PORTUGAL TELECOM SGPS SA
Form 6-K
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16 of the
Securities Exchange Act of 1934

For the month of April 2008
Commission File Number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of registrant as specified in its charter)

Av. Fontes Pereira de Melo, 40
1069 - 300 Lisboa, Portugal

(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F x Form 40-F o

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes o No x

Portugal Telecom

Annual report 2007

The terms PT , Portugal Telecom Group , PT Group , Group and Company refer to Portugal Telecom and its subsidiaries or any of them as the context.

Portugal Telecom

Portugal

Wireline Euro 1,962 million (revenues)	• Retail [PT Comunicações 100%] • Large corporates voice and data [PT Corporate 100%] • SMEs voice and data [PT Prime 100%] • ISP and broadband services [PT.COM 100%]
Mobile Euro 1,543 million (revenues)	• TMN 100%

Main international assets

			Revenues (Euro million)
Vivo 31.38%	• Brazil	• Mobile	2,463
Médi Télécom 32.18%	• Morocco	• Mobile	438
Unitel 25% (*)	• Angola	• Mobile	649
CTM 28%	• Macao	• Wireline, mobile, Internet and data	207
MTC 34% (*)	• Namibia	• Mobile	118
CVT 40% (*)	• Cape Verde	• Wireline, mobile, Internet and data	68
CST 51% (*)	• São Tomé e Príncipe	• Wireline, mobile, Internet and data	8
Timor Telecom 41.12%	• East Timor	• Wireline, mobile, Internet and data	23
UOL 29%	• Brazil	• ISP, contents and Internet	197

(*) These stakes are held by Africatel, which is controlled 78% by PT.

Support companies

Systems and IT [PT Sistemas de Informação 100%]; Innovation, research and development [PT Inovação 100%];

Backoffice and shared services [PT PRO 100%]; Procurement [PT Compras 100%];

Call centres and telemarketing services [PT Contact 100%]; Pension funds management [Previsão 82.05%]

Message to Shareholders

Dear Shareholders,

The end of the takeover bid over Portugal Telecom, that had been ongoing for over a year, was a key event of the beginning of 2007. As such, from 2 March 2007, the board of directors, with the full support of the shareholders, initiated the execution of the proposed remuneration package which included the payment of dividends, together with a share buyback programme and the spin-off of PT Multimédia.

At the present time, and considering the dividend proposal on this year s results, we can state that we have achieved, on the expected timing, over 80% of what we had promised without compromising the company s financial position, its investment capacity and, therefore, its future.

The spin-off was the key element for the liberalisation of the telecoms sector in Portugal

PT Multimédia s spin-off was proposed by PT in August 2006 and was not the Result of any regulation or legal imposition. As of November 13 2007, Portugal Telecom ceased to hold any shares in PT Multimedia, a measure that we consider to be beneficial to the telecommunications market in Portugal, since promotes competition.

With the spin-off, we have actively changed the competitive arena in Portugal and were responsible for the most important boost to competition ever witnessed in our market. Currently, in any of the telecoms segments where we operate voice, broadband or TV the two largest operators taken together have a dimension that is comparable to PT, which definitely overcomes the idea that our company holds a dominant market position in Portugal.

Brazil is and will continue to be an important market for Portugal Telecom

Vivo is currently the largest mobile operator in Brazil, and this position was further consolidated during 2007. The mature relationship that we maintain with our partner Telefónica was crucial in increasing the value of our holding and carrying out difficult but essential changes with a view to enhance Vivo s competitiveness. The implementation of GSM, which we delivered in record time, is a good example of this, as it has allowed us to overcome a disadvantage to our competitors. At the present time, over 85% of our new clients are on GSM, and around 34% of the 34.4 million Vivo customers use this technology.

In August 2007, Vivo acquired Telemig, the mobile operator of the state of Minas Gerais, guaranteeing control of more than 4 million customers in the third richest state in Brazil. Also worth highlighting is the acquisition of 1,9 Ghz licenses for the regions of Brazil where Vivo did not yet operate, achieving full national coverage. In addition, Vivo secured 3G coverage for the entirety of its operational area in December, bringing in the means to consolidate its strong competitive position.

As a result of the faultless carrying out of these projects Vivo is today stronger and more competitive than a year ago, with very encouraging growth prospects.

Reinforced investment in Africa with the creation of Africatel and partnership with Helios

We have always stated that the African markets are an important part of our international strategy. In August 2007 we realised this commitment through a partnership with Helios Investment Partners, who have acquired a 22% stake on Africatel, the PT Group company that holds our interests in the sub-saharian region of the continent.

