PHILIPPINE LONG DISTANCE TELEPHONE CO
Form 6-K
November 05, 2002

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

For the Nine Months Ended September 30, 2002

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

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

The financial information appearing in this report and in the accompanying financial statements is stated in Philippine pesos. All references to pesos, Philippine pesos or Php are to the lawful currency of the Philippines; all references to U.S. dollars, US$ or dollars are to the lawful currency of the United States; and all references to Japanese yen, JP¥ or ¥ are to the lawful currency of Japan. Translations of Philippine peso amounts into U.S. dollars in this report and in the accompanying financial statements were made based on the exchange rate of Php52.41 = US$1.00, the volume weighted average exchange rate at September 30, 2002 quoted through the Philippine Dealing System.

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

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

On June 4, 2001, Pilipino Telephone Corporation, or Piltel, completed the restructuring of approximately Php41.1 billion of indebtedness and other claims, representing approximately 98% of its total liabilities as of that date. Under the terms of Piltel's debt restructuring plan, PLDT is not permitted to demand or receive any payment, redemption or distribution in respect of any present or future liability owed by Piltel to PLDT or any affiliate until all amounts owed to participating creditors have been paid or discharged, except for payments due in respect of transactions having arm's-length terms. These severe long-term restrictions significantly impair the ability of Piltel to transfer funds to PLDT. In addition, PLDT is subject to contractual restrictions on the amount of financial support it can provide to Piltel under the PLDT letter of support issued in connection with Piltel s debt restructuring. On June 27, 2001, PLDT transferred 208 million common shares of Piltel, representing approximately 12.3% of Piltel's outstanding common shares, to financial advisors of Piltel to settle part of their fees in connection with the debt restructuring. As a result, our ownership of Piltel's outstanding common stock decreased from 57.6% to approximately 45.3%. Piltel ceased to be treated as a consolidated subsidiary effective June 27, 2001. Accordingly, Piltel's financial position and results of operations are excluded from our consolidated balance sheets as of September 30, 2002 (unaudited) and December 31, 2001(audited) and unaudited consolidated statements of income, changes in stockholders equity and cash flows for the nine months ended September 30, 2002. Our unaudited consolidated statements of income, changes in stockholders equity and cash flows for the nine months ended September 30, 2001 only include proportionately Piltel's results of operations up to June 27, 2001. For a more detailed discussion of the Piltel debt restructuring and the accounting treatment of Piltel, see Notes 2 and 7 to the accompanying financial statements.

Financial Highlights

(in million pesos, except where otherwise indicated)	September 30, 2002	December 31, 2001
	(unaudited)	(audited)
Consolidated Balance Sheets		
Total assets	305,040.5	307,622.3
Property, plant and equipment - net	252,201.5	256,477.0
Total debt	171,052.6	175,358.7
Total stockholders equity	91,765.3	88,627.6
Debt to equity ratio	1.86x	1.98x
	Nine Months Ended September 30,	
	2002	**2001**
	(unaudited)	
Consolidated Statements of Income		
Operating revenues	58,929.2	53,583.7
Operating expenses	43,975.6	41,242.8
Net operating income	14,953.6	12,340.9
EBIT(1)	16,292.7	13,022.4
EBITDA(2)	34,156.7	29,421.0
Net income	4,156.2	2,381.8
Operating margin	25.4%	23.0%
EBITDA margin	58.0%	54.9%
Consolidated Statements of Cash Flows		
Net cash provided by operating activities	40,418.6	25,905.0
Net cash used in investing activities	11,830.9	20,867.8
Capital expenditures	11,107.9	19,650.6
Net cash used in financing activities	25,500.5	10,270.3

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(1) EBIT is defined as earnings before minority interest in net earnings (losses) of consolidated subsidiaries, adding back interest expense and related items and taxes. EBIT should not be considered in isolation or as a substitute for operating income, net income, cash flows from operating activities and other income or cash flow statement data prepared in accordance with generally accepted accounting principles, or as a measure of profitability or liquidity.

(2) EBITDA is defined as earnings before minority interest in net earnings (losses) of consolidated subsidiaries, adding back interest expense and related items, taxes, depreciation and amortization and is presented because it is generally accepted as providing useful information regarding a company's ability to service and/or incur debt. EBITDA should not be considered in isolation or as a substitute for operating income, net income, cash flows from operating activities and other income or cash flow statement data prepared in accordance with generally accepted

accounting principles, or as a measure of profitability or liquidity.

EBIT and EBITDA on a consolidated basis for the nine months ended September 30, 2002 and 2001 are derived as follows:

	Nine Months Ended September 30,	
	2002	**2001**
	(in million pesos)	
Earnings before minority interest in net earnings (losses) of consolidated subsidiaries(a)	4,135.9	676.5
Add: Interest expenses and related items, net of capitalized interest(b)	10,693.2	11,225.1
Provision for income tax(a)	1,463.6	1,120.8
EBIT	16,292.7	13,022.4
Add: Depreciation and amortization(a)	17,864.0	16,398.6
EBITDA	34,156.7	29,421.0

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(a) See Statements of Income of the accompanying financial statements.

