Php2,700 million mainly due to higher commissions paid to dealers for the sale of prepaid cards.

Professional and other service fees increased by Php10 million, or 1%, to Php1,018 million because of consultancy fees incurred by PLDT Global relating to the establishment and operation of global points of presence, partially offset by lower advisory, consultancy and payment facility expenses incurred by PLDT as a result of streamlining its outsourced services.

Rental expense increased by Php37 million, or 4%, to Php970 million mainly due to higher rental charges incurred by PLDT for its international leased circuit requirements.

Taxes and licenses increased by Php99 million, or 24%, to Php507 million mainly on account of higher provision for NTC supervision and regulation fees (see Note 24 to our financial statements in Item 18 for a discussion relating to NTC supervision and regulation fees).

Other operating costs increased by Php24 million, or 1%, to Php1,699 million primarily due to higher travel, training and related expenses, partly offset by lower number of contractual employees and the overall reduction in other costs as a result of our cost-cutting efforts.

*Wireless*

Consolidated operating expenses associated with our wireless business in 2002 totaled Php43,180 million, a decrease of Php6,808 million, or 14%, from Php49,987 million in 2001.

The following table summarizes our consolidated wireless-related operating expenses for the years ended December 31, 2001 and 2002 and the percentage of each expense item to the total:

	Years Ended December	
	2001	2002
	(in millions)	
Wireless services		
Cost of cellular handsets sold	Php13,232	Php15,981
Depreciation and amortization	7,516	3,494
Selling and promotions	2,416	2,906
Compensation and benefits	1,744	2,710
Rent	1,570	1,971
Maintenance	1,369	1,436
Professional and other service fees	1,242	1,196
Provision for doubtful accounts	310	535
Taxes and licenses	511	588
Asset impairment charge	19,470	10,865
Other operating costs	608	1,498
Total	Php49,987	Php43,180

Cost of cellular handsets sold increased by Php2,749 million, or 21%, to Php15,981 million mainly due to an increase in GSM cellular subscribers both for Smart and Piltel.

Depreciation and amortization charges decreased by Php4,022 million, or 54%, to Php3,494 million mainly due to an asset impairment charge in 2001 for Smart's analog/ETACS and Piltel's analog/CDMA assets which reduced the depreciable value of Smart's and Piltel's assets. Having complied with the requirements set out by the NTC, Smart closed down the operation of its analog/ETACS network in December 2002.

Selling and promotion expenses increased by Php490 million, or 20%, to Php2,906 million, mainly due to increased gross activations of our cellular subscribers in 2002. Effective August 1, 2002, we reduced maximum commission paid to dealers for prepaid phone kit sales from a range of Php1,000 to Php1,300 per unit sold (depending on the volume purchased) in the form of prepaid call and text cards to Php800 in cash per prepaid phone kit. An additional 1% rebate is given on cash purchases.

Compensation and benefits increased by Php966 million, or 55%, to Php2,710 million primarily due to increased salaries and benefits of Smart's employees coupled with accrued long-term incentive plan benefits for managers and executives of Smart. Smart's employee headcount increased from 5,035 as of December 31, 2001 to 5,330 as of December 31, 2002 mainly due to the integration of TSI into Smart on December 1, 2002. TSI was the largest dealer of Smart.

Rental expense increased by Php401 million, or 26%, to Php1,971 million on account of higher site rentals incurred by Smart for its growing number of cell sites and base stations in line with its network expansion; increased operational requirements for satellite, microwave link and circuit facilities; and higher office space rentals due to increased wireless business centers. As of December 31, 2002, Smart had 2,110 GSM cell sites and 2,777 base stations, compared with 1,570 GSM cell sites and 2,091 base stations as of December 31, 2001.

Maintenance expense increased by Php67 million, or 5%, to Php1,436 million due to higher maintenance costs incurred by Smart relating to additional network equipment for its growing number of cell sites.

Professional and other service fees decreased by Php46 million, or 4%, to Php1,196 million mainly as a result of lower technical service fees incurred by Smart.

Provision for doubtful accounts increased by Php225 million, or 73%, to Php535 million due to an increase in Smart's provision for doubtful carrier accounts mainly on account of an increase in Smart's postpaid subscriber base and Smart's adoption of a more stringent provisioning policy.

Taxes and licenses increased by Php77 million, or 15%, to Php588 million due mainly to the increase in Smart's and Piltel's real property tax, municipal licenses and taxes, and NTC supervision and license fees. See Note 24 to our financial statements in Item 18 for a discussion relating to NTC supervision and regulation fees.

Asset impairment charges decreased by Php8,604 million, or 44%, to Php10,865 million in 2002 on account of impairment charges relating to Piltel's E.O. 109 limited mobility wireless local loop assets. Impairments relating to Smart's analog/ETACS and Piltel's analog/CDMA assets were fully recognized in 2001. Smart's customer list on its analog/ETACS service had been fully written off as at December 31, 2001 and as such, no similar write off was taken in 2002.