Through this strategic partnership with Helios we intend to continue developing and consolidating our operations in Africa, putting together our holdings and market knowledge to Helios strengths in the region and the financial discipline that such investors bring with them.

Africa is a market experiencing exponential growth, and we will continue to endeavor to translate such growth into value for our shareholders. We will be extremely selective on identifying opportunities for expansion, ensuring that we have an international strategy that truly delivers shareholder value.

Fixed-mobile convergence: structural changes to the business in Portugal

Regarding our operations in Portugal, we have initiated the implementation of a fixed and mobile convergence strategy. We are transforming our organisation in order to face this challenge and taking the necessary steps for the combined management of the business in Portugal. PT Portugal is underway and, in 2007, we started offering our clients integrated fixed-mobile telecommunication solutions.

The decision to launch a television service was also taken and is one of the highlights of 2007. This new area of business, where we are currently investing and will continue to do so in the coming years, is a key element of our strategy for residential customers going forward, a market segment where competition is already very strong and Portugal Telecom sees its commercial operations limited by an asymmetric regulatory framework.

Nevertheless, the commitment of our employees, this company s capacity to innovate and launch new services, its investment capacity, the reach and coverage of our distribution, maintenance and client support networks, lead me to be optimistic towards the future.

We continue to be largest investor in the information society in Portugal

I must also emphasise Portugal Telecom s contribution to the development of our country s information society. This year we have invested nearly 240 million euros in e.initiatives such as e.escolas . We distributed around 68 thousand portable computers with Internet connection to young students, fostering the access to new technologies.

In terms of training and development, I also highlight PT s commitment to the CMU programme in Portugal, which involves an investment of 5 million euros over five years. The retraining of our staff has also been a priority and in 2007, as part of the New Opportunities scheme, 664 of our collaborators saw the skills acquired throughout their professional life certified, giving a positive contribution to the development of the company and the country.

The year 2007 has closed the the takeover bid cycle

The management team which I lead is pleased with the results achieved over the last two years and with the response given by our staff and shareholders to the challenges faced, which demonstrated a clear and continuing support to this team.

PT is a reference and a leader in the development of the information society in Portugal. We have high ambitions for the future, not just in the domestic market, but also abroad. With the superior quality of our human resources, I am certain that we will continue to contribute positively to the development of the countries where we operate and to create value to our shareholders.

Henrique Granadeiro

Chairman and CEO

01 Financial review

Consolidated income statement (1)

Euro million

	2007	2006	Δ 07/06
Operating revenues	6,148.4	5,765.3	6.6%
Wireline	1,843.5	1,953.0	(5.6)%
Domestic mobile • TMN	1,464.6	1,426.2	2.7%
Brazilian mobile • Vivo (1)	2,462.9	2,104.7	17.0%
Other	377.3	281.4	34.1%
Operating costs, excluding depreciation and amortisation	3,791.7	3,528.3	7.5%
Wages and salaries	638.1	633.5	0.7%
Post retirement benefits	(65.1)	(72.1)	(9.8)%
Direct costs	907.3	724.9	25.2%
Cost of products sold	656.1	580.6	13.0%
Support services	233.6	202.1	15.6%
Marketing and publicity	147.2	138.3	6.5%
Supplies and external services	945.6	928.5	1.8%
Indirect taxes	201.8	175.9	14.7%
Provision and adjustments	127.0	216.6	(41.4)%
EBITDA (2)	2,356.7	2,237.0	5.3%
Depreciation and amortisation	1,123.1	1,130.7	(0.7)%
Income from operations (3)	1,233.6	1,106.3	11.5%
Other expenses (income)	317.9	129.2	146.0%
Curtailment costs, net	275.6	19.0	n.m.
Gains on disposal of fixed assets, net	(2.8)	(5.1)	(45.7)%
Other costs, net	45.1	115.4	(60.9)%
Income before financial results and taxes	915.7	977.1	(6.3)%
Financial expenses (income)	(116.8)	118.4	n.m.
Net interest expenses	197.4	220.1	(10.3)%
Net foreign currency exchange losses/(gains)	12.4	(4.5)	n.m.
Gains on financial assets and other investments, net	(248.8)	(18.3)	n.m.
Equity in earnings of associated companies, net	(126.1)	(130.6)	(3.4)%
Net other financial expenses	48.3	51.8	(6.7)%
Income before income taxes	1,032.5	858.6	20.3%
Provision for income taxes	(243.3)	21.4	n.m.
Income from continuing operations	789.2	880.0	(10.3)%
Net income from discontinued operations	45.5	74.1	(38.7)%
Losses (income) attributable to minority interests	(92.8)	(87.4)	6.3%
Consolidated net income	741.9	866.8	(14.4)%

(1) Considering a Euro/Real average exchange rate of 2.6661 in 2007 and 2.7315 in 2006. (2) EBITDA = operating income + depreciation and amortisation. (3) Operating income = income before financial results and taxes + work force reduction program costs + losses on disposals of fixed assets, net + other costs, net.

