



# CIRCULAR FOR BROKERS NO. 4721-2004

## The Philippine Stock Exchange, Inc.

<input checked="checked" type="checkbox"/> Disclosures	<input type="checkbox"/> Stockholders' Meeting	Others: _____
<input type="checkbox"/> Dividend Notice	<input type="checkbox"/> SEC / Gov't Issuance	_____
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Date : **October 27, 2004**  
Company : **MANILA ELECTRIC COMPANY**

Manila Electric Company ("MER" or the "Company") furnished the Exchange a copy of the Parent Company's 3<sup>rd</sup> Quarter results as submitted to the Securities and Exchange Commission.

Attached is a copy of the said report for your reference.

*(Original Signed)*  
**MA. PAMELA D. QUIZON-LABAYEN**  
*Head, Disclosure Department*

**Noted By:**

*(Original Signed)*  
**JURISITA M. QUINTOS**  
*Senior Vice President*

Finance / Admin / Membership	Compliance & Surveillance Grp.	Listing & Disclosures Grp.	COO / Automated Trading Grp.	Business Dev't & Info. Group	CEO / Legal
Tel. No.688-7560/7440/7460	Tel. No. 688-7559	Tel. No. 688-7501/7510	Tel. No. 688-7405/819-4400	Tel. No. 688-7590	Tel. No. 688-7400/819-4408

# 3rd Quarter Report

## I. ENERGY SALES

After registering an energy sales growth of 3.8% in the first half of 2004, sales continued to rise at the same pace of 3.8% in the third quarter, reaching a total kilowatt-hour sales volume of 6,392 GWh.

The sales growth in the third quarter was spurred by the 5.7% sales jump in the month of September, after an expansion of 2.9% and 3.0% in the month of July and August, respectively.

The commercial segment continued to lead the growth in energy sales in the third quarter, rising to 2,276 GWh or by 5.6% from the same period last year.

Commercial sales was driven by the retail trade and business services segments which grew by 59.0% and 17.8%, respectively, in the period.

Increased commercial operations of malls energized earlier this year such as Market ! Market ! by Ayala Land, Inc. and The Gateway by Robinson's Land Corporation heightened electricity demand for the period.

Furthermore, the opening of other malls before the end of 2004, namely SM Batangas and Araneta Center Gateway, is expected to provide a boost to commercial sales, especially during the Christmas season when mall hours are extended.

Sales to the residential segment grew to 2,230 GWh or by 1.7%. Cooler temperatures and increased inflationary pressures on basic commodities in the third quarter this year compared to the same period last year contributed to the reduction in electricity demand of the residential segment.

Sales to the industrial sector, despite declining in the number of services, became more buoyant in the third quarter as its sales grew to 1,852 GWh or by 4.3%.

The said quarter on quarter growth was the highest against quarter on quarter growths in the last three quarters of 2004 (1.0% in the first quarter and 3.5% in the second quarter this year). Strong industrial sales in the period was driven by electrical machinery and food segments which grew by 15.9% and 7.7%, respectively.

## II. REVENUES AND PROFITABILITY

Due to continued sales expansion, overall revenue growth for the third quarter 2004 was at 10.3% from P33.1 billion of the same period last year to P36.5 billion.

Likewise, distribution revenues rose by 10.7% to P6.2 billion this quarter from P 5.6 billion in the same period last year.

Total operating expenses, on the other hand, rose by 10.4% primarily due to the 10.2% rise in purchased power cost and 130.9% increase in taxes other than income tax.

A 15.3% increase in depreciation and amortization also contributed to the increase in the total operating expenses.

As a result, operating income still surged 8.3%, from P2.2 billion in 2003 to P2.3 billion in 2004.

With this, return-on-rate base (RORB) for the 12 months ending September improved to 4.16% from (2.05%) in the same period ending September 2003.

Other income (expenses) for the quarter, on the other hand, went down by 14.1% mainly due to the significant decrease in interest and other financial charges by about 20.7% as a consequence of limited borrowings and payment of loan amortizations and decrease in provision for disallowed recoveries by 58.1%.

