PHILIPPINE LONG DISTANCE TELEPHONE CO
Form 6-K
May 15, 2003

**MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**For the Three Months Ended March 31, 2003**

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

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

*The financial information appearing in this report and in the accompanying financial statements is stated in Philippine pesos. All references to pesos, Philippine pesos or Php are to the lawful currency of the Philippines; all references to U.S. dollars, US$ or dollars are to the lawful currency of the United States; and all references to Japanese yen, JP¥ or ¥ are to the lawful currency of Japan. Translations of Philippine peso amounts into U.S. dollars in this report and in the accompanying financial statements were made based on the exchange rate of Php53.604 = US$1.00, the volume weighted average exchange rate at March 31, 2003 quoted through the Philippine Dealing System.*

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

*A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. We have chosen these assumptions or bases in good faith, and we believe that they are reasonable in all material respects. However, we caution you that forward-looking statements and assumed facts or bases almost always vary from actual results, and the differences between the results implied by the forward-looking statements and assumed facts or bases and actual results can be material, depending on the circumstances. When considering* *forward-looking statements, you should keep in mind the description of risks and cautionary statements in this report and in our Annual Report on Form 20-F, dated June 25, 2002. You should also keep in mind that any forward-looking statement made by us in this report or elsewhere speaks only as of the date on which we made it. New risks and uncertainties come up from time to time, and it is impossible for us to predict these events or how they may affect us. We have no duty to, and do not intend to, update or revise the forward-looking statements in this report after the date hereof. In light of these risks and uncertainties, any forward-looking statement made in this report or elsewhere might not occur.*

**Financial Highlights**

| **(in million pesos, except where otherwise indicated)** | **March 31, 2003 (Unaudited)** | **December 31, 2002**(1) **(Audited)** |
|---|---|---|
| **Consolidated Balance Sheets** | | |
| Total assets | 302,536 | 303,330 |
| Property, plant and equipment - net | 248,909 | 252,025 |
| Total debt | 164,824 | 168,523 |
| Total stockholders equity | 90,272 | 88,088 |
| Debt to equity ratio | 1.83x | 1.91x |
| | **Three Months Ended March 31,** | |
| | **2003** | **2002**(2) |
| **Consolidated Statements of Income** | **(Unaudited)** | |
| Operating revenues | 22,736 | 18,674 |
| Operating expenses | 15,666 | 13,382 |
| Net operating income | 7,070 | 5,292 |
| EBIT(3) | 6,691 | 5,442 |
| EBITDA(4) | 12,504 | 11,048 |
| Net income | 2,479 | 1,571 |
| Operating margin | 31% | 28% |
| EBITDA margin | 55% | 59% |
| **Consolidated Statements of Cash Flows** | | |
| Net cash provided by operating activities | 11,686 | 8,790 |
| Net cash used in investing activities | 1,533 | 4,387 |
| Capital expenditures | 1,807 | 4,159 |
| Net cash used in financing activities | 8,491 | 4,910 |

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(1) As restated to reflect the change in accounting policy on preoperating expenses, as described in Note 3 to the accompanying financial statements.

(2) As restated to reflect the change in revenue recognition for prepaid cards from sales to usage and the change in accounting policy on preoperating expenses, as described in Note 3 to the accompanying financial statements.

(3) EBIT is defined as earnings before minority interest in net income (losses) of consolidated subsidiaries, adding back interest expense and related items and taxes. EBIT 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 conformity with generally accepted accounting principles, or as a measure of profitability or liquidity.

(4) EBITDA is defined as earnings before minority interest in net income (losses) of consolidated subsidiaries, adding back interest expense and related items, taxes, depreciation and amortization 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 conformity with generally accepted accounting principles, or as a measure of profitability or liquidity.

EBIT and EBITDA, on a consolidated basis for the three months ended March 31, 2003 and 2002, are derived as follows:

| | **Three Months Ended March 31,** | |
|---|---|---|
| | **2003** | **2002**(a) |
| **(in million pesos)** | **(Unaudited)** | |
| Earnings before minority interest in net income (losses) of consolidated subsidiaries(b) | 2,483 | 1,569 |
| Add: Interest expenses and related items, net of capitalized interest(c) | 3,229 | 3,381 |
| Provision for income tax(b) | 979 | 492 |
| EBIT | 6,691 | 5,442 |
| Add: Depreciation and amortization(b) | 5,813 | 5,606 |
| EBITDA | 12,504 | 11,048 |

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(a) As restated to reflect the change in revenue recognition for prepaid cards from sales to usage.