(b) See Note 15 to the accompanying financial statements.

Overview

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

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

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

- *Information and Communications Technology* information and communications infrastructure and services for Internet applications, Internet protocol-based solutions and multimedia content delivery provided by PLDT s subsidiary ePLDT, Inc., Internet access services provided by ePLDT s subsidiary Infocom Technologies, Inc., and e-commerce, call centers and IT-related services provided by other subsidiaries and affiliates of ePLDT, as described in Note 7 to the accompanying financial statements.

Results of Operations

The following table shows the contribution by each of our business segments to our consolidated operating revenues, operating expenses and net operating income (loss) for the nine months ended September 30, 2002 and 2001. Most of our revenues are derived from the Philippines. Our revenues derived from outside the Philippines consist primarily of revenues from incoming international calls to the Philippines.

	Nine Months Ended September 30,			
	2002	**%**(1)	**2001**	**%**(1)
	(in million pesos, except percentages)			
Operating Revenues				
Fixed line	33,929.5	57.6	35,846.9	66.9
Wireless	24,376.5	41.4	17,408.6	32.5
Information and communications technology	623.2	1.0	328.2	0.6
	58,929.2	100.0	53,583.7	100.0
Operating Expenses				
Fixed line	23,989.6	40.7	25,039.5	46.7
Wireless	19,044.0	32.3	15,688.8	29.3
Information and communications technology	942.0	1.6	514.5	1.0
	43,975.6	74.6	41,242.8	77.0
Net Operating Income (Loss)				
Fixed line	9,939.9	16.9	10,807.4	20.2
Wireless	5,332.5	9.1	1,719.8	3.2
Information and communications technology	(318.8)	(0.6)	(186.3)	(0.4)
	14,953.6	25.4	12,340.9	23.0

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

Consolidated Operating Revenues

Our consolidated operating revenues for the first nine months of 2002 increased by Php5,345.5 million, or 10.0%, to Php58,929.2 million from Php53,583.7 million for the same period in 2001 largely as a result of the continued strong growth of our wireless business. Smart contributed Php23,722.8 million in revenues for the first nine months of 2002, an increase of 50.7% from the Php15,742.6 million it contributed for the first nine months of 2001. Smart s revenue contribution from its cellular operations accounted for 40.3% of our consolidated operating revenues for the first nine months of 2002, compared to 29.4% for the same period in 2001.

Fixed Line

Our fixed line business provides local exchange service, international and national long distance services, data and other network services, and miscellaneous services. Total revenues from our fixed line business decreased by Php1,917.4 million, or 5.3%, to Php33,929.5 million in the first nine months of 2002 from Php35,846.9 million in the same period in 2001. The decrease was attributable to the general decline in revenues from fixed line business segments, except revenues from data and other network services, and the deconsolidation of Piltel, which contributed Php455.5 million in fixed line revenues in the first half of 2001. As a percentage of our consolidated operating revenues, fixed line revenues also decreased to 57.6% in the first nine months of 2002 from 66.9% in the same period in 2001 brought about by the strong growth of our wireless business.

The following table summarizes our consolidated operating revenues from our fixed line business for the nine months ended September 30, 2002 and 2001 by service segment:

	Nine Months Ended September 30,			
	2002	**%**	**2001**	**%**
	(in million pesos, except percentages)			
Fixed line services:				
Local exchange	15,936.2	47.0	16,428.2	45.8
International long distance	7,804.3	23.0	9,016.1	25.2
National long distance	5,836.8	17.2	6,559.0	18.3
Data and other network	4,125.8	12.2	3,516.9	9.8
Miscellaneous	226.4	0.6	326.7	0.9
Total	33,929.5	100.0	35,846.9	100.0

Local Exchange Service

Our local exchange service revenues consist of:

- flat monthly fees for our billed service;
- installation charges and other one-time fees associated with the establishment of customer service;
- fixed charges paid by other telephone companies, charges retained by PLDT for calls terminating to cellular subscribers within the local area, and local access charges paid by cellular operators for calls by cellular subscribers that terminate to our local exchange network;
- proceeds from sales of prepaid call cards (gross of commissions and discounts given to dealers, which are recorded as selling and promotion expenses) and calls from payphones and coin-operated phones; and
- charges for special features, including bundled value-added services such as *call waiting*, *call forwarding*, *3-party conference calling* and *Caller ID*.

The following table summarizes key measures of our local exchange service business segment as of and for the nine months ended September 30, 2002 and 2001:

	Nine Months Ended September 30,	
	2002	**2001**
Consolidated local exchange revenues (in million pesos)	15,936.2	16,428.2
Number of fixed lines in service		
PLDT Group	2,153,798	2,098,536
PLDT(1)	2,128,396	2,078,865
Number of PLDT employees	12,584	12,940
Number of PLDT fixed lines in service per PLDT employee	169	161

(1) Approximately 88% and 96% were postpaid fixed line subscribers as of September 30, 2002 and 2001, respectively.