This quarter, a 5.0% decrease in equity in net earnings of investees from P168.5 million in 2003 to P160.1 million in 2004 had a slight negative impact to the company's bottom line.

The company concluded the third quarter of 2004 with a 44.9% year-on-year increase in net income with P831.8 million realized this year as against P574.0 million in the same period in 2003.

Earnings per common share (excluding depreciation on appraisal increase) for the period under review was up by 27.6%, from P0.76 in 2003 to P 0.97 in 2004.

## III. CONTINGENCIES

The company has contingent liabilities. These include a pending case under the Court of Appeals where certain consumers questioned the ERC decision in Case Nos. 2001-646 and 2001-900 wherein the company was granted an increase of P0.0865. The Court of Appeals rendered a decision unfavorable to the company. Meralco has filed a Motion for Reconsideration of the Court of Appeals decision. The Motion for Reconsideration remains pending to date. The effect of an adverse decision will result to a reversal of revenues estimated at a minimum of P2.65 billion as of September 2004.

## IV. AVERAGE RETAIL RATE

Sales growth in the third quarter was also spurred by the decline in Meralco's average retail rate to P 5.86 per kWh from P 5.94 per kWh in the same period last year.

The reduction was largely brought about by the decrease in the transmission charge as a result of the reduced TransCo rate due to TransCo's intra-regional grid cross subsidy removal of approximately six centavos starting October 2003.

Average retail rates will, however, be further adjusted in the fourth quarter as a result of a number of issuances by the ERC to reflect the true cost of power in tariffs to end-users namely:

- A provisional authority to NPC to increase its rates by an average of P0.98 per kWh nationwide, P1.23 for NPC's Luzon Grid customers (including Meralco) and P0.22 and P0.27 for the Visayas and Mindanao Grids, respectively, effective September 26, 2004.

Since Meralco sources a portion of its power requirements from IPPs, the effect of the recent NPC rate adjustment and other prior adjustments on Meralco customers is estimated to be about P0.80 per kWh.

- Guidelines to allow distribution utilities to adjust their generation rates and system loss charges on a monthly basis, without seeking prior approval from the Commission.

This mechanism is intended to replace the Generation Rate Adjustment Mechanism (GRAM). Under the new guidelines, Meralco will be able to immediately reflect monthly changes in its purchased power costs through the "Generation Charge" and "System Loss Charge" components of the unbundled bill.

At the same time, end-users will be able to receive timely price signals on the actual cost of generating electricity.

- Order for Meralco to begin implementing a two-step phase-out of the "Inter-Class Subsidy" component of its tariffs. This component of the bill identifies whether an end-user is a recipient or a provider of subsidies of the bill.

Under the unbundled tariffs approved by the ERC, residential end-users receive a subsidy of about 71-centavos per kWh, which is in turn

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shouldered by commercial and industrial establishments.

Under the ERC Order, inter-class subsidies would be reduced by 40 percent this October 2004 and totally phased out by October 2005.

The ERC is also working on two areas to promote lower electricity rates in the medium term.

- First is the resolution setting a timetable for the introduction of open access and retail competition as envisioned by the EPIRA. For the Luzon Grid where Meralco operates, the target date for retail competition is July 2006. Target dates for the other grids will be determined by the ERC at a later time.

- Second is the conduct of regulatory proceedings on power supply related contracts of Meralco with generators.

Hearings are ongoing on NPC's and Meralco's joint application for the approval of a Settlement Agreement on their 10-year Contract for the Supply of Electricity.

Under the Settlement Agreement dated July 15, 2003, Meralco would pay NPC a net settlement amount of about P20 billion and NPC would commit to the dispatch of Meralco's IPPs at contract levels, resulting to a net reduction in costs to consumers. Hearings are also being conducted on the proposed amendments to the contracts with the First Gas plants.