(b) See statements of income in the accompanying financial statements.

(c) See Note 17 to the accompanying financial statements.

**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 PLDT Clark Telecom, Inc., Subic Telecommunications Company, Inc., Maranao Telephone Company, Inc. and Bonifacio Communications Corporation, which together account for approximately 1% of our consolidated fixed lines in service, and PLDT Global Corporation;

- *Wireless* wireless telecommunications services provided through our cellular service provider, Smart Communications, Inc., PLDT s subsidiary and satellite operators, Mabuhay Philippines Satellite Corporation, ACeS Philippines Cellular Satellite Corporation, and Telesat, Inc.; and

- *Information and Communications Technology* information and communications infrastructure and services for Internet applications, Internet protocol-based solutions and multimedia content delivery provided by PLDT s subsidiary ePLDT, Inc.; Internet access services provided by ePLDT s subsidiary Infocom Technologies, Inc.; and e-commerce, call centers and IT-related services provided by ePLDT s other subsidiaries and affiliates, as described in Note 9 to the accompanying financial statements.

**Results of Operations**

The table below shows the contribution by each of our business segments to our consolidated operating revenues, operating expenses and net operating income (loss) for the three months ended March 31, 2003 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.

| | **Three Months Ended March 31,** | | | |
|---|---|---|---|---|
| | **2003** | **%**(1) | **2002**(2) | **%**(1) |
| | **(Unaudited)** | | | |
| **(in million pesos)** | | | | |
| **Operating Revenues** | | | | |
| Fixed line | 11,439 | 50 | 11,232 | 60 |
| Wireless | 10,940 | 48 | 7,324 | 39 |
| Information and communications technology | 357 | 2 | 118 | 1 |
| | 22,736 | 100 | 18,674 | 100 |
| **Operating Expenses** | | | | |
| Fixed line | 8,104 | 36 | 7,804 | 42 |

| | | | | |
|---|---|---|---|---|
| Wireless | 7,130 | 31 | 5,366 | 29 |
| Information and communications technology | 432 | 2 | 212 | 1 |
| | 15,666 | 69 | 13,382 | 72 |
| **Net Operating Income (Loss)** | | | | |
| Fixed line | 3,335 | 14 | 3,428 | 18 |
| Wireless | 3,810 | 17 | 1,958 | 10 |
| Information and communications technology | (75) | | (94) | |
| | 7,070 | 31 | 5,292 | 28 |

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

(2) As restated to reflect the change in revenue recognition for prepaid cards from sales to usage.

**Consolidated Operating Revenues**

Largely driven by the continued strong growth of our wireless business, particularly Smart s cellular business, our consolidated operating revenues for the first quarter of 2003 increased by Php4,062 million, or 22%, to Php22,736 million from Php18,674 million for the first quarter of 2002. Smart contributed Php10,744 million in revenues for the first quarter of 2003, an increase of 51% over its revenue contribution of Php7,132 million for the same period in 2002. Smart s revenue contribution accounted for 47% of our consolidated operating revenues for the first quarter of 2003, compared to 38% for the same period in 2002.

***Fixed Line***

Our fixed line business provides local exchange service, international and national long distance services, data and other network services, and miscellaneous services. Revenues generated from this business in the first quarter of 2003 totaled Php11,439 million, an increase of Php207 million, or 2%, from Php11,232 million in the first quarter of 2002. This increase was due to higher revenues generated from international long distance service and data and other network services, partially offset by decreased revenues from local exchange service, national long distance service and miscellaneous services. As a percentage of our consolidated operating revenues, however, fixed line revenues decreased in the first quarter of 2003 to 50% from 60% in the same period in 2002 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 three months ended March 31, 2003 and 2002 by service segment:

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | **2003** | **%** | **2002** | **%** |
| | **(Unaudited)** | | | |
| **(pesos in millions)** | | | | |
| Fixed line services: | | | | |
| Local exchange(1) | 5,248 | 46 | 5,504 | 49 |
| International long distance | 3,053 | 27 | 2,509 | 22 |
| National long distance | 1,638 | 14 | 1,838 | 16 |
| Data and other network | 1,422 | 12 | 1,298 | 12 |
| Miscellaneous | 78 | 1 | 83 | 1 |
| Total | 11,439 | 100 | 11,232 | 100 |

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(1) 2002 has been restated to reflect the change in revenue recognition for prepaid cards from sales to usage.