Consolidated operating revenues

Consolidated operating revenues increased by 6.6% y.o.y in 2007 to Euro 6,148 million, reflecting the higher contribution from: (1) Vivo (Euro 358 million), due to the positive impact of the change in the interconnection regime (July 2006) as well as customer and ARPU growth; (2) TMN (Euro 38 million) on the back of the 9.8% y.o.y. increase in the number of customers, particularly in postpaid and wireless broadband; and (3) other businesses (Euro 96 million) primarily explained by MTC (Euro 79 million), which has been consolidated since September 2006 only, and the increase in revenues of other fully consolidated subsidiaries. These effects were partially offset by the reduction in the contribution from the wireline business (Euro 109 million), mainly as a result of the impact of continued line loss and pricing pressure on retail revenues, notwithstanding the improvement in wholesale and data and corporate revenues.

Consolidated operating revenues - standalone revenues by segment (1) Euro million

	2007	**2006**	**Δ 07/06**
Wireline	1,962.4	2,071.8	(5.3)%
Domestic mobile • TMN	1,542.9	1,502.4	2.7%
Brazilian mobile • Vivo (1)	2,463.0	2,104.7	17.0%
Other and eliminations	180.1	86.4	108.4%
Total operating revenues	6,148.4	5,765.3	6.6%

(1) Considering a Euro/Real average exchange rate of 2.6661 in 2007 and 2.7315 in 2006.

Consolidated operating costs

Consolidated operating costs amounted to Euro 4,915 million in 2007, an increase of 5.5% y.o.y. On a constant currency basis, operating costs would have increased by 4.2% y.o.y. in 2007.

Consolidated operating costs (1) Euro million

	2007	2006	Δ 07/06	% Rev.
Wages and salaries	638.1	633.5	0.7%	10.4%
Post retirement benefits	(65.1)	(72.1)	(9.8)%	(1.1)%
Direct costs	907.3	724.9	25.2%	14.8%
Telecommunications costs	739.6	567.8	30.3%	12.0%
Directories	68.0	74.4	(8.6)%	1.1%
Other	99.7	82.7	20.5%	1.6%
Costs of products sold	656.1	580.6	13.0%	10.7%
Support services	233.6	202.1	15.6%	3.8%
Marketing and publicity	147.2	138.3	6.5%	2.4%
Supplies and external services	945.6	928.5	1.8%	15.4%
Indirect taxes	201.8	175.9	14.7%	3.3%
Provisions and adjustments	127.0	216.6	(41.4)%	2.1%
Operating costs, excluding depreciation and amortisation	3,791.7	3,528.3	7.5%	61.7%
Depreciation and amortisation	1,123.1	1,130.7	(0.7)%	18.3%
Total operating costs	4,914.8	4,659.0	5.5%	79.9%

(1) Considering a Euro/Real average exchange rate of 2.6661 in 2007 and 2.7315 in 2006.

Wages and salaries _ Wages and salaries increased by 0.7% y.o.y. in 2007 to Euro 638 million, primarily as a result of the increase in the contributions from Vivo (Euro 13 million) and MTC (Euro 7 million), which has been consolidated since September 2006 only. These effects were partially offset by the 7.0% y.o.y decrease in wages and salaries for the wireline business as a result of the ongoing redundancy programme and the focus on containing wage increases. Wages and salaries accounted for 10.4% of consolidated operating revenues.

Post retirement benefits costs _ Post retirement benefit costs (PRB) were Euro 65 million negative (gain) in 2007, as compared to Euro 72 million negative in 2006. In 2007, post retirement benefit costs included prior year service gains amounting to Euro 110 million, mainly related to the vested rights resulting from some changes introduced in the Social Security Rules (Dec-Law 187/2007 and Law 52/2007) in order to guarantee the long-term financial sustainability of the Portuguese social security system. In 2006, post retirement benefit costs included prior year service gains amounting to Euro 151 million mainly related to the reduction in health care benefits (Euro 127 million), in connection with the changes made to Portugal

Telecom s Health Care Plan in order to maintain its long-term sustainability and financing. Excluding prior year service gains, post retirement benefit costs would have decreased from Euro 78 million in 2006 to Euro 46 million in 2007, primarily explained by the reduction in service costs, following the decrease in healthcare obligations occurred at the end of 2006, and also due to the reduction in interest costs and the increase in expected return on assets, in line with the decrease in the unfunded obligations.

