PHILIPPINE LONG DISTANCE TELEPHONE CO
Form 20-F
June 30, 2005

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

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2004

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.

Title of each class	Name of each exchange on which registered
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 Archipelago Exchange
Series III Convertible Preferred Stock, Par Value Ten Philippine Pesos Per Share	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 exchange.*

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.

9.875% Notes due 2005	10.500% Notes due 2009
9.250% Notes due 2006	11.375% Notes due 2012
7.850% Notes due 2007	8.350% Notes due 2017
10.625% Notes due 2007	

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

As at December 31, 2004:
170,213,722 shares of Common Capital Stock, Par Value Five Philippine Pesos Per Share
460,479,661 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 [X] No

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

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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 Basis of Consolidated Financial Statemenst Preparation* to the accompanying consolidated 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 peso 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 Php56.341 to US$1.00 on December 31, 2004. On June 28, 2005, the volume weighted average exchange rate quoted was Php55.579 to US$1.00.

In this report, each reference to:

- ACeS Philippines means ACeS Philippines Cellular Satellite Corporation, our wholly-owned subsidiary;
- AIL means ACeS International Limited;
- AMPS means advanced mobile phone system;
- BCC or Bonifacio Communications Corporation, our 75%-owned subsidiary;

- BSP means Bangko Sentral ng Pilipinas;
- CDMA means code division multiple access;
- Clark Telecom means PLDT Clark Telecom, Inc., our wholly-owned subsidiary;
- DigiPar means Digital Paradise, Inc., a 67.79%-owned subsidiary of ePLDT;
- 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 Satellite Corporation, our 67%-owned subsidiary;
- Maratel means PLDT-Maratel, 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;

- NTTC-UK means NTT Communications Capital (UK) Ltd., a wholly-owned subsidiary of NTT Communications;

- PAPTELCO means Philippine Association of Private Telephone Companies;

- Parlance means Parlance Systems, Inc., a wholly-owned subsidiary of ePLDT;

- Piltel means Pilipino Telephone Corporation, an associate in which we have a 92.1% 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 pay the benefits under the PLDT Employees Benefit Plan;

- PLDT Global means PLDT Global Corporation, our wholly-owned subsidiary;

- SEC means the Philippine Securities and Exchange Commission;

- 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;

- Ventus means ePLDT Ventus, Inc., a wholly-owned subsidiary of ePLDT;

- 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 at the date on which we made it. New risks and uncertainties come up from time to time, and it is impossible for us to predict these events or how they may affect us. We have no duty to, and do not intend to, update or revise the statements in this report after the date hereof. In light of these risks and uncertainties, you should keep in mind that actual results may differ materially from any forward-looking statement made in this report or elsewhere.

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 consolidated financial statements have been prepared and presented in conformity with U.S. GAAP.

Prior to the filing of our Annual Report on Form 20-F in respect of the year ended December 31, 2002, the consolidated financial statements included in our Annual Reports on Form 20-F filed with the U.S. Securities and Exchange Commission, or U.S. SEC, were prepared in conformity 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 loss and stockholders equity to U.S. GAAP was disclosed in a note to our previously filed consolidated financial statements.

	Consolidated Financial Data Years Ended December 31,					
	2004	**2004**(1)	**2003**(2)	**2002**(2)	**2001**(2)	**2000**(2)
	(in millions, except operating income (loss) per share, earnings per common share, ratio of earnings to fixed charges and dividends declared per common share)					
Amounts in conformity with U.S. GAAP:						
Statements of Operating Data:						
Operating Revenues	Php121,221	US$2,151	Php111,200	Php93,831	Php80,294	Php60,348
Service	114,952	2,040	100,486	81,686	67,279	55,586
Non-service	6,269	111	10,714	12,145	13,015	4,762
Operating Expenses	72,682	1,290	77,821	81,802	88,288	49,824
Operating Income	48,539	861	33,379	12,029	(7,994)	10,524
Operating income (loss) per share						
Basic	266.73	4.73	179.04	55.47	(59.52)	58.82
Diluted	252.20	4.48	165.37	52.23	(59.52)	58.82
Net income (loss)	28,101	499	11,045	(6,158)	(27,782)	(29,258)
Earnings per common share(3)						

Basic	146.32	2.60	47.20	(52.08)	(176.85)	(193.48)
Diluted	145.30	2.58	45.72	(52.08)	(176.85)	(193.48)
Balance Sheets Data:						
Cash and cash equivalents	27,321	485	19,372	10,974	4,276	9,674
Total assets	279,639	4,963	276,364	269,387	284,877	326,153
Total long-term debt - net of current portion	131,377	2,332	160,464	171,283	169,870	179,068
Long-term debt	159,397	2,829	184,274	190,908	190,099	191,925
Total debt(4)	159,455	2,830	186,407	191,668	196,561	196,042
Total liabilities(5)	215,743	3,829	236,633	240,622	249,563	238,915
Total stockholders equity	48,079	853	24,745	16,413	24,472	86,528
Other Data:						
Depreciation and amortization	20,098	357	21,812	17,566	16,218	12,756
Ratio of earnings to fixed charges(6)	4.1x	4.1x	2.0			
Net cash provided by operating activities	Php62,860	Php1,116	Php42,582	Php39,722	Php20,113	Php20,727
Net cash used in investing activities	24,764	440	20,021	17,167	29,376	25,183
Net cash provided by (used in) financing activities	(30,078)	(534)	(14,135)	(15,954)	3,841	5,511
Dividends declared to common shareholders					202	752
Dividends declared per common share(7)					1.20	4.80

(1) We maintain our accounts in Philippine peso. For convenience, the peso financial information as at and for the year ended December 31, 2004, has been translated into U.S. dollars at the exchange rate of Php56.341 to US$1.00, the rate quoted through the Philippine Dealing System as at December 31, 2004. 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) As reclassified to conform with the 2004 presentation, see Note 26 Changes in Presentation of Comparative Consolidated Financial Statements to the accompanying consolidated financial statements in Item 18.

(3) In 2002, 2001 and 2000 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 per share are the same.

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

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

(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 net losses in 2002, 2001 and 2000 the coverage ratio on a consolidated basis was less than 1.0x in these years. In order to achieve a coverage ratio of 1.0x, we would have had to generate additional consolidated earnings of Php2,4634 million, Php30,126 million and Php35,509 million for each of the three years ended December 31, 2002, 2001 and 2000, respectively.

(7) The most recent cash dividend declaration made by PLDT on its common stock was on May 5, 2005 at Php21 per common share to holders of record as at June 3, 2005 payable on July 14, 2005. On March 1, 2005, PLDT declared a cash dividend at Php14 per common share to holders of record as at March 31, 2005 which was paid on May 12, 2005. This was the first cash dividend declaration to common shareholders since March 2001.

Capital Stock

The following table summarizes PLDT s capital stock outstanding as at December 31, 2004, 2003 and 2002.

	December 31,		
	2004	**2003**	**2002**
	(in millions)		
Serial Preferred Stock			
10% Cumulative Convertible Preferred Stocks			
A to EE	Php4,091	Php4,099	Php4,068
Series III	46	46	46
Convertible Preferred Stocks Subject to Mandatory Redemption			
Series V(1)	22	26	25
Series VI(1)	47	47	49
Series VII(1)	38	38	36
Cumulative Non-convertible Redeemable Preferred Stock			
Series IV	360	360	360
	Php4,604	Php4,616	Php4,584
Common Stock	Php851	Php847	Php847

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(1) Preferred stock subject to mandatory redemption in 2008 and 2009 (see Note 14 Preferred Stock Subject to Mandatory Redemption to the accompanying consolidated financial statements in Item 18 for further discussion).

Dividends Declared

	Years Ended December 31,		
	2004	**2003**	**2002**
Cash dividends declared per share of PLDT s common stock, in pesos (1)	Php	Php	Php

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(1) The most recent cash dividend declaration made by PLDT on its common stock was on May 5, 2005 at Php21 per common share to holders of record as at June 3, 2005 payable on July 14, 2005. On March 1, 2005, PLDT declared a cash dividend at Php14 per common share to holders of record as at March 31, 2005 which was paid on May 12, 2005. This was the first cash dividend declaration to common shareholders since March 2001.

Dividends Paid

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

	In Philippine Peso	**In U.S. Dollars**

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
2002		
2003		
2004		
2005 (through June 28, 2005)	14.00	0.248

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(*Note*: *Dividends on PLDT's common stock were declared and paid in Philippine peso. 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 2000-2001 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 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,			
	Period End	**Average(1)**	**Low(2)**	**High(3)**
2000	Php49.986	Php44.179	Php39.830	Php51.680

2001	51.690	51.009	47.550	55.013
2002	53.254	51.583	49.336	53.841
2003	55.586	54.215	52.021	55.767
2004	56.341	56.044	55.142	56.443
2005 (through June 28, 2005)	55.579	54.815	53.912	56.226

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.

		Month		
	Period End	**Average(1)**	**Low(2)**	**High(3)**
2004				
December	Php56.341	Php56.044	Php55.142	Php56.443
2005				
January	55.097	55.707	55.097	56.226
February	54.685	54.791	54.556	55.176
March	54.747	54.430	53.912	54.964
April	54.332	54.472	54.053	54.902
May	54.489	54.349	53.976	54.706
June (through June 28, 2005)	55.579	55.176	54.496	55.793

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 Philippine peso amounts into U.S. dollars for your convenience. Unless otherwise specified, these conversions were made at the exchange rate as at December 31, 2004 of Php56.341 to 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 at June 28, 2005, the exchange rate quoted through the Philippine Dealing System was Php55.579 to 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, carry out new financings or incur capital expenditures

We have substantial indebtedness. As at December 31, 2004, we had consolidated total indebtedness of approximately Php159,455 million (US$2,830 million), including short-term debt of approximately Php58 million (US$1 million) and a consolidated ratio of debt to equity (total debt on a consolidated basis divided by total equity) of 3.32x. Our consolidated ratio of earnings to fixed charges was less than the minimum required ratio of 1.0x for the years ended December 31, 2002, 2001 and 2000. For an explanation on 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 on the basis of 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 Debt 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;

- limit our ability to incur capital expenditures; 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. Moreover, 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, including covenants that could prohibit us from paying dividends on common stock under certain circumstances, and require us to comply with specified financial ratios and other financial tests, calculated on the basis of Philippine GAAP, at relevant measurement dates, principally at the end of each quarterly period. 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 long-lived assets that may be recognized by PLDT and its consolidated subsidiaries and increases in our interest expenses. Since approximately 98% of our total consolidated debts are denominated in foreign currencies, principally in U.S. dollars, many of these financial ratios and other tests are negatively affected by any weakening of the peso, which declined by approximately 3% against the U.S. dollar to an average of Php56.044 to US$1.00 in 2004 from an average of Php54.215 to US$1.00 in 2003. As at December 31, 2004, the exchange rate was Php56.341 to US$1.00, equivalent to a 1% depreciation of the peso relative to the rate at the end of 2003. In addition, certain of our financial ratios are 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, 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 net revenues and cash flows generated by Smart and PLDT s other investees in assisting in complying with non-consolidated covenants or covenants that are calculated without giving effect to the results of PLDT s investees.

We have maintained compliance with all of our 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 ratios and covenants or be unable to incur new debt. Under some of our loan agreements, certain of our financial ratios became more restrictive towards the end of 2004, and will continue to become more restrictive in increments thereafter, which will make it more difficult for PLDT to maintain compliance with such ratios in the future. Inability to comply with our financial ratios and covenants or raise new financing could result in a declaration of default and acceleration of some or all of our indebtedness. The terms of some of our debt instruments have no minimum amount for cross-default.

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

A growing portion of our consolidated operating 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, June 2003, November 2003, May 2004 and December 2004, 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 investee 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 2004 and 2003 totaled Php19,268 million and Php17,943 million, respectively. Our 2005 budget for consolidated capital expenditures is approximately Php18,000 million, of which approximately Php8,000 million is budgeted to be spent by PLDT, approximately Php9,000 million is budgeted to be spent by Smart and the balance represents other subsidiaries capital spending. PLDT s capital spending is intended principally to finance the continued build-out of its data and internet protocol infrastructures and for its fixed line data services and the maintenance of its network. Smart s capital spending is focused on expanding and upgrading its transmission network facilities to meet increased demand for cellular services.

Future strategic initiatives could require us to incur significant additional capital expenditures. We may be required 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 raise new financing to fund our working capital, capital expenditures and other needs depends on many factors beyond our control

We may require new external financing in order to fund all of our operating, investment, capital expenditures and debt service requirements. 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 related 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 at December 31, 2004, approximately 98% of our total consolidated debts are 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 most 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 to US$1.00 on June 30, 1997 to Php56.341 to US$1.00 as at December 31, 2004. The peso declined by approximately 1% against the U.S. dollar to Php56.341 to US$1.00 as at December 31, 2004 from Php55.586 to US$1.00 as at December 31, 2003. The peso has also been subject to significant fluctuations. For example, during 2004 and 2003, the peso recovered to a high of Php52.021 to US$1.00 on May 9, 2003 and depreciated to a low of Php56.443 to US$1.00 on October 14, 2004. 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 competition in international long distance service

The international long distance business was historically one of our major sources of revenue. However, due to competition and the steep decline in international settlement 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 have overall declined in recent years.

Although revenue generated from our international long distance business increased in 2004 and 2003, primarily due to increased termination rates in 2004 and 2003, we anticipate that revenues from international communications and information services, including our services, will continue to decline in the future, primarily due 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;

- advances in technology;

- increased competition from other domestic and international telecommunications providers;

- alternative providers offering internet telephony and broadband capacity; and

- unauthorized traffic termination and bypass routings by international simple resale operators.

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 in recent years. 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 telecommunications 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 nine major local exchange carriers, 11 international gateway facility providers and six 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 cellular, fixed line and data and other network services segments.