## V. SYSTEM LOSS

Unrecoverable purchased power for the third quarter ended September 30, 2004 deteriorated to 11.23 percent, higher than the rate of 11.00 percent for the same period last year.

The higher system loss resulted to a corresponding peso-value loss for the quarter of P539.9 million, which could have been higher if not for the TransCo cross subsidy removal. The peso value loss for the same period in 2003 last year reached P 414.4 million.

## VI. CAPITAL EXPENDITURES

Capital expenditures for the quarter decreased by 22.6% from P1.7 billion in 2003 to P1.3 billion in 2004. A total of 99.6 % of capital expenditures in the third quarter of 2004 was attributed to the electric system and a minimal 0.4% was used for non-electric related capital expenditures.

## VII. QUALITY OF SERVICE

Even with the decrease in capital expenditure for the quarter, system reliability in terms of interruption frequency rate (IFR) and system availability as measured by cumulative interruption time (CIT) continued to reach record levels of 3.41 times (4.09 times in 3Qtr 2003) and 3.06 hours (4.39 hours in the third quarter of 2003), respectively.

The high level of quality of service was mainly due to the company's continued intensive electric system maintenance campaign.

## HIGHLIGHTS OF THE QUARTER

- The Energy Regulatory Commission (ERC) approved on Aug. 20, 2004 a P0.1737/kWh adjustment in the generation charge effective the September billing cycle, bringing the generation charge cost from P3.3213/kWh to P3.4950/kWh in customers' September bills. The adjustment was not a Meralco increase.

- Meralco on Sept. 3 submitted its proposed guidelines and procedures for Phase IV of the refund to the ERC, covering commercial and industrial customers including other non-residential and general service customers.

  
**MANUEL M. LOPEZ**  
Chairman & CEO

  
**JESUS P. FRANCISCO**  
President & COO

## Comparison of Kilowatthour Sales

For the quarters ended September 30, 2004 and 2003  
(In million kWh)

Customer Class	2004	2003	%Change
RESIDENTIAL	2,229.74	2,192.82	1.7
COMMERCIAL	2,275.71	2,155.11	5.6
INDUSTRIAL	1,852.04	1,775.61	4.3
STREETLIGHTS	34.46	33.46	3.0
<b>TOTAL</b>	<b>6,391.95</b>	<b>6,157.00</b>	<b>3.8</b>

## Comparison of Kilowatthour Sales

For the nine months ended September 30, 2004 and 2003  
(In million kWh)

Customer Class	2004	2003	%Change
RESIDENTIAL	6,599.32	6,395.50	3.2
COMMERCIAL	6,502.69	6,181.19	5.2
INDUSTRIAL	5,212.91	5,060.25	3.0
STREETLIGHTS	103.59	106.87	(3.1)
<b>TOTAL</b>	<b>18,418.51</b>	<b>17,743.81</b>	<b>3.8</b>

The foregoing unaudited Balance Sheet of Manila Electric Company as of September 30, 2004 and the related Statements of Income and Retained Earnings (Deficit) for the nine months ended, should be read in conjunction with the 2003 Annual Report. In the opinion of Management, all adjustments necessary for a fair presentation of the financial position and the results of operations of the Company have been duly effected in the preparation of these statements.

The aforementioned financial statements present fairly the financial position of Manila Electric Company as of September 30, 2004, and the results of its operations for the nine months ended, in conformity with generally accepted accounting principles consistently applied. They are not, however, necessarily indicative of the results which may be expected for the whole year 2004 because of seasonal factors affecting the operations of the Company.