*Local Exchange Service*

Our local exchange service revenues consist of:

- flat monthly fees for our postpaid service;
- installation charges and other one-time fees associated with the establishment of customer service;
- fixed charges paid by other telephone companies, charges retained by PLDT for calls terminating to cellular subscribers within the local area, and local access charges paid by cellular operators for calls by cellular subscribers that terminate to our local exchange network;
- revenues from usage of prepaid cards for calls within the local area and any unused peso value of expired prepaid cards;
- 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, speed calling* and *Caller ID*.

The following table summarizes key measures of our local exchange service business segment as of and for the three months ended March 31, 2003 and 2002:

| | **Three Months Ended March 31,** | |
|---|---|---|
| | **2003** | **2002** |
| | **(Unaudited)** | |
| Consolidated local exchange revenues (in million pesos) (1) | 5,248 | 5,504 |
| Number of fixed lines in service | | |
| PLDT Group | 2,111,721 | 2,126,073 |
| PLDT(2) | 2,087,237 | 2,103,510 |
| Number of PLDT employees | 11,777 | 12,869 |
| Number of PLDT fixed lines in service per PLDT employee | 177 | 163 |

(1) 2002 has been restated to reflect the change in revenue recognition for prepaid cards from sales to usage.

(2) Approximately 88% were postpaid fixed line subscribers as of March 31, 2003 and 2002.

Revenues from our local exchange service for the first quarter of 2003 decreased by Php256 million, or 5%, to Php5,248 million from Php5,504 million for the same period in 2002. The decrease was due to a continuing shift in subscriber preference from postpaid to prepaid services, which generate lower average revenue per subscriber, partially offset by the combined effects of (1) adjustments in our monthly local service rates pursuant to the currency exchange rate adjustment mechanism, and (2) increased local charges paid by cellular operators for calls terminating to our local exchange network. The percentage contribution of local exchange revenues to our total fixed line revenues also decreased in the first quarter of 2003 to 46% from 49% in the same period in 2002.

Gross additions to PLDT's fixed lines in service in the first quarter of 2003 totaled 92,629, an increase of 17% from the gross additions of 78,992 in the first quarter of 2002. On a net basis, however, PLDT s fixed lines decreased by 5,302 in the first quarter of 2003, as against an increase of 28,401 in the same period in 2002. While fixed line additions totaled 8,258 for PLDT s prepaid fixed line services, particularly *Teletipid* and *Telesulit*, PLDT s postpaid fixed lines in service declined by 13,560 in the first quarter of 2003.

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. *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.

Launched in February 2002, *Telesulit* is a premium variant to *Teletipid. 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. *Teletipid* subscribers migrating to *Telesulit* are able to retain their telephone numbers.

As of March 31, 2003, PLDT s active prepaid fixed line subscribers totaled 251,285, of which 116,874 were *Teletipid* subscribers and 134,411 were *Telesulit* subscribers. These subscribers accounted for approximately 12% of PLDT s total fixed lines in service as of March 31, 2003.

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 Philippine National Telecommunications Commission, or the NTC, we adjust our monthly local service rates upward or downward by 1% for every Php0.10 change in the peso-to-dollar exchange rate relative to a base rate of Php11.00 = US$1.00. During the first quarter of 2003, we implemented three upward adjustments in our monthly local service rates, as against two downward adjustments during the same period in 2002. The average peso-to-dollar rate in the first quarter of 2003 was Php54.074 = US$1.00, compared to the average of Php51.250 = US$1.00 in the first quarter of 2002. This change in the average peso-to-dollar rate translated to a peso depreciation of 5%, which also resulted in an average net increase of 5% in our monthly local service rates in the first quarter of 2003.

Effective January 1, 2003, local access charges for cellular subscribers calls that terminate to our 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.

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 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*.

The ratio of PLDT fixed lines in service per PLDT employee improved from 163 at March 31, 2002 to 177 at March 31, 2003. This improvement resulted from the net decrease in PLDT s headcount. During the twelve months ended March 31, 2003, PLDT s workforce was reduced by 1,092 employees, or 8%, mainly on account of PLDT s ongoing manpower reduction program. See Note 17 to the accompanying financial statements for further discussion.

*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 three months ended March 31, 2003 and 2002:

| | Three Months Ended March 31, 2003 | 2002 (Unaudited) |
|---|---|---|
| Consolidated international long distance revenues (in million pesos) | 3,053 | |