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 as of the filing of this annual report has not yet commenced cellular operations. The recent entry of Digitel has created and the recent grant of a license to Bayantel 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 our cellular rates may affect our cellular revenues and revenue growth. For example, our prepaid 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. As a result of competitive pressures, we have not increased our cellular rates to reflect fluctuations in the peso to U.S. dollar exchange rate since November 1998. Moreover, competitive pressures require us to continuously innovate our products and to conduct promotions, which may affect our cellular revenues and revenue growth. For example, in order to test the market demand for fixed rate or bucket plans for voice and text services and in response to similar types of promotions launched by our competitors, we launched in March and April 2005 the *Smart 258 Unlimited Call* and *Text* promotions pursuant to which all Smart and *Talk N Text* prepaid subscribers had the option to avail themselves of unlimited on-network (Smart-to-Smart) voice calls or unlimited on-network (Smart-to-Smart) text messages at a fixed rate. We cannot assure you that incurring these marketing expenses for these promotions and responding to rate pressures and the potential loss of customers arising from increased competition 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 are 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. Future development of new technologies, services or standards could require significant changes to our business model which could necessitate substantial new investments. In addition, new products and services may be expensive to develop and may result in increased competition. We cannot accurately predict how emerging and future technological changes will affect our operations and financial results. Furthermore, 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 customer lists. Piltel recognized impairment losses in respect of its AMPS/CDMA and Executive Order No. 109, or E.O. 109 assets in 2001 and 2002, respectively.

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

The majority of our consolidated operating revenues is currently derived from our cellular services. 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

We depend to a significant degree on an uninterrupted operation of our network to provide our services. We also depend on robust information technology systems to enable us to conduct our operations. The development and operation of our 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;
- equipment failure;
- 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 our ability to attract and retain subscribers, which 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 and that its creditors will not take measures to enforce their claims

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. While Smart acquired from Piltel s creditors approximately US$289 million, or 69.4%, of Piltel s total outstanding restructured debt at that time, in exchange for US$283.2 million, or Php15,854 million in July 2, 2004, in new debt of Smart and US$1.5 million, or Php84 million, in cash, in a debt exchange offer conducted by Smart in 2004, we cannot assure you that Piltel will be able to pay the claims relating to its remaining restructured debt or to restructure or otherwise pay the claims relating to its unrestructured debt or that Piltel will have sufficient cash flow to meet its debt service and other payment obligations.

As at December 31, 2004, Piltel had an aggregate principal amount of Php52 million of unrestructured 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.

The franchise of Smart may be revoked due to its failure to conduct a public offering of its shares by August 2004

Smart has publicly stated that it believes that it had ten years from the commencement of its operations, or until August 2004, to conduct a public offering of its shares required under the Public Telecommunications Policy Act, or R.A. No. 7925. As Smart has not conducted a public offering of its shares, the Philippine Congress may revoke the franchise of Smart for its failure to comply with the requirement under R.A. No. 7925 on the public offering of its shares. Moreover, a *quo warranto* case may be filed against Smart by the Office of the Solicitor General of the Philippines for the revocation of the franchise of Smart on the ground of violation of R.A. No. 7925. A bill is currently pending in the Philippine Senate, pursuant to which a telecommunications entity shall be deemed to have complied with the requirement of making a public offering of its shares if two-thirds of its outstanding voting shares are owned and controlled, directly or indirectly, by a listed company. However, we cannot assure you that such bill will be enacted and that the franchise of Smart will not be revoked due to Smart s failure to timely conduct a public offering of its shares.

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 31.2% of PLDT s common stock as at December 31, 2004. This is the largest block of PLDT s common stock that is directly or indirectly under common ownership. NTT Communications owns 14.8% of PLDT s common stock as at December 31, 2004 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, or LOS.

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 a major shareholder sells its interest in PLDT, the transaction may result in an event of default

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 JP¥9,760 million loan agreement with Japan Bank for International Cooperation, or JBIC, (formerly known as the Export-Import Bank of Japan) and our JP¥5,615 million syndicated term loan facility, and may result in a default under some of Smart s loan agreements. As at December 31, 2004, Php25,633 million in principal amount of PLDT s indebtedness is directly subject to a change in control offer to purchase or prepay requirement and Php14,787 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 *Note 12 Interest-bearing Financial Liabilities Long-term Debt Debt Covenants* to the accompanying consolidated financial statements in Item 18.

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. While an extension has not yet been formally granted, since 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.

In the first quarter of 2005, House Bill No. 926 was filed and is now pending in the House of Representatives of the Philippines. The proposed bill provides for the cancellation of the currency exchange rate mechanism pursuant to which utility companies, including us, are permitted to adjust our monthly local exchage service rates according to changes in the peso-to-U.S. dollar exchange rate. If this bill is passed into law or if the NTC issues guidelines to change the basis of the currency exchange rate mechanism mechanism, our ability to generate U.S. dollar linked revenues from our local exchange business could be adversely affected. A decline in our foreign currency-linked revenues could increase our exposure to risks from declines in the value of the Philippine peso against the U.S. dollar.

The NTC may implement changes in existing regulations and introduce new regulations, which may result in increased competition and may have negative implications for our revenues and profitability

On June 16, 2000, the NTC issued Memorandum Circular No. 13-6-2000 proposing that Philippine 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.

Along with the other Philippine cellular operators, Smart sought and obtained from a Quezon City trial court a preliminary injunction restraining the implementation of the memorandum circular. The NTC appealed the issuance of the injunction to the Court of Appeals which, on October 9, 2001, annulled the preliminary injunction, ruling that the NTC had jurisdiction over the matter. On January 10, 2002, the Court of Appeals denied the cellular operators motion to annul and reverse the decision of the Court of Appeals. On February 22, 2002, Smart filed an appeal with the Supreme Court arguing that the appellate court had erred in ruling that the NTC, and not the trial court, had jurisdiction over its case. On September 2, 2003, the Supreme Court upheld Smart s appeal, reversing and setting aside the decision of the Court of Appeals and affirming that the Quezon City trial court could hear and decide the case. The case was remanded to the Quezon City trial court for continuation of the proceedings. The NTC filed a motion for reconsideration on September 29, 2003 which was denied with finality by the Supreme Court on November 13, 2003. The Supreme Court stated that considering that the basic issues have already been passed upon and there is no substantial argument to warrant a modification of this court s decision, the court resolves to deny consideration with finality.

The NTC has also issued draft guidelines regarding the assignment and allocation of 3G and VoIP licenses and frequency bands, which are still subject to further discussions with incumbent operators and other market participants. We cannot predict what the final implementation guidelines for these services will contain, nor can we determine the timing of when these regulations will be implemented. In addition, we cannot assure you that other regulatory changes initiated by the NTC will not lead to increased competition and that it will not have an adverse effect on our business, results of operations and prospects.

The Philippine Government may impose new taxes and/or implement higher tax rates which may have negative implications for our revenues and profitability

On May 24, 2005, the President signed into law Republic Act No. 9337 amending certain sections of the National Internal Revenue Code with effect on July 1, 2005. In particular, the following amendments may negatively impact our profitability:

• increase of the income tax rate for corporations from 32% to 35% effective July 1, 2005, followed by a reduction to 30% effective January 1, 2009;

• conferment upon the President, upon the recommendation of the Secretary of Finance, of the power to raise the value-added tax, or VAT, rate from 10% to 12% effective January 1, 2006, after any one of the following conditions has been satisfied;

a. VAT collection as a percentage of the Gross Domestic Product, or GDP, exceeds 2.8% in 2005; or

b. the fiscal deficit as a percentage of GDP, which represented 3.8% in 2004, exceeds 1.5% in 2005.

• limited claim of input tax credits to 70% of output tax; and

• input tax on capital goods spread evenly over 5 years or estimated useful life, whichever is shorter.

We can not assure you that the proposed increase in taxes will not have a material adverse effect on our revenues, profitability and cash flows.

Moreover, the Philippine Congress is considering five bills which were filed prior to the signing into law of R. A. 9337. Each of the proposed bill, 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 calls and cellular data revenues and prohibit cellular operators from imposing additional charges or fees to compensate for the imposition of the proposed taxes. In addition, several bills have also been submitted for consideration by Congress, each of which, if passed by Congress and enacted into law, would impose a franchise tax at a rate of 7% or 5% tax on gross receipts of all telecommunications companies in lieu of the currently applicable 10% VAT. We cannot assure you that we would be able to impose additional charges or fees to compensate for the imposition of such taxes.

Risks Relating to the Philippines

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

In the past four years, an increasing number of kidnappings, 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. 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. This social unrest negatively impacted the operations of Piltel s fixed line business in Mindanao.

In November 2001, members of the rebel groups damaged three of our 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. On July 27, 2003, approximately 300 Philippine soldiers took control of a shopping center and apartment complex in Makati City in an effort to express their dissatisfaction with the Philippine government. The mutineers surrendered within 20 hours. The government has reported that the actions taken by the approximately 300 Philippine soldiers were part of a coup attempt. In October 2003, a group of unidentified armed men inflicted minor damage to Smart s cell site in Bicol.

The presidential election held on May 10, 2004 , resulted in a victory by the incumbent President Gloria Macapagal-Arroyo who successfully retained her post. The opposition has alleged irregularities in the presidential election, such as stolen ballots and vote buying. The Philippine Congress also commenced an inquiry into a wire tapped audio tape which contains a conversation allegedly between President Gloria Macapagal-Arroyo and a commissioner of the Commission on Elections discussing the vote count on the presidential election held on May 10, 2004. On June 27, 2005, President Gloria Macapagal-Arroyo publicly stated that she did speak to a commissioner of the Commission on Elections in order to protect her votes, but not to influence the outcome of the election. Moreover, the Philippine Congress announced in May 2005, that it would begin an inquiry into allegations that President Gloria Macapagal-Arroyo s family was involved in a gambling scandal. We cannot assure you that political events or terrorists activities will not 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 growth rates and economic instability in the Philippines and in Asia

In the past, the Philippines has experienced periods of slow growth, high inflation, significant devaluation of the peso, imposition of exchange controls, debt restructuring and electricity shortages and blackouts, and has been significantly affected by economic volatilities in the Asian Region.

In 2004, the Philippine government incurred a fiscal deficit of Php184,051 million which was lower by approximately 8% from the Php199,900 million incurred in 2003. The fiscal deficit incurred for 2004 represents 3.8% of the nominal gross domestic product. In order to reduce the fiscal deficit, the Philippine Government is targeting to generate additional revenues of over Php180 billion per year through executive reforms and implementing a legislative revenue agenda. In particular, on May 24, 2005, the President signed into law Republic Act No. 9337, which increases the income tax rate for corporations from 32% to 35% effective July 1, 2005, followed by a reduction to 30% effective January 1, 2009, and confers upon the President, upon the recommendation of the Secretary of Finance, the power to raise the VAT rate from 10% to 12% effective January 1, 2006, if either (i) the VAT collection as a percentage of GDP exceeds 2.8% in 2005 or (ii) the fiscal deficit as a percentage of GDP, which represented 3.8% in 2004, exceeds 1.5% in 2005. Moreover, the Philippine Government is considering the following additional measures that, if implemented, would impact us:

- adoption of gross income taxation; and
- re-imposition of franchise tax on telecommunications companies.

On May 30, 2005, Fitch Ratings revised the outlook on PLDT s long-term foreign currency rating to stable from negative. Simultaneously, Fitch has affirmed PLDT s long-term foreign currency rating, global bonds and senior notes at BB and PLDT s convertible preferred stock at B+ . PLDT s long-term local currency rating has also been affirmed at BB+ and the stable outlook on this rating remains in place. The rating actions reflect Fitch s decision to revise its outlook on the Republic of the Philippines BB long-term foreign currency rating to stable from negative.

On February 16, 2005, Moody s Investor s Service, Inc., or Moody s, downgraded the foreign currency senior unsecured debt rating of PLDT to Ba3 from Ba2 with a stable outlook. The rating action was taken as part of Moodys two-notch downgrade of the Republic of the Philippines foreign currency country ceiling to B1 from Ba2. On the same date, Moody s affirmed PLDT s B1 preferred stock rating with a stable outlook. Moody s views that there is a differential between PLDT s foreign currency rating and the Philippine sovereign rating because foreign currency bonds subject to international law are less likely to be subject to a debt moratorium than foreign currency obligations subject to local law. According to Moody s, PLDT s foreign currency debt rating is a function of its own risk of default and the probability of a Philippine government default on its foreign debt, the likelihood that the Philippine government would declare a moratorium in the event of a default, and if it did, the chances that it would exempt companies such as PLDT.

On January 17, 2005, Standard and Poor s Rating Group, or Standard and Poor s, revised its long-term foreign currency rating on PLDT from BB to BB- (BB minus) with a stable outlook. The rating action was taken immediately after Standard and Poor s downgraded the foreign currency rating on the Republic of the Philippines to BB- (BB minus).

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 the peso 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 and 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 damages and economic losses resulting from natural catastrophes.

Item 4. Information on the Company

Overview

We are the leading national telecommunications service provider in the Philippines. Through our three principal business groups wireless, fixed line, and information and communications technology we offer a wide range of telecommunications services to over 21 million wireless and fixed line subscribers in the Philippines across the nation's most extensive fiber optic backbone and fixed line, cellular and satellite networks.

We are the leading fixed line service provider in the Philippines with approximately 62% of the total reported fixed lines in service nationwide as at December 31, 2004. Smart, our wholly-owned subsidiary, is the leading cellular service provider in the country, with approximately 44% of total reported cellular subscribers as at December 31, 2004. Piltel, our 92.1%-owned subsidiary, had approximately 14% of total reported cellular subscribers as at December 31, 2004. We have interests in the information and communications technology sectors, including Infocom, one of the leading ISPs in the Philippines.