Direct costs _ Direct costs increased by 25.2% y.o.y to Euro 907 million in 2007 and accounted for 14.8 of consolidated operating revenues. Telecommunications costs, which are the main component of direct costs, increased by 30.3% to Euro 740 million in 2007, with the reduction in telecommunication costs at the wireline (Euro 3 million) and domestic mobile (Euro 9 million) businesses, primarily due to lower wireline traffic volumes and lower fixed-to-mobile and mobile-to-mobile interconnection rates in Portugal, being more than offset by the increase in telecommunications costs at Vivo (Euro 168 million), mainly due to the end of the partial Bill & Keep interconnection regime (Euro 127 million).

Cost of products sold _ Cost of products sold increased by 13.0% y.o.y in 2007 to Euro 656 million. Excluding the impact of the appreciation of the Real against the Euro (Euro 11 million), costs of products sold would have increased by 11.2% y.o.y to Euro 645 million in 2007, in line with increased commercial activity in the domestic and Brazilian mobile businesses, including the introduction of the GSM by Vivo, which was partially offset by lower handset prices, benefiting from the appreciation of the Real against the Dollar.

Support services _ Support services increased by 15.6% y.o.y in 2007 to Euro 234 million and represented 3.8% of consolidated operating revenues. This growth is primarily explained by the increase in support services from Vivo (Euro 28 million) and TMN (Euro 11 million), in line with higher commercial activity in both businesses.

Marketing and publicity _ Marketing and publicity increased by 6.5% y.o.y. in 2007 to Euro 147 million, primarily due to higher contributions from TMN (Euro 4 million) and Vivo (Euro 2 million), in line with increased commercial activity in both businesses, and also due to the increase in the contribution from MTC (Euro 4 million), which has been fully consolidated since September 2006 only. Marketing and publicity expenses accounted for 2.4% of consolidated operating revenues.

Supplies and external services _ Supplies and external expenses increased by 1.8% y.o.y in 2007 to Euro 946 million. Commissions, which are the main component of supplies and external services, remaining stable at Euro 264 million. The increase in other supplies and external services, is primarily explained by higher contributions from Vivo (Euro 10 million) and MTC (Euro 7 million), which has been consolidated since September 2006 only. The increase in the contribution of Vivo is primarily explained by the appreciation of the Real against the Euro (Euro 5 million) and by the increases of electricity expenses related to the GSM network and legal fees. Supplies and external services accounted for 15.4% of consolidated operating revenues.

Indirect taxes _ Indirect taxes, which mainly include spectrum fees (TMN and Vivo) and other taxes, increased from Euro 176 million in 2006 to Euro 202 million in 2007, mainly due to the increase in spectrum fees at Vivo and TMN in line with the growth in the customer base of both businesses.

Provisions and adjustments _ Provisions and adjustments decreased from Euro 217 million in 2006 to Euro 127 million in 2007. The decrease in this cost item is primarily related to decreases of Euro 59 million and Euro 32 million at Vivo and wireline business, respectively, mainly due to a reduction in doubtful accounts receivable at both businesses and also due to a one-off provision recorded by Vivo in 2006 (Euro 30 million) resulting from billing problems associated with the system migration to a unified platform. In 2007, provisions and adjustments accounted for 2.1% of consolidated operating revenues.

Depreciation and amortisation _ Depreciation and amortisation costs decreased by 0.7% y.o.y. in 2007 to Euro 1,123 million, with the reduction at the wireline business (Euro 32 million) being partially offset by higher contributions from Vivo (Euro 17 million), mainly due to the appreciation of the Real against the Euro (Euro 13 million), and from MTC (Euro 7 million), which has been consolidated since September 2006 only. This cost item accounted for 18.3% of consolidated operating revenues.