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## **Comparative Statements of Income**

For the quarters ended September 30, 2004 and 2003  
(In thousand pesos)

	2004	2003	%Change
<b>OPERATING REVENUES</b>	<b>36,535,248</b>	<b>33,131,190</b>	<b>10.3</b>
<b>OPERATING EXPENSES</b>			
Purchased power	30,365,322	27,559,223	10.2
Operations & maintenance	2,520,952	2,361,146	6.8
Depreciation & amortization	1,103,882	957,570	15.3
Taxes other than income tax	196,530	85,100	130.9
Total operating expenses	<b>34,186,686</b>	<b>30,963,039</b>	<b>10.4</b>
<b>OPERATING INCOME</b>	<b>2,348,562</b>	<b>2,168,151</b>	<b>8.3</b>
<b>OTHER INCOME (EXPENSES)</b>			
Interest & other financial charges-net	(659,600)	(831,531)	(20.7)
Unrecoverable purchased power-system loss	(539,856)	(414,410)	30.3
Provision for disallowed recoveries	(108,959)	(259,970)	(58.1)
Equity in net earnings of investee companies	160,102	168,556	(5.0)
Total other income (expenses)	<b>(1,148,313)</b>	<b>(1,337,355)</b>	<b>(14.1)</b>
<b>INCOME BEFORE INCOME TAX</b>	<b>1,200,249</b>	<b>830,796</b>	<b>44.5</b>
<b>PROVISION FOR INCOME TAX</b>	<b>368,409</b>	<b>256,778</b>	<b>43.5</b>
<b>NET INCOME</b>	<b>831,840</b>	<b>574,018</b>	<b>44.9</b>

## **Comparative Balance Sheets**

As of September 30, 2004 and 2003 (In thousand pesos)

<b>ASSETS AND OTHER DEBITS</b>			
	2004	2003	%Change
<b>UTILITY PLANT AND OTHERS - net</b>	<b>85,711,393</b>	<b>82,863,837</b>	<b>3.4</b>
<b>CONSTRUCTION IN PROGRESS</b>	<b>5,893,917</b>	<b>10,108,077</b>	<b>(41.7)</b>
<b>INVESTMENTS AND ADVANCES</b>	<b>4,253,449</b>	<b>3,805,001</b>	<b>11.8</b>
<b>CURRENT ASSETS</b>			
Cash & cash investments	5,422,375	6,718,989	(19.3)
Receivables - net	20,810,100	19,515,171	6.6
Inventories	1,131,247	989,711	14.3
Deferred income tax asset	1,326,291	1,631,171	(18.7)
Other current assets	391,630	1,461,348	(73.2)
Total current assets	<b>29,081,643</b>	<b>30,316,390</b>	<b>(4.1)</b>
<b>DEFERRED DEBITS AND OTHER ASSETS</b>	<b>23,325,411</b>	<b>21,621,155</b>	<b>7.9</b>
<b>TOTAL ASSETS AND OTHER DEBITS</b>	<b>148,265,813</b>	<b>148,714,460</b>	<b>(0.3)</b>

## **Comparative Statements of Income**

For the nine months ended September 30, 2004 and 2003  
(In thousand pesos)

	2004	2003	%Change
<b>OPERATING REVENUES</b>	<b>104,941,723</b>	<b>98,553,200</b>	<b>6.5</b>
<b>OPERATING EXPENSES</b>			
Purchased power	86,467,523	82,011,140	5.4
Operations & maintenance	7,385,080	6,782,844	8.9
Depreciation & amortization	3,513,433	3,214,328	9.3
Taxes other than income tax	493,190	1,444,762	(65.9)
Total operating expenses	<b>97,859,226</b>	<b>93,453,074</b>	<b>4.7</b>
<b>OPERATING INCOME</b>	<b>7,082,497</b>	<b>5,100,126</b>	<b>38.9</b>
<b>OTHER INCOME (EXPENSES)</b>			
Interest & other financial charges-net	(1,720,085)	(2,369,830)	(27.4)
Unrecoverable purchased power-system loss	(2,228,402)	(1,617,312)	37.8
Provision for disallowed recoveries	(328,480)	(570,181)	(42.4)
Equity in net earnings of investee companies	441,509	369,334	19.5
Total other income (expenses)	<b>(3,835,458)</b>	<b>(4,187,989)</b>	<b>(8.4)</b>
<b>INCOME BEFORE INCOME TAX</b>	<b>3,247,039</b>	<b>912,137</b>	<b>256.0</b>
<b>PROVISION FOR INCOME TAX</b>	<b>998,947</b>	<b>272,027</b>	<b>267.2</b>
<b>NET INCOME</b>	<b>2,248,092</b>	<b>640,110</b>	<b>251.2</b>