Our common shares are listed and traded on the Philippine Stock Exchange, or PSE, and our American Depositary Shares are listed and traded on the New York Stock Exchange and the Archipelago Exchange in the United States. We had a market capitalization of approximately Php252,568 million (US$4,483 million) as at May 31, 2005, representing one of the largest market capitalizations among Philippine-listed companies. For the year ended December 31, 2004, we had consolidated operating revenues of Php121,221 million (US$2,152 million).

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*. 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 its amended Articles of Incorporation, PLDT s corporate term is limited through 2028. In 1967, effective control of PLDT was sold by General Telephone and Electronics Corporation (a major shareholder since PLDT s incorporation) to a group 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 the 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, through NTTC-UK, became PLDT s strategic partner with approximately 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 be extended until 2028. The amended franchise (R.A. 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.

Since the implementation of its Subscriber Investment Plan, or SIP, in 1973 pursuant to Presidential Decree No. 217, which, until April 21, 2003, required telephone subscribers to purchase shares of PLDT's preferred stock, PLDT has developed a broad base of public ownership with approximately 2,200,367 common and preferred shareholders of record as at December 31, 2004. Approximately 2,183,736 of these shareholders are Philippine persons representing approximately 87% of PLDT's outstanding common and preferred shares. For purposes of the percentages described in this paragraph, all the ADSs evidenced by American Depositary Receipts, or ADRs, are considered to be held of record in the United States. As approved by the NTC, the purchase of PLDT preferred shares by PLDT subscribers pursuant to the SIP became optional starting April 22, 2003.

Our consolidated capital expenditures amounted to Php19,268 million, Php17,943 million, and Php17,239 million in 2004, 2003 and 2002, respectively. Of these amounts, Php3,917 million, Php6,100 million, and Php8,194 million were attributable to PLDT for 2004, 2003 and 2002, respectively, while Php14,721 million, Php11,305 million and Php7,564 million were spent by Smart for 2004, 2003 and 2002, respectively. The remaining balances were spent by our other subsidiaries, principally ePLDT and its subsidiaries.

Organization

As at May 31, 2005, our two largest shareholders were 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 owned 31.2% of our common shares, and NTT Communications, a wholly-owned subsidiary of Nippon Telegraph and Telephone Corporation of Japan, which beneficially owned 14.8% of our common shares.

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 Subsidiary/Investee	Principal Activity	Percentage of Ownership		
		2004	**2003**	2002

Wireless				
Smart and subsidiaries	Cellular mobile services	100.0	100.0	100.0
Piltel and subsidiaries	Cellular mobile and telecommunications services	92.1	45.3	45.3
Telesat	Satellite communications services	94.4	94.4	94.4
ACeS Philippines	Satellite phone services	100.0	100.0	100.0
Mabuhay Satellite	Satellite communications services	67.0	67.0	67.0
Fixed Line				
Clark Telecom	Telecommunications services	100.0	100.0	100.0
Subic Telecom	Telecommunications services	100.0	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	100.0
PLDT-Maratel	Telecommunications services	97.5	97.5	97.5
BCC	Telecommunications, infrastructure and related value-added services	75.0	75.0	37.5
Information and Communications Technology				
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

Smart s Acquisition of Meridian Telekoms, Inc., or Meridian

On July 5, 2004, Smart entered into a sale and purchase agreement, as amended and supplemented on August 11, 2004, to acquire 100% of Meridian, a company primarily engaged in providing wireless broadband and data services to small and medium-scale enterprises in the Philippines, for a total consideration of US$45 million. Payments of US$11 million and US$7 million for an equity interest of 40% in Meridian were made in 2004 and payment of US$4 million for an additional equity interest of 9% in Meridian was made in January 2005. The balance of US$23 million is payable on or before December 31, 2005 in respect of the remaining 51% equity interest in Meridian. The acquisition aims to strengthen Smart s position in the wireless data segment and is in line with Smart s overall strategy of providing the widest range of innovative wireless services. For further details, see *Note 9 Goodwill and Other Intangible Assets* to the accompanying consolidated financial statements in Item 18.

Changes in Piltel s Shareholdings

To integrate the PLDT Group s wireless holdings, on July 2, 2004, Smart entered into a sale and purchase agreement with PLDT to acquire PLDT s 59.3 million shares of Piltel Series K Class I Convertible Preferred Stock for a purchase price of Php2,066 million. The payment was settled through an offset of amounts owed to Smart by PLDT arising from interconnection charges. On July 9, 2004 and December 28, 2004, Smart converted a total of 4.8 million and 54.5 million shares, respectively, of Piltel Series K Class I Convertible Preferred Stock into 10,080 million shares of common stock of Piltel, equivalent to 85.6% of the resulting total outstanding shares of common stock after such conversion. On April 25, 2005, PLDT and Smart entered into a subscription and assignment agreement covering the transfer and assignment to Smart of 767 million shares of Piltel common stock owned by PLDT. As a result, Smart now owns 92.1% of the total outstanding common stock of Piltel, thereby consolidating the PLDT Group s wireless business under Smart.

Wireless

We provide cellular and satellite, VSAT and other services through our wireless business segment. Revenues from our wireless business accounted for 60%, 57% and 51% of our total operating revenues for the years ended December 31, 2004, 2003 and 2002, respectively. In 2004, 2003 and 2002, cellular service revenues accounted for 97%, 97% and 95%, respectively, of our wireless business service revenues.

Our cellular service (including handset sales), which accounted for about 97% of our wireless service revenues for the year ended December 31, 2004, is provided through Smart and Piltel. Smart is the leading cellular service provider in the Philippines, with approximately 14.6 million subscribers as at December 31, 2004, representing an estimated market share of approximately 44%. Piltel, a reseller of Smart's digital capacity under its own branding and pricing strategy for voice and text messaging services, had approximately 4.6 million subscribers as at December 31, 2004, representing an estimated market share of 14%. In 2004, the combined number of Smart's and Piltel's subscribers (being served using Smart s network) increased by 48%, representing the largest increase in the number of cellular subscribers in absolute terms in that period among Philippine cellular providers. As at December 31, 2004, cellular penetration in the Philippines was approximately 39%, which was nearly ten times the country's fixed line penetration.

Smart's and Piltel's cellular subscriber gains were predominantly attributable to their respective prepaid services. Approximately 98% of Smart's cellular subscribers were prepaid as at December 31, 2004. 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.

Our cellular subscriber growth has also been driven by text messaging service. Text messaging service 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. During 2004, our text messaging service system handled 40,953 million outbound messages, an increase of 42% compared to 28,825 million outbound messages handled during 2003.

As at December 31, 2004, Smart's digital network included 36 mobile switching centers with a capacity of 17.3 million subscribers and 5,303 base stations covering 1,433 cities and municipalities. Piltel s prepaid service, *Talk N Text*, is also supported on this network.

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 at December 31, 2004, we had approximately 2.2 million fixed lines in service. Revenues from our fixed line services accounted for 38% of our total operating revenues for the year ended December 31, 2004.

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.

Information and Communications Technology

Through our wholly-owned subsidiary, ePLDT, we provide broad-based integrated information and communications technology, or ICT, services focusing on infrastructure and solutions for internet applications, internet protocol-based solutions and multimedia content delivery. Incorporated in August 2000, ePLDT started commercial operations in February 2001. ePLDT's principal activities are the operation of an internet data center under the brand name *Vitro* , call center businesses 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 the newest business in the PLDT Group, revenues from our ICT services accounted for 2% of our consolidated service revenues in 2004.

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 75 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 network, has also gained significant recognition.

- *Leading Market Shares*. With over 21 million cellular and fixed line subscribers as at December 31, 2004, we have the leading market position in both the cellular and fixed line markets in the Philippines. ePLDT s subsidiary, Infocom, is one of the leading ISPs in the Philippines.

- *Diversified Revenue Sources*. As a result of the continued growth of wireless service in the country, approximately 60% of our consolidated operating revenues in 2004 are now derived from our wireless business segment. Fixed line revenues, which represent 38% of our consolidated operating revenues in 2004 compared to 41% in 2003, have remained stable over the past three years despite pressures on traditional fixed line voice revenues, resulting from increases in our fixed line data and other network services. We continue to identify and develop new revenue sources from our wireless, fixed line and ICT businesses.

- *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 Load, Talk N Text Load, Pasa Load* and *Smart Padala. Smart* and *Talk N Text Loads* are over-the-air electronic loading facilities designed to make reloading of air time credits more convenient for, and accessible to consumers. *Pasa Load* (literally means transfer load), a derivative service of *Smart* and *Talk N Text Loads,* allows load transfers to other *Smart Buddy* and *Talk N Text* subscribers. *Smart Padala,* a cash remittance service intended for overseas Filipino workers, is the first cash remittance service through text messaging service technology and is faster and more cost effective than traditional cash remittance services.

- *Strong Strategic Relationship*. We have an important strategic relationship with NTT Communications and First Pacific. The technological support, international experience and management expertise made available to us through these strategic relationships 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 wireless and fixed line businesses*. 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. Our operating target is to continue growth in profitability by increasing our revenues while controlling costs. 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.

- *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 market*. Using the existing network of our fixed line business, we are committed to further develop, enhance and lead our fastest growing business segment data and network services. Consistent with our strategy of introducing innovative products and services using advanced technology, we have launched various products and services that address different market needs.

- *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 generating cash returns from our investments in subsidiaries. Since December 2002, Smart has been regularly paying dividends to PLDT to supplement PLDT s cash flows available for debt reduction. Smart s dividend payments have increased from Php1,540 million in 2002 to Php16,100 million in 2004.

Business

Wireless

We provide cellular and satellite, VSAT and other services through our wireless business segment. In 2004, 2003 and 2002, cellular business accounted for 97%, 97% and 95%, respectively, of our wireless business service revenues.

Cellular Service

Overview

Our cellular business, which we provide through Smart and Piltel to over 19 million subscribers, approximately 99% of whom are prepaid subscribers, is focused on providing wireless voice communications, wireless data communications (primarily through text messaging) and a variety of other value-added services, which include (a) *Mobile Banking* (banking services delivered over the mobile phone); (b) *Smart zedTM*; (c) *Smart Money*; and (d) international roaming, as well as other value-added services developed on Smart s and Piltel s own platform. Smart services the almost five million subscribers of Piltel on its GSM network through a facilities service agreement with Piltel, under the brand name *Talk N Text*.

The following table summarizes key measures of Smart s and Piltel s cellular business as at and for the years ended December 31, 2004, 2003 and 2002:

	Years Ended December 31,		
	2004	**2003**	**2002**
Systemwide cellular subscriber base	19,208,232	12,947,197	8,599,306
Smart(1)	14,595,782	10,080,112	6,825,686
Prepaid	14,321,288	9,831,135	6,649,038
Postpaid	274,494	248,977	176,648
Piltel - Prepaid	4,612,450	2,867,085	1,773,620
Growth rate of cellular subscribers	48%	51%	35%
Smart	45%	48%	39%
Piltel(2)	61%	62%	33%
Cellular revenues (in millions)	Php73,141	Php63,480	Php46,595
Service	67,030	52,932	34,500
Non-service			
Handset sales	6,111	10,548	12,095
Percentage of cellular revenues to total operating revenues	58%	56%	49%

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(1) In December 2002, Smart closed down its analog/ETACS network.

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

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

Of Smart s total cellular subscribers as at December 31, 2004, 98% were *Smart Buddy, addict mobile prepaid* and *Smart Kid prepaid* subscribers and 2% were *Smart Gold, addict mobile, Smart Infinity* and *Smart Kid* postpaid subscribers. Introduced in April 2003, *addict mobile* offers exclusive multimedia content to subscribers and features personalized means for internet surfing and allows subscribers to apply their allocated free credits towards their choice of data and value-added services. *Smart Infinity* is a premium postpaid plan launched in January 2004 for the affluent and highly mobile market, offering first class quality services, including a round-the-clock dedicated personal concierge service, international assistance services, premium handset packages and exclusive lifestyle content. *Smart Kid*, launched in May 2004, is especially designed for children, and is equipped with Family Finder which automatically forwards the child s call to pre-assigned numbers on the phone, a location-based finder service to enable them to keep in touch with their family members, as well as with educational value-added services content. *addict mobile prepaid* and *Smart Kid prepaid*, the prepaid versions of *addict mobile* and *Smart Kid,* were introduced in October 2004.

Talk N Text, an example of Smart s successful market segmentation strategy, is the brand carried by Smart s subsidiary, Piltel. *Talk N Text* was introduced in April 2000 and aimed at the lower-income markets. Capitalizing on the Filipino s love for pop culture, *Talk N Text* extensively uses local celebrities as its endorsers and the vernacular in its advertising and promotional campaigns. With over 4.6 million subscribers, *Talk N Text* has the third-largest GSM subscriber base in the Philippines.

Text Messaging Service and Other Value-added Services. Our cellular subscriber growth has been driven by text messaging service on Smart s digital networks. Text messaging 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. Text messaging also utilizes less network capacity than voice, thereby increasing network efficiency. Strong volume growth in text messaging contributed significantly to our cellular revenue growth in 2004. The total volume of messages handled by our text messaging service system during 2004 increased by 42% to 40,953 million outbound messages from 28,825 million outbound messages handled during 2003.

Our value-added services are primarily based on text messaging service technology. Since 2000, Smart launched the following value-added cellular services:

- *Smart zed* , a partnership with international cellular operator Sonera zed Ltd., or Sonera zed, 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 has introduced a single platform that provides access to local and global information through text messaging 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.

We also offer value-added services such as voice mail, information-on-demand, which are services that allow subscribers to order information from our content providers whenever desired. Mobile banking and *TextMail*, are services that allow subscribers to send and receive text messages through their personal computers and location-based services. In addition, we have a number of interactive activities, such as text games and chat services, developed on our 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. In February 2004, at the sixth GSM World Congress, *Smart Load,* an over-the-air electronic loading facility designed to make reloading of air time credits more convenient for and accessible to subscribers was cited as the Best Mobile Application or Service for the Consumer Market.