EBITDA

EBITDA by business segment (1) (2) Euro million

	2007	2006	Δ 07/06
Wireline	1,008.8	1,072.9	(6.0)%
Domestic mobile • TMN	679.0	658.7	3.1%
Brazilian mobile • Vivo (1)	595.0	496.2	19.9%
Other	73.9	9.2	n.m.
Total EBITDA (2)	2,356.7	2,237.0	5.3%
EBITDA margin (%)	38.3	38.8	(0.5pp)

(1) Considering a Euro/Real average exchange rate of 2.6661 in 2007 and 2.7315 in 2006. (2) EBITDA = income from operations + depreciation and amortisation

EBITDA increased by 5.3% y.o.y in 2007 to Euro 2,357 million, equivalent to an EBITDA margin of 38.3%, a decrease of 0.5 p.p. y.o.y. EBITDA growth in the period was driven primarily by growth in mobile businesses and an increase in other businesses. Although part of the improvement in Vivo EBITDA is explained by the impact of a one-off provision recorded in 2006 (Euro 30 million), underlying EBITDA increased by 17.0% y.o.y in local currency on the back of the strong increase in top-line. TMN EBITDA increased by 3.1% y.o.y driven by robust customer growth, in voice and data, combined with strict cost control, notwithstanding increased commercial activity (+20.8% increase in net additions). Wireline EBITDA decreased by 6.0% y.o.y, mainly as a result of the decrease in prior years service gains in 2007. Excluding this impact, Wireline EBITDA would have decreased by 2.6% y.o.y in 2007, with the 1.3pp improvement in underlying EBITDA margin resulting from the continued reduction in personnel-related and other operating costs. Other EBITDA increased from Euro 9 million in 2006 to Euro 74 million in 2007, mainly as a result of the increase in the contribution of MTC (Euro 38 million), which was only fully consolidated since September 2006, and the increase in EBITDA of other fully consolidated subsidiaries.

Net income

Curtailment costs, net _ Curtailment costs amounted to Euro 276 million in 2007, including a cost of Euro 289 million related to the reduction of 1,004 employees and a gain of Euro 14 million related with the settlement of benefits. In 2006 curtailment costs amounted to Euro 19 million due to the booking of net gains of Euro 209 million related to the termination of the protocol with the national healthcare system. Work force reduction programme costs in 2006 amounted to Euro 228 million corresponding to the reduction of 772 employees.

Net interest expenses _ Net interest expenses decreased by 10.3% y.o.y to Euro 197 million in 2007, mainly as a result of the reduction in the average cost of debt in Portugal and Brazil, as well as the decrease in Vivo s average net debt in the period, and notwithstanding the increase in PT s average net debt in the period due to the execution of the share buyback. Excluding Brazil and the interest cost associated with PTM equity swap (settled in the second quarter of 2007), PT s the average cost of debt was 3.7% in 2007, as compared to 3.8% in 2006.

Net foreign currency exchange losses/(gains) _ Net foreign currency exchange losses amounted to Euro 12 million in 2007, as compared to net foreign currency exchange gains of Euro 4 million in 2006. In 2007 and 2006, this item included mainly foreign currency losses related to dividends receivable from Unitel (denominated in US Dollars), following the devaluation of the US Dollar against the Euro in both periods, and foreign currency gains related to Vivo s US Dollar debt not swapped to Reais, in connection with the appreciation of the Real against the Dollar in both periods.

Gains on financial assets and other investments, net _ Net gains on financial assets amounted to Euro 249 million in 2007, as compared to net gains of Euro 18 million in 2006. This caption includes mainly the following: (1) the sale of 22% of Africatel (gain of Euro 111 million in 2007), the holding company that aggregates all of PT s interests in Africa excluding Médi Télécom; (2) equity swap contracts on PT Multimedia shares (gains of Euro 77 million in 2007, as compared to 10 million in 2006); (3) the financial settlement of equity swaps over PT s own shares (gains of Euro 32 million in 2007, as compared to Euro 24 million in 2006); and (4) the disposal of the investment in BES (gain of Euro 36 million in 2007).

Equity in earnings of associated companies, net _ Equity in earnings of associated companies decreased 3.4% to Euro 126 million in 2007, as compared to Euro 131 million in 2006, on the back of the reduction in the contribution from Médi Télécom (Euro 3 million in 2007 vs. Euro 46 million in 2006) resulting primarily from the recognition in 2006 of tax losses carried forward from previous years. This item included mainly PT s share in the earnings of Unitel in Angola (Euro 92 million in 2007, as compared to Euro 82 million in 2006), CTM in Macao (Euro 17 million in 2007, as compared to Euro 15 million in 2006) and UOL (Euro 13 million in 2007, as compared to Euro 6 million in 2006).

Net other financial expenses _ Net other financial expenses decreased 6.7% to Euro 48 million in 2007, as compared to Euro 52 million in 2006 and included mainly banking services, commissions, financial discounts and other financing costs. The reduction in this cost item is primarily explained by the financial taxes paid by Vivo in 2006, in connection with its debt restructuring occurred in that period.