<b>LIABILITIES AND OTHER CREDITS</b>			
	2004	2003	%Change
<b>PROPRIETARY CAPITAL</b>	<b>49,155,039</b>	<b>44,590,918</b>	<b>10.2</b>
<b>LONG-TERM DEBT - Net of Current Portion</b>	<b>9,721,422</b>	<b>17,343,297</b>	<b>(43.9)</b>
<b>CURRENT LIABILITIES</b>			
Current portion of long-term debt	9,240,193	7,237,517	27.7
Notes payable	4,841,715	5,245,497	(7.7)
Accounts payable & accrued expenses	19,643,850	14,861,920	32.2
Income tax payable	2,142,992	885,032	142.1
Customers' refund - current	3,269,106	5,000,959	(34.6)
Other current liabilities	1,931,179	2,381,521	(18.9)
Total current liabilities	<b>41,069,035</b>	<b>35,612,446</b>	<b>15.3</b>
<b>DEFERRED INCOME TAX</b>	<b>1,883,349</b>	<b>4,747,819</b>	<b>(60.3)</b>
<b>CUSTOMERS' DEPOSITS</b>	<b>13,643,648</b>	<b>12,899,921</b>	<b>5.8</b>
<b>CUSTOMERS' REFUND-NONCURRENT</b>	<b>18,688,934</b>	<b>23,562,875</b>	<b>(20.7)</b>
<b>DEFERRED PASS-THROUGH FUEL COSTS</b>	<b>8,389,214</b>	<b>6,708,437</b>	<b>25.1</b>
<b>OPERATING RESERVES &amp; OTHERS</b>	<b>5,715,172</b>	<b>3,248,747</b>	<b>75.9</b>
<b>TOTAL LIABILITIES AND OTHER CREDITS</b>	<b>148,265,813</b>	<b>148,714,460</b>	<b>(0.3)</b>

# 3rd Quarter Report

## Comparative Statements of Retained Earnings (Deficit)

For the nine months ended September 30, 2004 and 2003  
(In thousand pesos)

	2004	2003	%Change
<b>BALANCE, BEGINNING</b> (as previously reported)	2,952,200	26,855,104	(89.0)
Reversal of self-insurance	-	408,001	(100.0)
Prior period adjustments arising from customers' refund	-	(28,699,146)	100.0
<b>BALANCE, BEGINNING</b> (as restated)	2,952,200	(1,436,041)	305.6
Add: Net income	2,248,092	640,110	251.2
Realized revaluation surplus	440,443	471,586	(6.6)
<b>TOTAL</b>	<b>5,640,735</b>	<b>(324,345)</b>	<b>1,839.1</b>
<b>DEDUCT: APPROPRIATION</b>			
Appropriated retained earnings, beginning	-	12,600,000	(100.0)
Transfer from/(to) unappropriated retained earnings	200,000	(12,600,000)	101.6
<b>Total Appropriation</b>	<b>200,000</b>	<b>-</b>	<b>100.0</b>
<b>BALANCE</b>	<b>5,440,735</b>	<b>(324,345)</b>	<b>1,777.5</b>
<b>Deduct: Cash Dividends Declared</b>			
Preferred	-	39,620	(100.0)
Common	-	-	-
<b>Total cash dividends declared</b>	<b>-</b>	<b>39,620</b>	<b>(100.0)</b>
Stock dividends declared			
Common	-	-	-
<b>Total dividends declared</b>	<b>-</b>	<b>39,620</b>	<b>(100.0)</b>
<b>BALANCE, ENDING</b>			
<b>UNAPPROPRIATED</b>	<b>5,440,735</b>	<b>(363,965)</b>	<b>1,594.9</b>