On August 1, 2004, Smart launched *Smart Padala*, a cash remittance service intended for overseas Filipino workers. *Smart Padala* is the first cash remittance service through text messaging service technology and is faster and more cost effective than traditional remittance services. It is ideally suited for the lower income market where cash remittances have the highest need and appreciation. *Smart Padala* has been launched in collaboration with Banco de Oro, a Philippine financial institution, as well as partnerships with several internationally-licensed remittance companies (e.g., CBN, Travelex) and domestic encashment centers (e.g., McDonald s, 7-Eleven, Seaoil and Tambunting Pawnshops). *Smart Padala* is one of the innovative services emanating from Smart s *Smart Money* platform.

Due to the high level of text messaging service 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 and 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 continue to upgrade our network to Enhanced Data for GSM Evolution, or EDGE. EDGE is a technology that would further increase the speed and data capability of our GSM network.

The NTC is currently expected to issue draft guidelines regarding the issuance of 3G licenses in the Philippines in the near future. However, in light of the limited acceptance of 3G technology in other markets in the world where 3G services have been offered, as well as the significant expenses involved in any potential future 3G roll-out, we currently expect that text-based informational and e-commerce services using existing GSM and GPRS services, particularly text messaging, will remain more popular in the Philippines in the foreseeable future.

Rates and Discounts

Our current policy is to recognize a prepaid subscriber as active only when the subscriber activates and uses the SIM card and reloads at least once during the month of initial activation or in the immediate succeeding month. For example, if a customer activated a SIM card in April 2004 but had not reloaded by May 31, 2004, this customer would not be counted as a subscriber. Subscribers can reload their air time by purchasing prepaid call and text cards that are sold in denominations of Php300, Php500 and Php1,000, or by purchasing additional air time over the air via *Smart Load* in smaller denominations of Php30, Php60, Php115 and Php200; and by receiving loads of Php2, Php5, Php10 and Php15 via *Pasa Load*, or through their handsets using *Smart Money*. Reloads have validity periods ranging from one day to two months, depending on the amount reloaded. A prepaid cellular subscriber is disconnected if the subscriber does not reload within four months after the full usage or expiry of the last reload.

Prior to June 2004, a prepaid cellular subscriber was recognized as an active subscriber when that subscriber activated and used the SIM card in the handset, which already contained Php50 of pre-stored air time (reduced from Php100 in April 2004). The rationale for the change in our policy in June 2004 for the recognition of active prepaid subscribers stems from our observance of SIM-swapping activities in the market beginning February 2004. SIM-swapping refers to the promotional activity wherein subscribers can exchange their current prepaid SIM card for another operator s SIM card at no cost to the subscriber. We believe that these activities have given rise to a situation where certain subscribers may swap their SIM cards between mobile operators upon full usage of the pre-stored air time, which, without the adjustment to subscriber recognition, may have led, based on the approach used in the past, to an overstatement of our prepaid subscriber base. In May 2005, we terminated our "SIM-swapping" promotions. As a result, we expect our churn rates to increase significantly in the next few months as the subscribers acquired through SIM-swapping leave the system.

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 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, we introduced *Smart Load* and *Talk N Text Load*, an over-the-air electronic loading facility designed to make reloading of air time credits more convenient for, and accessible to consumers. These over-the-air reloads come in the following denominations and corresponding expiration periods:

Denomination	**Load Expiry**	**Equivalent Values**
Php30	3 days	30 text messages or 4 local call minutes
Php60	6 days	60 text messages or 8 to 9 local call minutes
Php115	12 days	115 text messages or 15 to 17 local call minutes
Php200	30 days	200 text messages or 26 to 30 local call minutes

Smart and *Talk N Text Loads* were followed in January 2004 with *Pasa Load*, a derivative service allowing prepaid subscribers to transfer even smaller denominations to other prepaid subscribers for a charge of Php1.00 per transfer. *Pasa Load* comes in denominations of Php2, Php5, Php10 and Php15, all carrying a one-day load expiry. *Smart Buddy* subscribers who reload other *Smart Buddy* or *Talk N Text* subscribers via *Pasa Load* are charged Php1.00.

Beginning January 2004, *Smart Buddy* subscribers pay the following air time rates per minute: (a) Php6.50 for Smart-to-Smart and Smart-to-*Talk N Text* subscribers; and (b) Php7.50 for Smart-to-other mobile operators, fixed lines and national long distance calls.

Prior to January 2004, *Smart Buddy* subscribers paid a rate of Php8.00 per minute for calls made during peak hours and Php4.00 per minute for calls made during off-peak hours, regardless of whether the calls were made within the Smart network or to other mobile operators networks. From October 25 to December 31, 2003, national long distance calls were charged at Php11.00 per minute for peak hours and Php7.00 per minute for off-peak hours. Previous to that date, *Smart Buddy* subscribers paid varying national long distance rates depending on the destination of the call.

Beginning January 25, 2004, *Smart Gold* launched its flat rate and consumable plans as follows:

- Flat Rate (regular plans) Plans are available with monthly service fees ranging from Php500 to Php9,000 with varying amounts of free air time and text messages and different rates beyond the free minutes and text messages, depending on the monthly service fee. Monthly service fees for these plans are applicable only to local calls and text messages. All other services are billed on top of the monthly service fee; and

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- Consumable plans are available with monthly service fees ranging from Php800 to Php8,000 with different amounts of free air time and text messages and different rates beyond the free minutes and text messages. Subscribers to these plans may apply their monthly service fees to all voice calls, text messages (both local and international) and value-added services.

Under both types of plans, the rates for calls to other mobile operators, landlines and NDD calls are Php1.00 higher than calls within the Smart network.

From January 1, 2002 to January 24, 2004, *Smart Gold* subscribers could choose from seven different subscription plans with monthly services fees ranging from Php500 to Php3,500 with different amounts of free air time and text messages and different rates beyond the free minutes and text messages. Under each of these plans, calls during peak hours and to other mobile operators, landlines and NDD calls were charged at higher rates per minute than calls within the Smart network.

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 above.

On January 25, 2004, *addict mobile* began offering flat rate plans similar to the ones launched for *Smart Gold* on the same day with monthly service fees ranging from Php500 to Php3,500 with different amounts of free air time and text messages and different rates beyond the free minutes and text messages. Under each of these plans, calls to other mobile operators and landlines are charged at higher rates per minute than calls within the Smart network.

From April 12, 2003 to January 24, 2004, *addict mobile* offered seven different subscription plans with monthly services fees ranging from Php500 to Php3,500 with different amounts of free air time and text messages and different rates beyond the free minutes and text messages. Under each of these plans, calls during peak hours to other mobile operators, landlines and NDD calls were charged at higher rates per minute than calls within the Smart network.

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 to 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.

All Smart subscribers pay an international direct dialing rate of US$0.40 per minute. This rate applies to 201 destinations, including the United States, Hong Kong, Japan, Singapore, the United Kingdom and the United Arab Emirates. Smart charges US$0.98 per minute for 27 other destinations such as Afghanistan and Cuba and US$2.18 per minute for another ten destinations such as East Timor and the Falkland Islands.

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

- for *Smart Buddy, addict mobile* and *Smart Kid prepaid* subscribers, Php1.00 per message; and

- for *Smart Gold* and *Smart Infinity* subscribers, Php0.50 or Php1.00 per message, depending on air time plan.

Smart Buddy, Smart Gold and *addict mobile* subscribers pay the same charges for SMS-based value-added services, as follows:

• Php15.00 per message for international text for *Smart Buddy* subscribers and Php10.00 per message for international text under the new *Smart Gold* plans and for *addict mobile* and *Smart Infinity* subscribers;

• Php2.50 per message for e-text and information-on-demand services, such as news, stock and entertainment updates;

• Php15.00 per download of ring tones and logos;

• Php2.50 per Mobile Banking and *Smart Money* transaction, such as balance inquiry and fund transfer; and

• Php10.00 per subscription download. Daily subscription of logos, ringtones: Php5.00 per logo or ringtone for *addict mobile* and *Smart Kid*, and Php10.00 for other brands

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, Php3.00 for *addict mobile* and *Smart Kid* and Php5.00 for other brands;

• Php15.00 per download of pictures, greeting cards, polyphonic ring tones and traffic shots;

• Php2.50 per MMS for e-text and information-on-demand services (such as news, stock and entertainment updates) Php5.00 for *addict mobile* and *Smart Kid* and Php10.00 for other brands;

• Php2.50 per transaction when surfing on the Smart WAP portal depend on the type of service, if information-based, Php5.00 for *addict mobile* and *Smart Kid* and Php10.00 for other brands; if personalized-based, (logo or ringtones), Php15.00 per download for all brands; and

- Php0.25 per kilobyte when surfing outside the Smart WAP portal.

For voice mail retrieval, all Smart subscribers are charged Php6.50 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.

Piltel's *Talk 'N Text* prepaid cards are sold in the same denominations and offer the same international direct dialing rates as *Smart Buddy* prepaid cards at US$0.40 per minute to all destinations. In October 2003, Piltel implemented an all-day/all-night flat rate of Php9.50 per minute for local calls, calls to other network and national long distance calls replacing the Php12.00 per minute during peak hours and Php8.00 per minute during off-peak hours. In January 2004, this flat rate was further reduced to Php6.50 per minute while the rate for *Talk N Text* to *Talk N Text* calls was reduced to a flat rate of Php5.50 per minute from Php6.50 per minute. The same rate of Php5.50 per minute is charged for voice mail retrieval. *Talk N Text* subscribers are charged Php1.00 for a regular text message in excess of free text allocations while for value added services, such as text games, logo and ring tone downloads are charged within a range of Php2.50 to Php15.00 per message.

On March 11, 2005, Smart launched the *Smart 258 Unlimited Call and Text* promotion pursuant to which Smart prepaid subscribers such as *Smart Buddy, addict mobile prepaid, Smart Kid prepaid* and *Talk N Text* nationwide had the option for the duration of the promotion to avail of unlimited on-network (Smart-to-Smart) voice calls or unlimited on-network (Smart-to-Smart) text messaging service. The *Smart 258 Unlimited Call* promotion covered only on-network (Smart-to-Smart) voice calls for Php115 with a validity of 10 days. To initiate a *Smart 258 Unlimited Call*, the subscriber had to send a text message of the called party s cellphone number to a designated number. Both parties then received a call back to set-up the call. Off-network calls, all text messaging (on-net and off-net) and value-added service downloads were not part of this promotion and were charged at prevailing rates. On the other hand, *Smart 258 Unlimited Text* covered only on-network (Smart-to-Smart) text messaging service for Php60 with a validity of six days. Off-network text messages, all voice calls (on-net and off-net) and value-added service downloads were not part of this promotion and were charged at prevailing rates.

On April 21, 2005, Smart reinstituted the *Smart 258 Unlimited Call* and *Text* promotions for another 30 days with the following modifications:

- the *Smart 258 Unlimited Call* Php115 load was valid for seven days with a maximum call duration of three minutes;

- the *Smart 258 Unlimited Text* Php60 load was valid for four days; and

- subscribers could avail themselves of *Smart 258 Unlimited Call* and *Text* simultaneously.

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 major 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. With the introduction of *Smart Load* and *Talk N Text Load* in May 2003, Smart and Piltel moved into a new mode of distribution. These over-the-air reloads, which were based on the sachet marketing concept of consumer goods such as shampoo and ketchup, required a distribution network more comparable to those of soft drink and beer distributors. Starting with just 50,000 outlets when it was launched, *Smart Load* s distribution network now encompasses over 700,000 retail agents, 90% of which are micro businesses (e.g. neighborhood stores, individuals acting as roving agents). With the prepaid reloading distribution network now extended to corner store and individual retailer levels and minimum reloading denominations down to US$0.50, Smart prepaid service became even more affordable to subscribers, thus attracting new subscribers in previously underserved segments of the market.

For prepaid services, we provided discounts to dealers for prepaid phone kits, air time cards and over-the-air reloads sold. Beginning August 1, 2002, Smart and Piltel reduced the maximum discount to dealers for prepaid phone kit sales from a range of Php1,000 to Php1,300 per unit sold 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 was given on cash purchases. Air time cards and over-the-air reloads are sold to distributors at volume discounts determined by the value of the cards purchased by the distributors. Commissions for air time cards sold range from 8% to 10% while commissions on over-the-air reloads range from 4% to 5%. Air time cards cannot be returned or refunded and normally expire within six to 12 months after release from the Smart warehouse. For postpaid services, we pay 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.

Mabuhay Satellite

We currently own 67% of Mabuhay Satellite, which is engaged in the control and operation of the Agila II satellite. Commencing commercial operations in January 1998, Agila II is the Philippines' first communications satellite. Mabuhay Satellite leases satellite space segments in both the C and Ku bands on the Agila II. Through 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 8 Investments* to the accompanying consolidated financial statements in Item 18 for a discussion 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

We currently own 100% of ACeS Philippines, which owns approximately 20.23% of AIL. AIL 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, or ACeS System and ACeS Service. AIL has entered into interconnection agreements and roaming service agreements with PLDT and other major telecommunications operators that will allow ACeS subscribers to access GSM terrestrial cellular systems in addition to the ACeS system. Further, AIL has an Air Time Purchase Agreement, or ATPA, with National Service Providers, or NSPs, in Asia, including PLDT. For further discussion of this ATPA, please see *Note 16 Related Party Transactions* and *Note 21 Contractual Obligations and Commercial Commitments* to the accompanying consolidated financial statements in Item 18.

Revenues

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 an average annual rates of approximately US$1.0 million and US$0.7 million for its C-band and Ku-band transponders, respectively. Telesat provides its VSAT services on a cost plus mark-up basis. ACeS Service 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 an off-peak hour rate of Php8.00 per minute for domestic calls regardless of destination. For ACeS System public calling offices, callers are charged Php4.50 and Php7.00 per minute for calls terminating to fixed line and cellular networks, respectively. Rates for international long distance calls, depending 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.