Provision for income taxes _ Provision for income taxes amounted to Euro 243 million in 2007, as compared to a gain of Euro 21 million in 2006. The increase in this caption is primarily explained by the recognition in 2006 of: (1) a tax credit amounting to Euro 53 million, following the liquidation of a holding company, (2) a Euro 142 million gain related the reduction of deferred tax liabilities resulting from the voluntary taxation of certain capital gains, and (3) tax losses from previous periods amounting to Euro 134 million at Vivo following the completion of its corporate restructuring. Adjusting for these one-off effects, provision for income taxes would have been Euro 308 million in 2006, with the adjusted effective tax rate falling from 36% in 2006 to 24% 2007 mainly as a result: (1) the reduction in allowances for deferred taxes on tax losses generated by Vivo, following the corporate restructuring completed in the end of 2006; (2) the reduction in the statutory tax rate in Portugal from 27.5% in 2006 to 26.5% in 2007; and (3) the booking of non-taxable capital gains in 2007 related to the disposals of 22% of Africatel and of the investment in shares of BES.

Net income from discontinued operations _ Net income from discontinued operations includes the results of companies that have been disposed during the reportable periods, and the after-tax gains obtained with the sale of these investments. Following the approval of the spin-off of PT Multimedia in PT s Annual General Meeting hold on 27 April 2007, this business was reported as a discontinued operation in all reportable periods, in accordance with IFRS rules. As a result, the earnings of PT Multimedia before minority interest until the conclusion of the spin-off process that occurred in November 2007 were included in this caption. In 2007, this caption included costs related to the spin-off process amounting to Euro 18 million, net of tax, in connection with employee, organisational and IT restructuring costs.

Minority interests _ Income attributable to minority interests increased to Euro 93 million in 2007 from Euro 87 million in 2006, mainly due to the increase in income attributable to the minority interests of MTC (from Euro 9 million in 2006 to Euro 23 million in 2007), which has been consolidated since September 2006 only, and Africatel (Euro 10 million in 2007), following the disposal of a 22% stake of this investment in July 2007. These effects were partially offset by the decrease in the income attributable to minority interests of Vivo (from Euro 34 million in 2006 to Euro 15 million in 2007), primarily explained by the share of minority interests in the tax gains booked by Vivo in 2006.

Net income _ Net income decreased by 14.4% y.o.y in 2007 to Euro 742 million, primarily as a result of the increase in curtailment costs in 2007 and lower provision for income taxes in 2006, which more than offset the increase in EBITDA and higher net financial gains.

Capex

Capex by business segment (1) Euro million

	2007	2006	Δ 07/06
Wireline (2)	292.1	238.5	22.5%
Domestic mobile • TMN (3)	182.9	188.6	(3.0)%
Brazilian mobile • Vivo (1)	359.9	386.8	(7.0)%
Other	64.4	53.8	19.7%
Total capex	899.3	867.7	3.6%
Capex as % of revenues (%)	14.6	15.1	(0.4pp)

(1) Considering a Euro/Real average exchange rate of 2.6661 in 2007 and 2.7513 in 2006. (2) Includes the capitalisation of Euro 43 million related with transponder satellite capacity for the DTH offer. (3) Excludes the commitments under the terms of the UMTS licence (Euro 242 million in 2007).

Capex amounted to Euro 899 million in 2007, equivalent to 14.6% of revenues. The increase in Wireline capex was primarily due to: (1) network upgrades to provide greater bandwidth, in part related to IPTV services launched in June 2007; (2) the capitalisation of transponder satellite capacity for the DTH offer, and (3) client-related capex. This increase was partially offset by the decrease in Vivo and TMN s capex, with this being directed mostly towards build up of network capacity and 3G/3.5G coverage. Capex at Vivo was directed towards to the GSM/EDGE overlay as well as network coverage and capacity. Other capex includes capex related to consolidated businesses not included in the main segments and support companies. In 2007, other capex increased to Euro 64 million, as compared to Euro 54 million in 2006, mainly as a result of the consolidation of MTC (Euro 17 million) from September 2006.

Cash flow

EBITDA minus Capex by business segment (1) Euro million

	2007	2006	y.o.y
Wireline	716.7	834.3	(14.1)%
Domestic mobile • TMN	496.1	470.1	5.5%
Brazilian mobile • Vivo (1)	235.1	109.4	114.9%
Other	9.5	(44.6)	n.m.
Total EBITDA minus Capex	1,457.4	1,369.3	6.4%

(1) Considering a Euro/Real average exchange rate of 2.6661 in 2007 and 2.7315 in 2006.