## Comparative Cash Flow Statements

For the quarters ended September 30, 2004 and 2003  
(In thousand pesos)

	2004	2003	%Change
<b>CASH BALANCE BEGINNING, June 30</b>	<b>3,674,809</b>	<b>4,799,110</b>	<b>(23.4)</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Operating & other income	2,755,794	1,971,362	39.8
Depreciation & amortization	1,103,882	957,570	15.3
Increase in other assets and liabilities	1,521,978	2,972,422	(48.8)
<b>Net Cash from Operations</b>	<b>5,381,654</b>	<b>5,901,354</b>	<b>(8.8)</b>
Add: Equity issues	393,341	342,993	14.7
Short term borrowings	-	-	0.0
Long term borrowings	-	-	0.0
<b>TOTAL SOURCES OF FUNDS</b>	<b>5,774,995</b>	<b>6,244,347</b>	<b>(7.5)</b>
Less: Short term debt service	-	-	0.0
Long term debt service	413,749	184,511	124.2
Other interest expense	530,417	545,165	(2.7)
<b>Total debt service</b>	<b>944,166</b>	<b>729,676</b>	<b>29.4</b>
Unrecoverable purchased power - System loss	539,856	414,410	30.3
CAPEX	1,282,595	1,658,004	(22.6)
Preferred equity redemptions	162,109	98,487	64.6
Refund to customers - Phases I-III	1,098,703	1,418,661	(22.6)
Dividends	-	5,230	(100.0)
<b>TOTAL USES OF FUNDS</b>	<b>4,027,429</b>	<b>4,324,468</b>	<b>(6.9)</b>
<b>NET INCREASE IN CASH</b>	<b>1,747,566</b>	<b>1,919,879</b>	<b>(9.0)</b>
<b>CASH BALANCE, END - September 30</b>	<b>5,422,375</b>	<b>6,718,989</b>	<b>(19.3)</b>

## Comparative Cash Flow Statements

For the nine months ended September 30, 2004 and 2003  
(In thousand pesos)

	2004	2003	%Change
<b>CASH BALANCE BEGINNING, Jan. 1</b>	<b>5,106,632</b>	<b>6,193,164</b>	<b>(17.5)</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Operating & other income	8,116,526	4,795,883	69.2
Depreciation & amortization	3,513,433	3,214,328	9.3
Increase in other assets and liabilities	4,115,783	6,972,665	(41.0)
<b>Net Cash from Operations</b>	<b>15,745,742</b>	<b>14,982,876</b>	<b>5.1</b>
Add: Equity issues	946,739	562,493	68.3
Short term borrowings	-	-	-
Long term borrowings	88,170	389,267	(77.3)
<b>TOTAL SOURCES OF FUNDS</b>	<b>16,780,651</b>	<b>15,934,636</b>	<b>5.3</b>
Less: Short term debt service	490,105	1,566,560	(68.7)
Long term debt service	4,235,962	3,339,064	26.9
Other interest expense	1,656,806	2,223,893	(25.5)
<b>Total debt service</b>	<b>6,382,873</b>	<b>7,129,517</b>	<b>(10.5)</b>
Unrecoverable purchased power - System loss	2,228,402	1,617,313	37.8
CAPEX	3,872,142	4,766,649	(18.8)
Preferred equity redemptions	362,406	140,300	158.3
Refund to customers - Phases I-III	3,619,085	1,715,412	111.0
Dividends	-	39,620	(100.0)
<b>TOTAL USES OF FUNDS</b>	<b>16,464,908</b>	<b>15,408,811</b>	<b>6.9</b>
<b>NET INCREASE IN CASH</b>	<b>315,743</b>	<b>525,825</b>	<b>(40.0)</b>
<b>CASH BALANCE, END - September 30</b>	<b>5,422,375</b>	<b>6,718,989</b>	<b>(19.3)</b>


**MERALCO**

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Corporate Communication  
October 2004