Other operating costs increased by Php890 million, or 146%, to Php1,498 million primarily due to increases in Smart's various other operating expenses, such as insurance, facility usage fees, travel and transportation, and communications expenses.

### *Information and Communications Technology*

Consolidated operating expenses associated with our information and communications technology business in 2002 totaled Php1,452 million, an increase of Php335 million, or 30%, from Php1,117 million in 2001. The increase was due principally to the full commercial operations of ePLDT and its newly formed subsidiaries. The three largest expense items related to our information and communications technology business in 2002 were maintenance, compensation and benefits, and depreciation and amortization, representing 39%, 36% and 28%, respectively, of our total operating expenses related to this business.

### *Net Operating Income*

Our consolidated net operating income in 2002 was Php14,971 million, compared to a net operating loss of Php9,576 million in 2001. Accordingly, our consolidated operating margin (net operating income as a percentage of operating revenues) improved to positive 15% in 2002 from negative 12% in 2001.

The following table shows the break-down of our consolidated net operating income for the years ended December 31, 2001 and 2002 by business segment:

	<b>Years Ended December</b>	
	<b>31,</b>	
	<b>2001</b>	<b>2002</b>
	<b>(pesos in millions)</b>	
Fixed line services	Php14,305	Php12,526
Wireless services	(17,598)	2,878

Information and communications technology services	(647)	(511)
Total	Php(3,942)	Php14,893

*Fixed Line*

In 2002, our fixed line business segment contributed an operating income of Php12,526 million, which was lower by Php1,779 million, or 12%, than Php14,305 million in 2001. This lower operating income contribution was due largely to higher depreciation and amortization charges.

*Wireless*

Our wireless business segment registered an operating income of Php2,878 million in 2002, compared to an operating loss of Php17,598 million in 2001. This marked improvement was due to a substantial increase in our cellular operating revenues and a decline in asset impairment provisions.

*Information and Communications Technology*

In 2002, our information and communications technology business segment posted an operating loss of Php511 million, an increase of Php136 million, or 21%, compared to an operating loss of Php647 million incurred in 2001. These operating losses reflect the start-up nature of ePLDT's businesses and those of ePLDT's subsidiaries.

*Other Expenses Net*

The following table shows our consolidated other expenses net for the years ended December 31, 2001 and 2002:

	<b>Years Ended</b>	
	<b>December 31,</b>	
	<b>2001</b>	<b>2002</b>
	<b>(in millions)</b>	
Interest expenses and related items	Php17,043	Php16,006
Capitalized interest	(2,404)	(1,344)
Subtotal	Php14,639	Php14,662



Interest and other income	(1,458)	(2,567)
Other expenses net	10,654	4,587
Total	Php23,835	Php16,682

On a consolidated basis, our other expenses, net of other income, decreased by Php1,500 million, or 8%, to Php16,682 million in 2002 from Php18,182 million in 2001 due to the combined effects of:

- an increase in interest expense and related items, net of capitalized interest, of Php23 million attributable mainly to (1) a decrease in interest expense of Php858 million due to the debt restructuring of Piltel and (2) a decrease of Php171 million in Mabuhay Satellite's interest expense due to debt payments and lower interest rates mainly on Mabuhay Satellite's foreign currency-denominated loans bearing fluctuating interest rates. The above decreases were partially offset by (1) a net increase of Php12 million in PLDT's interest expense and related items mainly due to the inclusion of the tender premium of Php518 million related to our tender offer for notes due 2003 and 2004 completed in May 2002, which was substantially offset by the combined effects of lower interest rates, particularly LIBOR, and amortizations and prepayments of various loans in 2002; (2) an increase of Php302 million in Smart's interest expense due to a higher level of indebtedness in 2002; (3) a net increase of Php7 million in other subsidiaries' interest expenses, and (4) decrease in capitalized interest.;
- an increase in interest and other income of Php1,109 million mainly due to a net gain of Php633 million resulting from PLDT's termination of an interest rate swap agreement;
- a decrease of Php6,067 million in other expenses net due mainly to decrease in impairment losses of Php5,653 million, a decrease in Php826 million in equity partially offset by an increase in foreign currency swap costs by Php207 million; and
- equity in net losses of investees.

***Loss Before Income Tax and Minority Interest***

Our loss before income tax and minority interest in net losses of consolidated subsidiaries in 2002 was Php1,799 million, a decrease of Php25,538 million, or 93%, from a loss of Php27,327 million in 2001.

In 2002, our effective corporate tax rate on a consolidated basis was 16%. Our effective corporate tax rate was lower than the 32% statutory corporate tax rate due to the following:

- the effect of a three-year income tax holiday granted to Smart by the Philippine Board of Investments in connection with the pioneer status it awarded to Smart's GSM network expansion project;
- income already subjected to a final tax; and
- equity in net income of our subsidiaries, which has already been subject to tax and therefore, as income to PLDT, is no longer subject to income tax.