EBITDA minus Capex _ EBITDA minus Capex increased by 6.4% y.o.y to Euro 1,457 million in 2007. On a combined basis, the domestic businesses accounted for approximately 83% of total EBITDA minus Capex.

Free cash flow Euro million

	2007	2006	y.o.y
Operating free cash flow	1,432.8	1,586.6	(9.7)%
Net disposal (acquisition) of financial investments	238.5	(142.3)	n.m.
Interest paid	(234.3)	(311.0)	(24.7)%
Contributions and payments related to PRBs	(167.2)	(278.5)	(40.0)%
Financial settlement of PTM equity swap	94.5	0.0	n.m.
Income taxes paid	(206.5)	(47.9)	n.m.
Other cash movements (1)	83.8	17.9	n.m.
Free cash flow	1,241.6	824.9	50.5%

(1) In 2007, other cash movements included Euro 149 million related to dividends received, mainly from PTM (Euro 54 million) and Unitel (Euro 73 million).

Operating free cash flow _ In 2007, operating free cash flow decreased by 9.7% y.o.y to Euro 1,433 million. The reduction in operating cash flow is explained by the working capital investment in 2007, versus a divestment in 2006, primarily as a result of higher commercial activity at TMN and Vivo.

Free cash flow _ Free cash flow increased from Euro 825 million in 2006 to Euro 1,242 million in 2007, primarily as a result of: (1) the increase in net disposal of financial investments, mainly due to disposals of Africatel and BES in 2007 amounting to Euro 117 million and Euro 110 million, respectivatily, as compared to the investment in MTC of Euro 109 million in 2006; (2) the cash settlement of the PTM equity swap in 2007 (Euro 94 million); (3) lower interest paid, and (4) lower contributions and payments related to post retirement benefits, as a result of the Euro 87 million reimbursement made in 2007 by PT Prestações, the fund created to cover healthcare responsibilities, on account of healthcare expenses paid by PT in previous years. These effects were only partially offset by higher income taxes paid, as PT s tax losses carried forward were fully used in 2006. The reduction in interest paid from Euro 311 million in 2006 to Euro 234 million in 2007, is primarily explained by the fact that PT paid in 2006 the last annual interest installment (Euro 52 million) on the Eurobond repaid in 2006 and by the decrease in Vivo s interest payments following its debt restructuring undertaken in 2006.

Consolidated balance sheet (1)

Euro million

	31 December 2006	31 December 2006
Cash and equivalents	1,834.9	2,083.7
Accounts receivable, net	1,441.8	1,417.0
Inventories, net	160.6	130.3
Financial investments	565.3	631.5
Intangible assets, net	3,383.1	3,490.9
Tangible assets, net	3,585.4	3,942.0
Post retirement benefits	134.1	134.1
Other assets	910.7	1,050.5
Deferred tax assets and prepaid expenses	1,106.2	1,291.4
Total assets	13,122.2	14,171.2
Accounts payable	1,108.9	1,115.1
Gross debt	6,216.8	5,840.3
Post retirement benefits	1,463.9	1,807.6
Other liabilities	1,878.4	1,995.7
Deferred tax liabilities and deferred income	372.3	306.5
Total liabilities	11,040.4	11,065.2
Equity before minority interests	1,338.2	2,255.2
Minority interests	743.6	850.8
Total shareholders equity	2,081.8	3,106.0
Total liabilities and shareholders equity	13,122.2	14,171.2

(1) Considering the Euro/Real exchange rate of 2.5963 at the end of 2007 and 2.8118 at the end of 2006.

Assets and liabilities _ The decrease in assets and liabilities in 2007 is primarily explained by the conclusion of the spin-off process of PT Multimedia occurred on November 2007.

The net exposure to Brazil _ The net exposure (assets minus liabilities) to Brazil amounted to R$ 7,525 million as at 31 December 2007 (Euro 2,898 million at the Euro/Real exchange rate prevailing as at 31 December 2007). The assets denominated in Brazilian Reais in the balance sheet as at 31 December 2007 amounted to Euro 5,454 million, equivalent to approximately 41.6% of total assets.

Gearing ratio _ The gearing ratio [net debt / (net debt + shareholders equity)] increased to 67.8% as at 31 December 2007, from 54.7% as at 31 December 2006, while the shareholders equity plus long-term debt to total assets ratio increased from 53.4% to 53.7%. As at 31 December 2007, the net debt to EBITDA ratio was 1.9 times and EBITDA cover was 11.9 times.