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.

The following table summarizes key measures of our local exchange service segment as at and for the years ended December 31, 2004, 2003 and 2002:

	Years Ended December 31,		
	2004	**2003**	**2002**
Number of fixed lines in service (at year-end)	2,152,027	2,185,951	2,188,612
Net additions (reductions)	(33,924)	(2,661)	14,530
Growth rate	(2%)		1%
Number of fixed line employees (at year-end)	9,692	10,518	12,351
Number of fixed lines in service per employee	222	208	177
Consolidated local exchange service revenues (in millions)	Php20,606	Php20,728	Php21,345
Growth rate	(1%)	(3%)	
Local exchange service revenues as a percentage of total service revenues	17%	20%	26%

We also provide local exchange services through our subsidiaries Clark Telecom, Subic Telecom, Maratel and Piltel. Together, these subsidiaries account for approximately 3% of our consolidated fixed lines in service.

We regularly adjust our rates and 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, we have launched a prepaid fixed line service, introduced additional value-added services, introduced initiatives aimed at increasing subscription in areas where we have excess capacity and reduced our installation fees, as described below under "   Rates."

Initially intended as an alternative affordable telephone service for consumers under difficult economic conditions, our prepaid fixed line services now form an important part of PLDT   s overall churn and credit risk exposure management and subscriber retention strategy.

Rates

As at December 31, 2004, basic monthly charges for our local exchange service in the Metropolitan Manila area were Php663.78 for a single-party residential line and Php1,383.62 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. In July 2003, we launched the Telegusto promotion waiving installation charges up to December 31, 2003 to encourage subscriber growth. Installation charges amount to Php1,200 for residential customers and Php1,500 for business customers. Other than basic monthly charges, we do not charge our postpaid subscribers for local calls.

Pursuant to a currency exchange rate mechanism authorized by the NTC, we adjust our 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, we are 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$1.00. During 2004, we implemented six upward and one downward adjustments in our monthly local exchange service rates.

In the first quarter of 2005, House Bill No. 926 was filed and is now pending in the House of Representatives of the Philippines. The proposed bill provides for the cancellation of the currency exchange rate mechanism currently in place. If this bill is passed into law or if the NTC issues guidelines to change the basis of the currency exchange rate mechanism, our ability to generate U.S. dollar linked revenues from our local exchange business could be adversely affected.

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, and was further increased to Php3.00 per minute effective January 1, 2004.

A prepaid fixed line subscriber is recognized as an active subscriber when that subscriber activates and uses a prepaid call card. Prepaid fixed line subscribers can reload their accounts by purchasing call cards that are sold in denominations of Php500, Php300 and Php150. Reloads are valid for two months for the Php500 and Php300 card. The lower denomination Php150 card, launched in September 2003, has an account life of 15 days. A prepaid fixed line subscriber is disconnected if that subscriber does not reload within one month for the Php500 card, four months for the Php300 card and 15 days for the Php150 card after the expiry of the last reload. All sales of prepaid cards, whether through dealers or through PLDT s business offices, are non-refundable. Our prepaid fixed line customers do not pay a basic monthly charge and are charged based on usage. The international and national long distance rates we charge to our prepaid fixed line customers are similar to the rates we charge to our postpaid customers. Prepaid fixed line customers are charged based on usage at a rate of Php1.00 per minute for local calls. For a description of these rates, see International Long Distance Service Rates and National Long Distance Service Rates. Prepaid phone k each containing Php500 worth of pre-stored call credits, are sold for Php1,900 per unit.

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 packet-based voice services are transmitted over our existing traditional circuits: voice over internet protocol, or VOIP; network of a consortium of dominant carriers in Asia; ATM; and internet protocol global backbone of PLDT Global.

The following table shows certain information about our international long distance business as at and for the years ended December 31, 2004, 2003 and 2002:

	Years Ended December 31,		
	2004	**2003**	**2002**
Total call volumes (million minutes)	2,348	2,286	2,815
Growth rate	3%	(19%)	(14%)
Inbound call volumes (million minutes)	2,192	2,128	2,644
Growth rate	3%	(20%)	(15%)
Outbound call volumes (million minutes)	156	158	171
Growth rate	(1%)	(8%)	2%
Inbound-outbound call ratio	14.1:1	13.5:1	15.5:1
Total international long distance service revenues (in millions)	Php12,804	Php12,767	Php10,637
Growth rate		20%	(9%)
International long distance service revenues as a percentage of total service revenues	11%	12%	13%

International long distance service historically has been a major source of revenue. However, due to the steep decline in inbound termination and collection rates and intense competition, revenues derived from our international long distance service had 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 inbound termination rates at that time; by reducing our rates, we reduced the incentive for unauthorized traffic termination and bypass routings by international simple resale operators, and therefore were able to recover some lost traffic. Secondly, we intensified our efforts to identify and contain unauthorized traffic termination and bypass through more effective monitoring of our international trunks, leased lines or local network. 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, which is illegal in the Philippines.

We are pursuing a number of other initiatives to further strengthen our inbound business. Through PLDT Global, 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. PLDT Global is also enhancing the presence of PLDT in other international markets by offering new products and services such as international prepaid cards, SMS transit and other global bandwidth services. We believe this strategy will help us maximize the use of our existing international facilities, and develop alternative sources of revenue.

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, 2004, 2003 and 2002:

	Net Settlement Years Ended December 31,		
	2004	**2003**	**2002**
	(in millions)		
United States	US$75	US$52	US$68
Saudi Arabia	18	15	5
Japan	17	12	16
Italy	16	14	5
United Arab Emirates	13	10	8
Canada	10	15	7
Hong Kong	7	9	3
Taiwan	6	4	6
Australia	2	11	5
Others	64	77	63
Total	US$228	US$219	US$186

Rates

We adopted the U.S. FCC accounting rate benchmark 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. Termination rates for inbound calls from the United States continued to decline through the end of 2002 to levels below the U.S. FCC benchmark accounting rate under pressure from unauthorized terminations and bypass operations. Termination rates for inbound calls from other countries have also been declining generally. As at 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 for its international inbound traffic terminating on its fixed line network to an average of approximately US$0.12 per minute effective February 1, 2003. See Item 8. Financial Information Legal Proceedings U.S. Federal Communications Commission, or FCC, Ruling versus Philippine Telecommunications Companies , Investigation by U.S. Department of Justice and *Note 25 Other Matters* to the accompanying consolidated financial statements in Item 18 for further discussion.

Rates for outbound international long distance calls are based on the type of service, such as whether the call is operator-assisted or direct dialed. Our rates are quoted in U.S. dollars and billed in pesos. The peso amounts are determined at the time of billing. We charge a flat rate of US$0.40 per minute to retail customers for direct-dialed calls, applicable to all call destinations at any time on any day of the week.

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 at and for the years ended December 31, 2004, 2003 and 2002:

	Years Ended December 31,		
	2004	**2003**	**2002**
Total call volumes (million minutes)	1,853	2,016	2,181
Growth rate	(8%)	(8%)	(22%)
Total national long distance service revenues (in millions)	Php6,736	Php6,561	Php7,818
Growth rate	3%	(16%)	(8%)
National long distance service revenue as a percentage of total service	6%	6%	9%

revenues

Cellular substitution and the widespread availability and growing popularity of alternative, more economical, non-voice means of communications, particularly e-mailing 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, as approved by the NTC, has also negatively affected our national long distance call volumes, and consequently, our revenues. Because of this integration, calls between two exchanges located within the same province are no longer considered national long distance calls but are treated as local calls.

A substantial portion of our national long distance calls were 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.

Rates

Rates for national long distance calls are based on the type of service, such as whether the call is operator-assisted or direct-dialed. 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 per minute 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. In addition, NDD calls originating from and terminating to PLDT was also adjusted to Php5.00 per minute from a flat rate of Php4.50 per minute effective June 8, 2003. PLDT is currently reviewing a change of the present rate structure from per minute rate charges to a single fee for unlimited calls. This is envisioned to make rates for national long distance calls competitive with VOIP rates and to revitalize interest in fixed line usage. Currently, various pricing models are being studied in respect of this new rate plan. On February 14, 2005, PLDT launched a Php10 per call promotion to any PLDT fixed line subscriber nationwide and to all Smart and *Talk 'N Text* subscribers. The promotion introduced a shift from per-minute charging to a single fee for unlimited calls.

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 to a high of Php10.94 per minute for calls terminating to cellular subscribers, depending on whether the calls were local or long distance. 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.

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, this segment registered the highest percentage growth in revenues among our fixed line services and it continued to grow in 2003 and 2004.

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, DSL, internet gateway, bandwidth on demand, or BOD, and wholesale broadband of electrical and optical interfaces digital signal level 3, or DS3; STM1, ESCON Fiber Channel, Fast Ethernet; and

- other switching services integrated services digital network, or ISDN, and videocon.

The foregoing services are used for the following:

- domestic and international communications;

- broadband data transmission services that transmit data, voice and video over a wider range of frequencies or bandwidth;

- 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.

In 2004, 2003 and 2002, we continued to broaden our service offerings with the launch of new services and expansion or enhancement of some of the existing ones.

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 *DSL* broadband for heavy internet users. As at December 31, 2004, the number of PLDT s fixed line subscribers for *PLDT Vibe* stood at 369,435, of which 146,909 were exclusive postpaid users, 163,585 were exclusive prepaid users, and 58,941 are were both postpaid and prepaid users, compared to 188,034 as at December 31, 2003, of which 110,502 were exclusive postpaid users, 58,939 were exclusive prepaid users, and 18,593 were both postpaid and prepaid users, while the number of *DSL* subscribers reached 49,476 and 23,884 as at December 31, 2004 and 2003, respectively.

In April 2004, PLDT introduced additional enhanced IP-based services under an umbrella brand *IP-Plus*, namely, *Quality of Service*, or *QoS*, *IP Security*, or *IP Sec*, and *Voice over Virtual Private Network*, or *VoVPN*. With *QoS*, customers are given priority service for voice, premium and basic, with the highest priority given to voice since it requires error-free transmission. *IP Sec* optimizes the latest encryption technology to ensure utmost confidentiality of vital information. *VoVPN* gives customers toll-grade quality without the cost of toll charges. All these *IP Plus* services translate to cost-efficiency, high reliability and increased security and flexibility.

In June 2004, PLDT established an Innovation Laboratory, or *Innolab*, in Cebu, a show and demonstration room where existing and potential clients as well as students can have a hands-on experience on various PLDT products and services designed for our corporate clients. It also serves as a venue for testing software applications and computer programs and is expected to be the starting ground for innovative ideas where new products and cost-effective solutions may be created.

On March 10, 2005, PLDT launched *PLDT WeRoam,* a wireless broadband service running on Smart s nationwide wireless network and utilizing GPRS, EDGE and Wi-Fi technologies. *PLDT WeRoam* enables businesses to provide their employees with wireless access to their corporate intranet and the internet over their laptop, anywhere within Smart s nationwide wireless network coverage area.

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 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 businesses are the operation of: (a) an internet data center under the brand name *Vitro* ; (b) call centers through Vocativ, Parlance and Ventus; and (c) an ISP through Infocom.

Infrastructures and Services

Data Center

ePLDT operates *Vitro* , one of the Philippines first internet data centers. The Philippine Board of Investments, or BOI, granted *Vitro* pioneer status, which entitles it 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.

Call Centers

ePLDT is focusing on developing its call center services business, which capitalizes on the availability of English-speaking labor in the Philippines. The call center service business is being undertaken through the following wholly-owned subsidiaries of ePLDT:

- Vocativ which owns and operates a 998-seat call center facility with 749 customer service representatives, or CSRs, exclusively for clients of a global provider of customer relationship management services;

- Parlance which owns and operates a 1,177-seat call center facility with 1,109 CSRs, exclusively for one of the largest direct-to-home satellite service providers in the United States for customer support and billing requirements; and

- Ventus, which owns and operates a 400-seat call center facility located in Iloilo province, has commenced full commercial operations in March 2005. We currently expect that Ventus will be expanding in Metro Manila with a 678-seat call center facility to accommodate current and new client requirements. This facility is expected to be completed by November 2005.

ePLDT sold its entire 51% interest in Contact World, Inc., another call center facility, on June 30, 2003 and assigned its receivables from the same to Service Zone, Inc., a U.S.-based call center operator, for a total consideration of US$700,000.

Internet and Gaming

ePLDT s internet and gaming business is conducted through several subsidiaries. ePLDT s equity interests in and a brief description of the businesses of these subsidiaries are as follows:

- a 99.6% interest in Infocom, one of the country s leading ISPs. Infocom offers consumer prepaid internet access under the name of *WarpSpeed* and *Speed Tipid*, and postpaid internet access, dedicated dial-up and multi-user dial-up, corporate leased lines and broadband internet access through *DSL* or *NOW* cable internet, as well as web consulting, development and hosting. The *NOW* cable internet brand was sold on February 1, 2005;

- a 67.79% interest in DigiPar, an Internet café business which assumed the assets and brand of Netopia Computer Technologies, Inc., under the brand *Netopia*. *Netopia* is now one of the largest and fastest growing internet café chains in the country with over 130 branches and over 6,000 work stations. DigiPar offers high-speed internet services, including internet advertising, gaming and printing;

- a 51% interest in Digital Paradise Thailand, Ltd., or DigiPar Thailand, an affiliate of DigiPar offering similar services in Thailand; and

- a 60% interest in netGames, Inc., or netGames, a publisher for Massively Multiplayer Online Game, or MMOG, in the Philippines. netGames, which was incorporated on June 21, 2004, is the Philippine licensee of Khan Online, the country s first full 3D online game. netGames commenced full commercial operations in February 2005.