Revenues from our local exchange service for the first nine months of 2002 decreased by Php492.0 million, or 3.0%, to Php15,936.2 million from Php16,428.2 million for the same period in 2001. The decrease was mainly due to the effects of the deconsolidation of Piltel, which contributed local exchange revenues of Php300.8 in the first six months of 2001, and a shift in subscriber preference from postpaid to prepaid services that generate lower average revenue per subscriber. Partially offsetting these two factors were the combined effects of a slight increase in our monthly local service rates resulting from currency-related rate adjustments and an increase in subscription to our bundled value-added services. As a percentage of our total fixed line revenues, local exchange service revenues increased to 47.0% in the first nine months of 2002 from 45.8% in the same period in 2001.

Gross additions to PLDT's fixed lines in service in the first nine months of 2002 totaled 405,703, which was 15.3% higher than the 351,887 gross additions for the same period in 2001. On a net basis, PLDT s fixed line additions in the first nine months of 2002 totaled 53,287, which was 67.3% lower compared to the net additions of 162,880 in the first nine months of 2001. While fixed line additions totaled 114,699 for our prepaid fixed line services, particularly *Teletipid* and *Telesulit*, postpaid fixed lines declined by 61,412 in the first nine months of 2002.

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

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

As of September 30, 2002, PLDT s active prepaid fixed line subscribers totaled 259,201, of which 129,801 were *Teletipid* subscribers and 129,400 were *Telesulit* subscribers. Approximately 70% of *Teletipid* subscribers were new subscribers and the remaining 30% were migrated subscribers from PLDT s postpaid fixed line service instead of being disconnected from the service for non-payment of bills, while approximately 59% of *Telesulit* subscribers were new subscribers and the remaining 41% were previously postpaid fixed line subscribers. As of September 30, 2002, prepaid fixed line subscribers represented approximately 12% of PLDT s total fixed lines in service.

A prepaid fixed line subscriber is recognized as a subscriber when that subscriber activates and uses a prepaid call card. Prepaid fixed line subscribers can reload their accounts by purchasing call cards that are sold in denominations of Php300 in the case of *Teletipid* and Php500 in the case of *Telesulit*. Reloads are valid for two months. A prepaid fixed line subscriber is disconnected if that subscriber does not reload within four months for *Teletipid* and within one month for *Telesulit* after the expiry of the last reload. Revenues from the sale of prepaid cards are recognized when sold to dealers or directly to consumers through PLDT's business offices. All sales of prepaid *Teletipid* and *Telesulit* cards, whether through dealers or through PLDT's business offices, are on a non-refundable basis.

Pursuant to a currency exchange rate adjustment mechanism authorized by the Philippine National Telecommunications Commission, or the NTC, we increase or decrease our monthly local service rates by 1% for every Php0.10 change in the peso-to-dollar exchange rate relative to a base rate of Php11.00 = US$1.00. We increase our local exchange service rates after giving 15 days' prior notice to the NTC following a depreciation of the peso; conversely, we decrease our local exchange service rates immediately following an appreciation of the peso. Under this mechanism, we implemented six downward adjustments and seven upward adjustments in our monthly local service rates during the first nine months of 2002, compared to eight upward adjustments and four downward adjustments during the same period in 2001. The average peso-to-dollar rate in the first nine months of 2002 was Php51.134 = US$1.00, compared to the average of Php50.781 = US$1.00 in the first nine months of 2001. This change in the average peso-to-dollar rate corresponded to a peso depreciation of 0.7%, which resulted in a 0.6% average net increase in our monthly local service rates, thus contributing to the increase in our local exchange revenues.

To attract new fixed line subscribers and retain existing ones, PLDT has introduced additional value-added products and services such as *Caller ID* and *tXt 135*. *Caller ID* allows subscribers to identify callers by telephone number, and it is now bundled at special rates with other value-added phone services, such as *call waiting*, *call forwarding*, *3-party conference calling* and *speed calling*. *tXt 135* allows one-way text messaging from PLDT fixed lines to Smart and Piltel GSM handsets and is capable of international text messaging. PLDT intends to launch a full two-way text messaging service in 2003.

The ratio of PLDT fixed lines in service per PLDT employee improved from 161 at September 30, 2001 to 169 at September 30, 2002 due to the increase in PLDT's fixed lines in service and the reduction of PLDT's workforce. During the 12 months ended September 30, 2002, PLDT's workforce was reduced by 356 employees, or 2.8%, mainly as a result of PLDT s ongoing manpower reduction program.

International Long Distance Service

International long distance revenues generated through our international gateway facilities consist of:

- inbound call revenues representing settlements from foreign telecommunications carriers for inbound international calls;

- access charges paid to us by other Philippine telecommunications carriers for terminating inbound international calls to our local exchange network; and

- outbound call revenues representing amounts billed to our customers (other than our cellular customers) for outbound international calls, net of amounts payable to foreign telecommunications carriers for terminating calls in their territories.

The following table shows information about our international long distance business for the nine months ended September 30, 2002 and 2001:

	Nine Months Ended September 30,	
	2002	**2001**
Consolidated international long distance revenues (in million pesos)	7,804.3	9,016.1
Inbound	6,158.0	7,105.8
Outbound	1,646.3	1,910.3
International call volumes (in million minutes)		