Smart's three-year income tax holiday, which will expire in May 2004, applies to the incremental income generated from its GSM network expansion. We expect our effective tax rate to increase following the expiration of the tax holiday granted to Smart.

### *Net Loss*

As a result of the foregoing factors our consolidated net loss in 2002 stood at Php4,559 million, an improvement of Php22,925 million, or 83%, over our consolidated net loss of Php27,484 million in 2001. This improvement was largely due to increased net income contribution of our cellular business for 2002.

Basic and diluted loss per share of common stock amounted to Php72.44 and Php67.22, respectively, in 2002, compared to basic and diluted loss per share of Php175.08 in 2001, after giving retroactive effect to stock dividend declarations.

### **2001 Compared to 2000**

#### *Consolidated Operating Revenues*

Our consolidated operating revenues grew by Php17,179 million, or 28%, to Php79,128 million in 2001 compared with Php61,949 million in 2000 largely as a result of the continuing strong growth of our wireless business. Our

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cellular business contributed Php31,627 million in revenues for 2001, an increase of 103% from Php15,576 million in 2000. Our cellular revenues, which was derived mostly from its cellular operations, accounted for 40% of our consolidated operating revenues in 2001, compared with 25% in 2000.

The following table shows the break-down of our total consolidated operating revenues for the years ended December 31, 2000 and 2001 by business segment:

	<b>Years Ended December 31,</b>			
	<b>2000</b>	<b>%</b>	<b>2001</b>	<b>%</b>
	<b>(pesos in millions)</b>			
Fixed line services	Php45,352	73	Php46,270	58
Wireless services	16,358	26	32,389	41
Information and communications technology services	239	1	469	1
Total	Php61,949	100	Php79,128	100

***Fixed Line***

In 2001, our fixed line business generated revenues of Php46,270 million, an increase of Php918 million, or 2%, from Php 45,352 million in 2000. The increase was mainly due to increases in revenues from our local exchange service and data and other network services, partially offset by decreases in our national and international long distance revenues. However, our fixed line revenues dropped to 58% of consolidated operating revenues in 2001 from 73% in 2000 due to the significant growth in our wireless business.

The following table summarizes our consolidated operating revenues from our fixed line business for the years ended December 31, 2000 and 2001 by service segment:

	<b>Years Ended December 31,</b>			
	<b>2000</b>	<b>%</b>	<b>2001</b>	<b>%</b>
	<b>(in millions)</b>			
Fixed line services:				
Local exchange	Php18,739	41	Php21,470	47
International long distance	13,226	29	11,544	25
National long distance	10,453	23	8,367	18
Data and other network	2,925	7	4,776	10
Miscellaneous	9	0	113	
Total	Php45,352	100	Php46,270	100

*Local Exchange Service*

The components of our local exchange revenues are described under " 2002 Compared to 2001 Consolidated Operating Revenues Fixed Line Local Exchange Service."

The following table summarizes key measures of our local exchange service business segment as of and for the years ended December 31, 2000 and 2001:

	<b>Years Ended December 31, 2000      2001</b>	
Consolidated local exchange revenues (in millions)	Php18,739	Php21,470
Number of fixed lines in service		
PLDT Group	1,999,922	2,174,082
PLDT(1)	1,915,985	2,075,109
Number of PLDT employees	13,285	12,915
Number of PLDT fixed lines in service per PLDT employee	144	161

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*(1) Approximately 99% and 93% were postpaid fixed line subscribers as of December 31, 2000 and 2001, respectively.*

Revenues from our local exchange service increased by Php2,731 million, or 15%, to Php21,470 million in 2001 compared with Php18,739 million in 2000 principally due to:

- currency-related adjustments in our monthly local service rates; and
  
- higher average number of billed fixed lines in service.

As a percentage of total fixed line revenues our local exchange service revenues increased to 47% in 2001 from 41% in 2000.

During 2001, we implemented ten upward and four downward adjustments in our monthly local service rates to reflect the movements of the peso-to-dollar exchange rate pursuant to a currency adjustment mechanism allowed by the NTC. During 2000, we implemented 12 upward adjustments and one downward adjustment. Under this mechanism, we increase or decrease our monthly local service rates by 1% for every Php0.10 change in the peso-to-dollar exchange rate relative to a base rate of Php11.00 = US\$1.00. Following a depreciation of the peso, we increase our local exchange service rates after giving 15 days' prior notice to the NTC; conversely, we decrease our local exchange service rates immediately following an appreciation of the peso. The average peso-to-dollar exchange rate in 2001 was Php51.009 = US\$1.00, compared to the average of Php44.179 = US\$1.00 in 2000. Rate adjustments under this mechanism relating to this 15% depreciation of the peso resulted in a 16% net increase in our average monthly local service rates, thus increasing our local exchange revenues.

Despite lower gross fixed line additions in 2001, PLDT achieved a higher number of net additional fixed lines in service because of a lower number of disconnections during the year than in 2000. Gross additions to PLDT's fixed lines in service in 2001 totaled 4