Other Investments

ePLDT also currently holds equity interests in the following entities:

• mySecureSign, Inc., a wholly-owned subsidiary of ePLDT and an affiliate of VeriSign, Inc., which issues VeriSign digital certificates in the Philippines for e-commerce transactions;

• iPlus Intelligent Network, Inc., or iPlus, a wholly-owned subsidiary of ePLDT, which provides IT helpdesk/contact center services and terminals for credit, debit and cash card transactions;

• 22.5% interest in 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; and

• 19.17% interest in BayanTrade Dotcom, Inc., or BayanTrade, an e-procurement joint venture established together with six of the Philippines leading conglomerates. Initial shareholding in BayanTrade was originally 20.5%, which was subsequently diluted to 19.17% in August 2004 due to an equity call to which ePLDT did not subscribe.

Wireless Network Infrastructure

Cellular

Through Smart, we operate a digital GSM network. To meet the growing demand for cellular services, Smart has implemented an extensive deployment program for its GSM network covering substantially all of Metro Manila and most of the other population centers in the Philippines. In 2004, Smart added 1,399 base stations to its nationwide cellular network, bringing to 5,303 Smart's total base stations in operation. Smart has 36 mobile switching centers and 39 text messaging service centers, which have raised significantly Smart's network capacity to cover approximately 17.3 million subscribers as at December 31, 2004.

Smart has an operating spectrum of 7.5 Megahertz, or Mhz, in the 900 Mhz band supporting both its GSM and previously its ETACS network and 17.5 Mhz in the 1800 Mhz band for GSM. Its dual-band GSM network allows it to efficiently deploy high capacity 1800 Mhz base transceiver stations in dense urban areas while its 900 Mhz base transceiver stations can be much more economically deployed in potentially high growth, but less densely populated provincial areas. Spectrum constraints will not affect the Smart s expansion plans for GSM in the foreseeable future. Piltel, on the other hand, has an operating spectrum of 11.5 Mhz out of the 12.5 Mhz allocated in the 800 Mhz band.

Due to its access to PLDT s network assets, Smart has been able to achieve significant capital expenditure savings, which are understood to be significantly less, on a per net addition basis, than its current competitors. This translates into an improved ability to price competitively and target the mass market subscriber base in the Philippines, while retaining profitability. Based on existing equipment purchase contracts, Smart expects incremental capital expenditure per net additional subscriber to amount to less than US$50.

The coming years will see continued increases in coverage (particularly indoor), as well as new types of base transceiver station, or BTS, for outdoor, street level and commercial office coverage. Smart has introduced the Nokia *ConnectSite* GSM system for wider coverage and increased efficiencies in underserved areas of the Philippines. The new base station equipment called *ConnectSite* can be up to 25% more efficient than traditional outdoor cell sites. Smart is one of the very first operators in the world to adopt this system.

Smart and Piltel have been co-locating their cell sites where their base stations are installed. As at December 31, 2004, 21 of Smart's mobile switching centers and 110 of Smart's cell sites are housed in PLDT s fixed line complexes while 242 of Smart s cell sites are co-located with Piltel. These operational synergies have allowed Smart to reduce switch installation time from three months to five weeks.

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, six have restricted usage due to satellite interference. 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 serve as the primary interface between the ACeS 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.

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 at December 31, 2004, 2003 and 2002:

	As at December 31,		
	2004	**2003**	**2002**
Number of central office exchanges	183	183	183
Number of fixed lines in service	2,152,027	2,185,951	2,188,612
Employees per 10,000 local exchanges in service	45	48	56

We have our own 5,400 kilometer 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. 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. We use *CS PLDT*, a cable ship which we lease from NTT World Engineering Marine Corporation pursuant to a five-year Chartered Arrangement Maintenance Contract to maintain the 2,400 kilometers of submarine cable comprising the submerged portion of our domestic fiber optic network, or DFON.

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. We further expanded our transmission and data network capacities in 2003 and 2004.

International

We provide international network services using our three international gateway switching exchanges. As at December 31, 2004, our international long distance facilities allow direct correspondence with 50 countries/territories (representing 79 correspondents) and can reach 360 foreign destinations (via direct and transited routes including breakouts) worldwide. We also own interests in submarine and satellite systems, through which we route most of our international traffic.

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

Cable System	**Countries Being Linked**
G-P	Guam and the Philippines
Asia-Pacific Cable Network	Korea, Japan, Hong Kong, Taiwan, Australia, Philippines, Singapore, Malaysia, Indonesia and Thailand
Asia-Pacific Cable Network 2	Philippines, Hong Kong, Japan, Korea, Malaysia, Singapore, China and Taiwan
Transpacific Cable No. 5	Guam, Japan, Hawaii and the U.S. Mainland
SEA-ME-WE-3	Japan, Korea, China, Taiwan, Hong Kong, Macau, Philippines, Vietnam, Cambodia, Brunei, Malaysia, Singapore, Indonesia, Australia, Thailand, Myanmar, Sri Lanka, India, Pakistan, United Arab Emirates, Oman, Djibouti, Saudi Arabia, Egypt, Cyprus, Turkey, Greece, Italy, Morocco, Portugal, France, UK, Belgium and Germany
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
Asia Pacific	Hong Kong, Japan, Singapore, Malaysia and Taiwan
PacRim East	Hawaii and New Zealand
M-T	Malaysia and Thailand
C-J	China and Japan
North Pacific	Japan, Alaska and the U.S. Mainland
Americas Cable 1	U.S. Mainland, U.S. Virgin Islands, Brazil, Trinidad and Venezuela
China-U.S. Cable	Japan, China, Taiwan, Korea, Guam and U.S. Mainland
Columbus II Cable	U.S. Mainland, Italy, U.S. Virgin Islands, Mexico, Portugal and Spain

FLAG Cable	Japan, Korea, China, Hong Kong, Malaysia, Thailand, India, United Arab Emirates, Saudi Arabia, Egypt, Italy, Spain and UK
MAT 2 Cable	Italy and Spain
RIOJA Cable	Spain, UK, Belgium and the Netherlands
RJK Cable	Russia, Japan and Korea
Southern Cross Cable	U.S. Mainland, Hawaii, Fiji, Australia and New Zealand
TAT 10 Cable	Germany and the Netherlands
TAT 12/13 Cable	U.S. Mainland, UK and France
TVH Cable	Thailand, Vietnam and Hong Kong
EAC Cable	Japan, Hong Kong, Korea, Taiwan, Singapore and the Philippines
PC-1 and Japan-U.S. Cable	Japan and the U.S.

Interconnection Agreements

Since the issuance of Executive Order 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.

Prior to July 1, 2001, PLDT retained an origination charge of Php2.00 per minute on every call terminating to the network of Smart or Globe Telecom, Inc., or Globe. From July 1, 2001 to December 31, 2001, Smart and Globe charged PLDT for local calls at Php6.50 per minute pursuant to an amended interconnection agreement. The new arrangement also applied to national long distance calls originating from PLDT and terminating to the cellular network of either Smart or Globe removing any distinction between access charges for local calls and national long distance calls. For calls originating from PLDT and terminating to the cellular networks of Smart and Globe, Smart and Globe charged 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 were charged a termination rate of Php4.00 per minute, a decrease from the previous Php4.50 per minute.

Effective January 1, 2003, access from cellular operators, including Smart and Piltel, which terminate calls on PLDT s fixed line network increased from Php2.00 per minute to Php2.50 per minute, which further increased 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, Globe and PAPTELCO. PAPTELCO is comprised of 48 local exchange carriers, or LECs, operating in 129 sites nationwide. 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.

Effective February 1, 2003, international calls terminating to PLDT s fixed line network were charged a termination rate of an average of approximately US$0.12 per minute from the previous rate of an average of approximately US$0.08 per minute. Also, international calls terminating on Smart s and Piltel s cellular network were charged a termination rate of an average of approximately US$0.16 per minute, an increase from the previous termination rate of an average of approximately US$0.12 per minute.

Effective January 1, 2002, Smart charged a termination rate of Php4.00 per minute for calls originating from/terminating to another cellular operator s network. For SMS originating from Smart and Piltel and terminating on other operators cellular network and for SMS originating from other operators and terminating on Smart s and Piltel s cellular network, the charge is Php0.35 per message.

Licenses and Regulation

PLDT, Smart and Piltel provide telecommunications services pursuant to legislative franchises, which expire, in the case of PLDT, November 28, 2028, in the case of Smart, March 27, 2017 and, in the case of Piltel, May 14, 2019. 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. 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.

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 expired 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. While an extension has not yet been formally granted, PLDT expects that the NTC will grant these extensions; however, there is no assurance that this will occur. The period of validity of some of PLDT s CPCNs expired on November 28, 2003, coterminous with the term of its previous franchise under R.A. No. 6146, which has been extended further by the NTC to November 28, 2028, coterminous with PLDT s current franchise under R.A. 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 Risks Factors Risks Relating to Us Our business is significantly affected by governmental laws and regulations, including regulations in respect of our franchises and rates. Piltel holds a CPCN to provide a nationwide cellular telephone service which expires in August 2019.

Smart operates its cellular, international long distance, national long distance services 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.

Piltel is authorized to provide virtually every type of telecommunications service, including the transmission of voice, data facsimile, audio and video and information services, in and between provinces, cities and municipalities throughout the Philippines. The franchise, which was last amended on May 14, 1992, expires on May 14, 2019 and may be extended by a legislative act of the Philippine Congress.

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

Carrier	Spectrum System	Frequency Assignment	Bandwidth
Smart	ETACS/GSM 900	897.5-905/942.5-950 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	824-835/869-880 Mhz	11.0 Mhz
		845-846.5/890-891.5 Mhz	1.5 Mhz

Operators of international gateway facilities and cellular telephone operators, pursuant to E. O. 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 ten 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 these disputes, see Item 8. Financial Information Legal Proceedings Taxation NTC supervision and regulation fees, or SRF.

On May 27, 1998, Smart filed an Urgent Ex Parte Motion and Manifestation regarding the permit fee in the amount of approximately Php113 million assessed by the NTC for CPCN 93-482, pertaining to Smart s Integrated Local Exchange Telephone Service, Domestic Toll Service and Private Line Service. 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 of this annual report.

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

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

Piltel has also been assessed by the NTC for deficiency SRF. Based on the latest computation of deficiency supervision and regulation fees received from the NTC, which is dated July 6, 2004, the total amount assessed on Piltel stands at approximately Php1,306 million, including penalty fees amounting to approximately Php501 million as at September 30, 2003. Piltel has protested the assessments in good faith. Piltel continues to make payments for which it believes are properly due to the NTC. On September 30, 2003, Piltel made a payment to the NTC under protest in the amount of Php9.1 million. However, the NTC refused to apply this payment to the SRF but instead applied it to alleged penalties for 1997 prompting Piltel to order a stop payment on the check for the aforementioned amount. On October 2, 2003, Piltel filed a complaint for consignation before the regional trial court of Quezon City, which remains pending. On February 11, 2005, Piltel paid under protest the amount of Php559 million in respect of NTC fees for the period from 1992 to 2004.

In order to diversify the ownership base of public utilities, R.A. No. 7925 requires a telecommunications entity with regulated types of services, such as Smart and Piltel, to make a public offering through the stock exchanges representing at least 30% of its aggregate common shares 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 had 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 R.A. No. 7925 provides that any advantage granted under existing franchises automatically becomes part of previously granted telecommunications franchises, Smart believes that it was also entitled to this ten-year period. However, because Smart has not conducted a public offering of its shares, the Philippine Congress may revoke the franchise of Smart. Moreover, a *quo warranto* case may be filed against Smart by the Office of the Solicitor General of the Philippines on the ground of violation of R.A. No. 7925 due to Smart s failure to conduct public offering of its shares by August

2004. In September 2004, Senate Bill No. 1675 was filed seeking to amend Section 21 of R.A. No. 7925. The bill seeks to declare that a telecommunications entity shall be deemed to have complied with the requirement of making a public offering of its shares if two-third of its outstanding voting stock are owned and controlled directly or indirectly, by a listed company. The bill is currently pending in the Philippine Senate. PLDT regularly evaluates various strategic options with respect to its capital structure.

On May 24, 2005, the President signed into law Republic Act No. 9337 amending certain sections of the National Internal Revenue Code with effect on July 1, 2005. In particular, the following amendments may negatively impact our profitability:

- increase of the income tax rate for corporations from 32% to 35% effective July 1, 2005, followed by a reduction to 30% effective January 1, 2009;

- conferment upon the President, upon the recommendation of the Secretary of Finance, of the power to raise VAT rate from 10% to 12% effective January 1, 2006, after any one of the following conditions has been satisfied;

a. VAT collection as a percentage of the GDP exceeds 2.8% in 2005; or

b. the fiscal deficit as a percentage of GDP, which represented 3.8% in 2004, exceeds 1.5% in 2005.

- limited claim of input tax credits to 70% of output tax; and

- input tax on capital goods spread evenly over 5 years or estimated useful life, whichever is shorter.

Moreover, the Philippine Congress is considering five bills which were filed prior to the signing into law of R.A. No. 9337. Each of the proposed bill, 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 calls and cellular data revenues and prohibit cellular operators from imposing additional charges or fees to compensate for the imposition of the proposed taxes. In addition, several bills have also been submitted for consideration by Congress, each of which, if passed by Congress and enacted into law, would impose a franchise tax at a rate of 7% or 5% tax on gross receipts of all telecommunication companies in lieu of the currently applicable 10% VAT.

Competition

The enactment of the R.A. 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 nine major local exchange carriers, 11 international gateway facility providers, and six 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 cellular, fixed line and data and other network services segments.

Cellular Service

There are six operating service providers, namely Smart, Piltel, Globe, Islacom, Digitel and Express Telecom. Globe acquired Islacom (now known as *Innove*) to form into one operating group while Smart and Piltel, both being part of the PLDT Group, formed another operating group.

Competition in the cellular business has intensified with the availability of affordably priced handsets and the introduction by competitors of new and improved plans for postpaid subscribers, reduced rates per minute and aggressive marketing and promotional strategies. The principal bases of competition are price, including handset cost, quality of service, geographic coverage and attractiveness of packaged services. Smart's network leads the industry in terms of coverage with 3,957 cell sites as at December 31, 2004 compared to Globe s and *Sun Cellular s* declared cell sites of 3,736 and 1,300, respectively.

In October 2004, *Sun Cellular* launched its 24/7 service whereby its prepaid subscribers were offered unlimited calls and text messaging within the *Sun Cellular* network over a certain period for a fixed fee (e.g. Php100 for 10 days and Php250 for 30 days of unlimited calls and text messaging). On March 15, 2005, the Php250 monthly fee was increased to Php350 while the duration of the Php100 service was shortened to seven days. *Sun Cellular* postpaid subscribers can utilize a similar feature by adding Php350 per month to their monthly service fee. On March 8, 2005, Touch Mobile, a prepaid service offering of *Innove*, launched its Todo Tawag, Todo Text promotion wherein Touch Mobile subscribers have the option to avail themselves of unlimited local calls and text messaging among Touch Mobile subscribers for a fixed fee. The promotion covers local voice calls and text messaging only between Touch Mobile subscribers for Php150 with a validity of 15 days. On March 11, 2005, Smart launched Smart *258* , a promotion open to all Smart and *Talk N Text* prepaid subscribers who wished to avail themselves of unlimited on-network voice calls for Php115 for 10 days and unlimited on-network text messaging service for Php60 for six days. On March 22, 2005, Globe launched its unlimited call and text promotion wherein Globe subscribers can call and text other Globe subscribers for a fee of Php300.

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, multimedia 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 Smart s churn management efforts, Smart "locks" the handsets it sells to its subscribers, rendering them incompatible with SIM cards issued by competitors. However, subscribers may have their handsets unlocked by unauthorized parties, for a nominal fee, and purchase new SIM cards from competing operators or may swap the existing SIM for a SIM of a competing operator for free, inclusive of pre-loaded air time. Unlocking does not involve significant cost. Switching to another cellular operator would, however, result in a change of the subscriber s cellular telephone number.

Local Exchange Service

The concerted nationwide local exchange line build-out by various players, 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. In June 2005, Innove Communications, a wholly-owned subsidiary of Globe, was granted a national franchise by the NTC to provide landline service nationwide.

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 the growing number of cellular subscribers, and (3) the popularity of alternative and cheaper means of long distance communications, such as text messaging, e-mailing and internet telephony, further heightening the competition.

With respect to inbound calls into the Philippines, 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. 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 presence in key cities overseas to identify 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 our fixed line network to an average of approximately 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. See Item 8. Financial Information Legal Proceedings U.S. Federal Communications Commission, or FCC, Ruling versus Philippine Telecommunications Companies , Item 5. Operating and Financial Review and Prospects Results of Operations 2004 Compared to 2003 Consolidated Operating Revenue Fixed Line International Long Distance , Item 3. Key Information Risks Factors Risks Relating to Us Our results of operations have been, and may continue to be, adversely affected by competition in international long distance service and *Note 25 Other Matters* to the accompanying consolidated financial statements in Item 18 for further discussion.

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 text messaging and e-mailing. In addition, various internet service providers have launched voice services over the internet to their subscribers nationwide.

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 DFON. In order to mitigate the decline of our national long distance revenues, we have renegotiated the interconnection agreements with the cellular operators to provide the fixed line business a more equitable access charge arrangement for calls between fixed line and cellular subscribers.

On January 5, 2005, *Globelines* launched a plan that offered all its subscribers free NDD calls nationwide. Digitel's flat rate for Sun-to-Sun calls was being positioned not only as a strong alternative to cellular, but also as a replacement to the fixed line. On February 14, 2005, PLDT launched its Php10 per call promotion to any PLDT fixed line subscriber nationwide and to all Smart and *Talk 'N Text* subscribers. The promotions introduced a shift from the per minute charging to a single fee for unlimited calls.

Data and Other Network Services

Another rapidly growing segment of the industry is the market for data and other network services. The growth is spurred by the significant growth in consumer/retail narrowband and broadband internet access, enterprise resource planning applications, call centers, business process outsourcing, on-line gaming and other e-services that drive the need for broadband and internet-protocol based solutions both here and abroad. Our principal competitors in this area are Globe/Innove, BayanTel, Eastern Telecommunications and Digitel. The principal bases of competition in the data services market are price, customer service and quality of 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 accompany most of our equipment purchases.

Properties

We own four office buildings located in Makati City and own and operate 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 at December 31, 2004, we had 3,957 cellular cell sites and 5,303 base stations.

As at December 31, 2004, our principal properties, excluding property under construction, consisted of the following, based on book value:

- 58% consisted of cable and cellular facilities, including our DFON, subscriber cable facilities, inter-office trunking and toll cable facilities and cellular facilities;

- 25% consisted of central office equipment, including three international gateway facilities, six pure national toll exchanges and 15 combined local and toll exchanges, and communications satellite;

- 9% consisted of land and improvements and buildings, which we acquired to house our telecommunications equipment, personnel, inventory and/or fleet;

- 1% 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 7 Property, Plant and Equipment* to the accompanying consolidated 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 and Smart s properties are free from any mortgage, charge, pledge, lien or encumbrance. However, substantial properties of Piltel and Mabuhay Satellite and a portion of ePLDT s property are subject to liens.

PLDT Group has various long-term lease contracts, the bulk of which have lease terms ranging from two to ten years covering certain offices, warehouses, telecommunications equipment locations and various office equipment.

Item 5. Operating and Financial Review and Prospects

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 at December 31, 2004 and 2003 and for the years ended December 31, 2004, 2003 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 "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, 2004 of Php56.341 to US$1.00, as quoted through the Philippine Dealing System.*

Overview

We are the largest and most diversified telecommunications company in the Philippines. We have organized our business into three main segments which serve as the basis for management s decision to allocate resources and evaluate operating performance:

- *Wireless* wireless telecommunications services provided by PLDT s subsidiaries, Smart and Piltel, our cellular service providers, and Mabuhay Satellite, ACeS Philippines, and Telesat, our satellite and VSAT operators;

- *Fixed Line* fixed line telecommunications services primarily provided through PLDT. We also provide fixed line services through PLDT s subsidiaries Clark Telecom, Subic Telecom, Maratel, Piltel and BCC, which together account for approximately 3% of our consolidated fixed lines in service, (in 2004) and PLDT Global; 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; call center services provided by ePLDT s subsidiaries Parlance, Vocativ and Ventus; internet access and gaming services provided by ePLDT s subsidiaries, Infocom, DigiPar and netGames; and e-commerce and IT-related services provided by other investees of ePLDT, as discussed in *Note 8 Investments* to the accompanying consolidated financial statements in Item 18.

Key performance indicators and drivers that our management uses for the management of our business include, among others, the general economic conditions in the Philippines, our subscriber base, traffic volumes, and interconnection arrangements.

Wireless

Our wireless business provides cellular and satellite, VSAT and other services, with cellular services contributing about 97% and satellite, VSAT and other services contributing 3% of our wireless service revenues as at December 31, 2004. Rapid growth in the cellular market has resulted in a change in our revenue composition and sources of our revenue growth. Starting 2003, cellular service has been our major revenue source surpassing fixed line revenues by five percentage points. As at December 31, 2004, Smart and Piltel, which offers service using Smart s network, had the largest and third largest cellular subscriber bases, respectively, in the Philippines. In addition, Smart s and Piltel s subscribers increased by 48% in 2004, resulting in our aggregate system-wide cellular subscribers outnumbering our fixed line in service by more than 9 to 1 at the end of 2004. Cellular data services, which include all text messaging and text-related services ranging from ordinary text to value-added services, contributed significantly to our revenue increase. Cellular service revenues accounted for 56%, 51% and 42% of our total service revenues for 2004, 2003 and 2002, respectively.

Fixed Line

Our fixed line business provides local exchange service, international and national long distance services, data and other network services and miscellaneous services. Until 2003, fixed line services have been our major revenue source contributing 56% and 69% of consolidated service revenues in 2002 and 2001, respectively. Although relatively stable in absolute terms, our fixed line revenues contribution to total operating revenues have declined to 38% in 2004, largely due to the substantial growth in our wireless business. Local exchange revenues have declined slightly owing to shift in subscriber preference from postpaid to prepaid service. National long distance revenues have also been declining largely due a drop in call volumes, and an increase in the proportion of calls subject to revenue sharing with other carriers. Mitigating these declines was the steady growth of our data and other network services over the recent years. Recognizing the growth potential of the data and other network services segment, we have put considerable emphasis on the development of new packet-switched, data-capable and internet-based networks. International long distance revenues have declined until 2002 due to lower inbound call volumes, lower termination rates and increased competition and substitution, but has increased its contribution to the overall fixed line revenues in 2003 and 2004 on account of an increase in our average termination rates in 2003.

Information and Communications Technology

Our information and communications technology business is conducted through our wholly-owned subsidiary, ePLDT, which was incorporated in August 2000 and started commercial operations in February 2001. ePLDT s principal businesses are the operation of an internet data center under the brand name *Vitro* ; three wholly-owned call centers, Vocativ, Parlance and Ventus, which commenced full commercial operations in March 2005, and Infocom, an ISP. As a percentage of our total service revenues, our information and communications technology service revenues increased to 2% in 2004 from 1% in 2003 and 2002.

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 consolidated financial statements and related notes. In preparing these consolidated 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.

Revenue Recognition

Our revenue recognition policies require us to make use of estimates and assumptions that may affect the reported amounts of our revenues and receivables. While we believe that our judgments and assumptions are appropriate and reasonable, significant changes in our judgments and assumptions may materially affect our reported amounts of our revenues and receivables.

Our agreements with domestic and foreign carriers for inbound and outbound traffic subject to settlements require traffic reconciliations before actual settlement is done, which may not be the actual volume of traffic as measured by us. Initial recognition of revenues is based on our observed traffic adjusted by our normal experience adjustments, which historically have not been material in our consolidated financial statements. Differences between the amounts initially recognized and actual settlements are taken up in the accounts upon reconciliation. However, there is no assurance that such use of estimates may not result to material adjustments in future periods.

Revenues under a multiple element arrangement specifically applicable to our wireless business are split into separately identifiable components and recognized when the related components are delivered in order to reflect the substance of the transaction. The fair value of components is determined using verifiable objective evidence. Revenue for handset sales is quantified and identified separately using the residual value method from our cellular service revenue.

Estimating Useful Lives of Property, Plant and Equipment

We estimate the useful lives of our property, plant and equipment based on the period over which our assets are expected to be available for use. The estimated useful lives of our property, plant and equipment are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of our assets. In addition, our estimation of the useful lives of our property, plant and equipment is based on our collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future results of operations could be materially affected by changes in our estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of our property, plant and equipment would increase our recorded expenses and decrease our noncurrent assets. Property, plant and equipment amounted to Php186,093 million and Php190,217 million as at December 31, 2004 and 2003, respectively.

Asset Impairment

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 prior to January 1, 2002, affected our results of operations for the amount of future period amortization expense. Since January 1, 2002, goodwill has been subject to a periodic impairment test and may no longer be amortized. Determining the fair value of property, plant and equipment, investments and intangible assets requires us to make estimates and assumptions, such as the determination of future cash flows expected to be generated from the continued use and ultimate disposition of such assets, that can materially affect our consolidated financial statements. Future events could cause us to conclude that property, plant and equipment, investments and intangible assets 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.

The determination of the 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.

Total goodwill and intangible assets as at December 31, 2004 and 2003 amounted to Php16,561 million and Php15,464 million, respectively. Total asset impairment charges amounted to Php1,412 million in 2004, Php675 million in 2003 and Php13,279 million in 2002.

Financial Assets and Liabilities

U.S. GAAP requires that we carry certain of our financial assets and liabilities at fair value, which requires extensive use of accounting estimates and judgment. While significant components of fair value measurement were determined using verifiable objective evidence (e.g., foreign exchange rates, interest rates, volatility rates), the fair value would differ if we utilized different valuation methodology. Any changes in fair value of these financial assets and liabilities would affect directly our profit and loss and equity.

The fair value of financial assets and liabilities as at December 31, 2004 amounted to Php46,153 million and Php191,923 million, respectively. Total gain on debt exchange in 2004 amounted to Php2,620 million. The fair value of financial assets and liabilities as at December 31, 2003 amounted to Php39,861 million and Php212,385 million, respectively.

Estimating Allowance 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 where we have information that certain customers are 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 received affects the amounts estimated. Second, a general provision is established as a certain percentage of operating revenues based on the aging profile of receivables. This percentage is based on a collective assessment of historical collection, write-off experience, current economic trends, changes in our customer payment terms and other factors that may affect our ability to collect payments.

Full allowance is provided for receivables from permanently disconnected subscribers and carriers. Such permanent disconnections generally occur within 105 days from due date. Partial allowance is provided for active subscribers and carriers based on the age status of receivables.

The amounts 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 expenses and decrease our current assets. Provision for doubtful accounts amounted to Php3,948 million in 2004, Php4,092 million in 2003 and Php4,160 million in 2002. The provision for doubtful accounts represented approximately 3% of our consolidated service revenues in 2004, 4% in 2003 and 5% in 2002. Trade and other receivables, net of allowance for doubtful accounts, amounted to Php10,404 million and Php17,087 million as at December 31, 2004 and 2003, respectively.

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 Php23,096 million. Based on management's review and estimate, Php5,900 million was recorded as the value of customers acquired (Php2,705 million and Php3,195 million were attributed to Global System for Mobile Communication, or GSM, and analog subscribers, respectively). Prior to 2002, the excess of the total acquisition cost over the fair value of the net assets acquired was amortized on a straight-line basis over five years. Starting 2002, the unamortized balance is reviewed annually for impairment using the fair value approach. 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.

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. Over the past years, the Philippine peso has depreciated significantly against the U.S. dollar, resulting in substantial foreign exchange losses, and has resulted in our incurring net losses 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 and Other Retirement Benefits

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 17 Employee Benefits* to the accompanying consolidated 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. Unrecognized net actuarial loss as at December 31, 2004 amounted to Php89 million.

Deferred Tax Assets

We review the carrying amounts of our deferred tax assets at each balance sheet date and recognize a valuation allowance to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. However, there is no assurance that we will generate sufficient taxable profit to allow all or part of our deferred tax assets to be utilized. Significant changes in our judgments and assumptions may materially affect the reported amounts of our valuation allowance and the carrying amounts of our deferred tax assets.

As at December 31, 2004 and 2003, our deferred tax assets amounted to Php20,027 million and Php20,712 million, respectively, net of valuation allowance amounting to Php13,663 million and Php19,590 million, respectively.

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 currently do not believe these proceedings will have a material adverse effect on our consolidated financial statements. 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 Taxation. Outstanding provisions to cover these contingencies amounted to Php5,199 million as at December 31, 2004.

Results of Operations

The following table shows the contribution by each of our business segments to our consolidated operating revenues, expenses and net income (loss) for each of the years ended December 31, 2004, 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.

	Wireless	Fixed Line	ICT	Inter-segment Transactions	Total
			(in millions)		
For the year ended December 31, 2004					
Operating Revenues	Php75,161	Php48,484	Php2,401	(Php4,825)	Php121,221
Service	69,050	48,484	2,080	(4,662)	114,952
Non-service	6,111		321	(163)	6,269
Operating Expenses	42,769	31,909	3,035	(5,031)	72,682
Net Income (Loss)	27,513	1,287	(699)		28,101
For the year ended December 31, 2003					
Operating Revenues	65,183	46,820	1,783	(2,586)	111,200
Service	54,635	46,820	1,467	(2,436)	100,486
Non-service	10,548		316	(150)	10,714
Operating Expenses	46,264	32,303	2,272	(3,018)	77, 821
Net Income (Loss)	13,275	(1,902)	(328)		11,045
For the year ended December 31, 2002					
Operating Revenues	48,252	46,186	977	(1,584)	93,831
Service	36,157	46,186	772	(1,429)	81,686
Non-service	12,095		205	(155)	12,145
Operating Expenses	37,915	43,793	1,458	(1,364)	81,802
Net Income (Loss)	5,931	(11,602)	(487)		(6,158)

2004 Compared to 2003

On a Consolidated Basis

Consolidated Operating Revenues

Largely driven by the continued strong growth of our wireless business, particularly Smart s cellular business, our consolidated operating revenues for 2004 increased by Php10,021 million, or 9%, to Php121,221 million from Php111,200 million in 2003. The revenue contribution of our wireless business accounted for 62% of our consolidated operating revenues for 2004, compared to 59% in 2003.

The following table shows the breakdown of our consolidated operating revenues for the years ended December 31, 2004 and 2003 by business segment:

	Years Ended December 31,					
					Change	
	2004	**%**	**2003**	**%**	**Amount**	**%**
			(in millions)			
Wireless	Php75,161	62	Php65,183	59	Php9,978	15
Fixed line	48,484	40	46,820	42	1,664	4
Information and communications technology	2,401	2	1,783	1	618	35
Inter-segment revenues	(4,825)	(4)	(2,586)	(2)	(2,239)	87
Total	Php121,221	100	Php111,200	100	Php10,021	9

Consolidated Operating Expenses

Our consolidated operating expenses in 2004 decreased by Php5,139 million, or 7%, to Php72,682 million from Php77,821 million in 2003. The decrease was primarily due to lower operating expenses associated with our wireless and fixed line businesses, partially offset by an increase in operating expenses associated with our information and communications technology business. As a percentage of our consolidated operating revenues, consolidated operating expenses decreased to 60% in 2004 from 70% in 2003.

The following table shows the breakdown of our consolidated operating expenses for the years ended December 31, 2004 and 2003 by business segment:

	Years Ended December 31,					
					Increase/(Decrease)	
	2004	**%**	**2003**	**%**	**Amount**	**%**
			(in millions)			
Wireless	Php42,769	59	Php46,264	59	(Php3,495)	(8)
Fixed line	31,909	44	32,303	42	(394)	(1)
Information and communications technology	3,035	4	2,272	3	763	34
Inter-segment expenses	(5,031)	(7)	(3,018)	(4)	(2,013)	67
Total	Php72,682	100	Php77,821	100	(Php5,139)	(7)

Consolidated Operating Income

Our consolidated operating income in 2004 was Php48,539 million, an increase of Php15,160 million, or 45%, compared to Php33,379 million in 2003 as a result of an increase in our consolidated operating revenues, complemented by a decrease in our consolidated operating expenses.

Consolidated Financing Costs

Financing costs on a consolidated basis decreased by Php7,686 million, or 31%, to Php17,097 million primarily due to lower foreign exchange losses pertaining to the foreign exchange revaluation of the carrying values of financial liabilities because the level of peso depreciation was lower in 2004 as compared to 2003 and also because of lower foreign denominated debt balances in 2004 compared to 2003 and lower interest expense and related items owing to lower debt balances in 2004 compared with 2003.

Consolidated Interest Income

Interest income on a consolidated basis increased by Php429 million, or 84%, to Php942 million in 2004 from Php513 million in 2003 mainly attributable to higher average cash balances.

Consolidated Other Income - Net

Other income on a consolidated basis totaled Php2,530 million in 2004, an increase of Php1,731 million, or 217%, compared to Php799 million in 2003. The increase was mainly due to a gain on a debt exchange restructuring transaction conducted by Smart in 2004 pertaining to the wireless business. There was no similar gain of the same nature in 2003. For further details, see Item 5. Operating and Financial Review and Prospects Other Information Piltel Debt Exchange Transaction and *Note 12 Interest bearing Financial Liabilities Term Loans US$283 Million Term Loan Facility, or Debt Exchange Facility* to the accompanying consolidated financial statements in Item 18.

Consolidated Income Before Income Tax, Cumulative Effect of Change in Accounting Policy and Minority Interest in Net Loss (Income) of Consolidated Subsidiaries

Our income before income tax, cumulative effect of change in accounting policy and minority interest in net loss (income) of consolidated subsidiaries in 2004 was Php34,840 million, an increase of Php25,020 million, or 255%, from Php9,820 million in 2003.

Provision for (Benefit from) Income Tax

Provision for income tax amounted to Php6,826 million in 2004 compared to a benefit from income tax of Php1,400 million in 2003 due to a tax loss position, as non-tax deductible charges were higher in 2003.

In 2004 and 2003, our effective corporate tax rate on a consolidated basis was 20% and 14%, respectively. Our effective corporate tax rate was lower than the 32% statutory corporate tax rate due to the following: our income was already subjected to a final tax; our income was already subjected to a lower tax rate; and our equity in net income of our subsidiaries, which had already been subjected to tax and was therefore no longer subject to income tax. Our effective tax rate increased in 2004 primarily due to the expiration in May 2004 of the three-year income tax holiday granted to Smart. We currently expect that our effective corporate tax rate will be higher going forward than in previous years due to the expiration of Smart s income tax holiday.

Consolidated Net Income

Our consolidated net income in 2004 was Php28,101 million, an increase of Php17,056 million, or 154%, compared to Php11,045 million in 2003. The following table shows the breakdown of our consolidated net income (loss) for the years ended December 31, 2004 and 2003 by business segment:

	Years Ended December 31,					
					Change	
	2004	**%**	**2003**	**%**	**Amount**	**%**
			(in millions)			
Wireless	Php27,513	98	Php13,275	120	Php14,238	107
Fixed line	1,287	5	(1,902)	(17)	3,189	168
Information and communications technology	(699)	(3)	(328)	(3)	(371)	(113)
Total	Php28,101	100	Php11,045	100	Php17,056	154

On Business Segment Basis

Wireless

Operating Revenues

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

The following table summarizes our total operating service and non-service revenues from our wireless business for the years ended December 31, 2004 and 2003 by service segment:

	Years Ended December 31,					
					Increase (Decrease)	
	2004	**%**	**2003**	**%**	**Amount**	**%**
			(in millions)			
Wireless services:						
Service Revenues						
Cellular	Php67,030	89	Php52,932	81	Php14,098	27
Satellite, VSAT and others	2,020	3	1,703	3	317	19
	69,050	92	54,635	84	14,415	26
Non-service Revenues						
Sale of handsets and SIM-packs	6,111	8	10,548	16	(4,437)	(42)
Total Wireless Operating Revenues	Php75,161	100	Php65,183	100	Php9,978	15

Service Revenues

Our wireless service revenues increased by Php14,415 million, or 26%, to Php69,050 million in 2004 compared to Php54,635 million in 2003 mainly as a result of the continued growth of Smart s and Piltel s subscriber base. Accordingly, as a percentage of our total wireless operating revenues, wireless service revenues increased to 92% in 2004 from 84% in 2003.

Cellular Service

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

Our cellular service revenues consist of:

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

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

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

- other charges, including those for reconnection and migration.

Our cellular service revenues in 2004 amounted to Php67,030 million, an increase of Php14,098 million, or 27%, from Php52,932 million in 2003. Cellular service revenues accounted for 89% and 81% of our total wireless operating revenues in 2004 and 2003, respectively. The increase in cellular service revenues was primarily due to the continued growth of Smart s and Piltel s subscriber base. As at December 31, 2004, the combined cellular subscribers of Smart and Piltel reached 19,208,232, an increase of 6,261,035, or 48%, over their combined cellular subscriber base of 12,947,197 as at December 31, 2003. Prepaid and postpaid net subscriber activations totaled 6,235,518 and 25,517, respectively, in 2004, or a quarterly average addition of 1,558,880 prepaid and 6,379 postpaid subscribers.

The table below shows our cellular subscribers base as at December 31, 2004 and 2003:

	As at December 31,			
			Increase	
	2004	2003	Amount	%
Cellular subscriber base	19,208,232	12,947,197	6,261,035	48
Prepaid	18,933,738	12,698,220	6,235,518	49
Smart	14,321,288	9,831,135	4,490,153	46

Piltel	4,612,450	2,867,085	1,745,365	61
Postpaid	274,494	248,977	25,517	10

Of our 19,208,232 subscribers as at December 31, 2004, prepaid subscribers accounted for approximately 99% while postpaid subscribers accounted for the remaining 1%. Our cellular prepaid subscriber base grew by 49% to 18,933,738 as at December 31, 2004 from 12,698,220 as at December 31, 2003, whereas our postpaid subscriber base increased by 10% to 274,494 as at December 31, 2004 from 248,977 as at December 31, 2003. Smart s prepaid and postpaid net subscriber activations totaled 4,490,153 and 25,517, respectively, in 2004, or a quarterly average addition of 1,122,538 prepaid and 6,379 postpaid subscribers. On the other hand, Piltel s prepaid subscribers increased by 61% to 4,612,450 as at December 31, 2004 from 2,867,085 as at December 31, 2003, or a quarterly average addition of 436,341 subscribers.

Our quarterly net subscriber activations (reductions) over the last eight quarters are as follows:

	Prepaid		**Postpaid**	**Total**
	Smart	**Piltel**	**Smart**	
2004				
First Quarter	1,162,301	218,038	16,866	1,397,205
Second Quarter	1,207,542	468,772	7,691	1,684,005
Third Quarter	797,686	635,978	10,445	1,444,109
Fourth Quarter	1,322,624	422,577	(9,485)	1,735,716
2003				
First Quarter	527,158	205,086	36,963	769,207
Second Quarter	744,251	241,630	9,331	995,212
Third Quarter	858,723	319,528	8,816	1,187,067
Fourth Quarter	1,051,965	327,221	17,219	1,396,405

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. Gross service revenues from these services for 2004 amounted to Php2,020 million, an increase of Php317 million, or 19%, from Php1,703 million in 2003.

Non-service Revenues

Our wireless non-service revenues consist of:

- Proceeds from sale of cellular handsets; and
- Proceeds from sale of cellular SIM-packs.

Our wireless non-service revenues decreased by Php4,437 million, or 42%, to Php6,111 million in 2004 as compared to Php10,548 million in 2003 mainly attributable to lower handset sales due to the fact that activations in 2004 were primarily driven by more SIM-pack sales and SIM-swap activities.

Operating Expenses

Operating expenses associated with our wireless business in 2004 amounted to Php42,769 million, a decrease of Php3,495 million, or 8%, from Php46,264 million in 2003. A significant portion of this decrease was mainly attributable to decreases in costs of cellular handsets and SIM-packs sold and depreciation and amortization, partially offset by higher rent and selling and promotion expenses. As a percentage of our total wireless operating revenues, operating expenses associated with our wireless business decreased to 57% in 2004 from 71% in 2003.

Cellular business expenses accounted for 93% while satellite, VSAT and other business expenses accounted for 7% of our wireless business expenses in 2004, compared to 94% and 6%, respectively, in 2003.

The following table summarizes our wireless-related expenses for the years ended December 31, 2004 and 2003 and the percentage of each expense item to the total:

	Years Ended December 31,					
					Increase (Decrease)	
	2004	**%**	**2003**	**%**	**Amount**	**%**
			(in millions)			
(in millions)						
Wireless services						
Costs of cellular handsets and SIM-packs sold	Php10,599	25	Php15,790	34	(Php5,191)	(33)
Depreciation and amortization	10,085	24	12,183	26	(2,098)	(17)
Selling and promotions	4,320	10	3,310	7	1,010	31
Rent	4,160	10	2,235	5	1,925	86

Compensation and benefits(1)	3,205	8	3,801	8	(596)	(16)
Maintenance	2,616	6	2,051	4	565	28
Cost of satellite air time	1,299	3	1,919	4	(620)	(32)
Taxes and licenses	1,222	3	1,174	3	48	4
Professional and other service fees	1,012	2	624	1	388	62
Insurance and securities						