Consolidated net debt

Change in net debt | Euro million

	2007	2006
Net debt (initial balance)	3,756.6	3,672.5
Less: PTM Net debt as at 31 December 2006	178.9	0.0
Less: Free cash flow	1,241.6	824.9
Less:PTM free cash flow	0.0	(74.0)
Commitments under the UMTS license	241.7	0.0
Translation effect on foreign currency debt	32.6	(12.1)
Dividends paid (1)	552.7	552.2
Acquisitions of treasury shares (2)	1,158.3	62.1
Extraordinary contribution to pension fund	117.0	302.3
Other	(56.6)	(69.5)
Net debt (final balance)	4,381.8	3,756.6
Change in net debt	625.3	84.1
Change in net debt (%)	16.6%	2.3%

(1) In 2007, this item included dividends paid by PT (Euro 517 million) and certain of its subsidiaries. (2) In 2007, this item corresponds to the notional amount of equity swaps contracted over 117.7 million PT shares, in connection with the share buyback programme announced by the Board of Directors on 20 February 2007 and approved at the AGM of 27 April 2007.

Net debt _ Consolidated net debt as at 31 December 2007 increased to Euro 4,382 million, as compared to Euro 3,757 million as at 31 December 2006. The increase in net debt over the period is primarily explained by: (1) the share buyback, currently under execution; (2) the recognition of the investments in UMTS commitments, and (3) the extraordinary contribution to the pension fund.

Consolidated net debt Euro million

	31 December 2007	31 December 2006	Change	Change (%)
Short-term	1,256.1	1,372.7	(116.6)	(8.5)%
Bonds	96.3	0.0	96.3	n.m.
Bank loans	431.3	406.9	24.4	6.0%
Other loans	324.0	749.9	(425.9)	(56.8)%
Commitments under the UMTS license	55.9	0.0	55.9	n.m.
Liability with equity swaps on own shares	323.2	187.6	135.6	72.3%
Financial leases	25.5	28.4	(2.9)	(10.3)%
Medium and long-term	4,960.7	4,467.4	493.3	11.0%
Exchangeable bonds	689.4	0.0	689.4	n.m.
Bonds	3,061.7	3,133.6	(71.9)	(2.3)%
Bank loans	940.9	1,103.3	(162.4)	(14.7)%
Commitments under the UMTS license	144.7	0.0	144.7	n.m.
Other loans	0.0	0.3	(0.3)	n.m.
Financial leases	124.0	230.2	(106.2)	(46.1)%
Gross debt	6,216.8	5,840.2	376.6	6.4%
Cash and equivalents	1,834.9	2,083.7	(248.8)	(11.9)%
Net debt	4,381.8	3,756.6	625.3	16.6%

Total debt _ As at 31 December 2007, 79.8% of total debt was medium and long-term, while 64.0% of total debt was at fixed rates. As at 31 December 2007, 85.7% of total debt was denominated in Euros, 0.1% in US Dollars and 14.1% in Brazilian Reais. PT s rating was confirmed as Baa2 by Moody s and BBB- by S&P, both with stable outlook, on 5 March 2007 and 16 March 2007, respectively. The total undrawn amount of PT s domestic commercial paper lines and standby facilities stood at Euro 1,451 million as at 31 December 2007. The amount of available cash from the domestic operations plus the undrawn amount of PT s domestic commercial paper lines and standby facilities totalled Euro 2,672 million at the end of December 2007.

The 50% share of Vivo s net debt, proportionally consolidated by PT, amounted to Euro 370 million as at 31 December 2007. Approximately 95% of Vivo s net debt is either Real-denominated or has been swapped into Reais.

Net debt maturity profile

Euro million

Maturity	Net debt	Notes
2008	(578.9)	Net cash position
2009	1,122.5	Includes a Euro 880 million Eurobond issued in April 1999
2010	226.3	
2011	159.8	
2012	1,282.2	Includes a Euro 1,000 million Eurobond issued in March 2005
2013	67.4	
2014	881.6	Includes a Euro 689 million related to the exchangeable bonds issued in August 2007
2015	225.4	
2016	0.0	
2017 and following	995.4	Includes a Euro 500 million Eurobond issued in March 2005 (matures in 2017) and a Euro 500 million Eurobond issued in June 2005 (matures in 2025)
Total	4,381.8	

Cost of debt and maturity _ PT s average cost and maturity of net debt in 2007 was 4.9% and 6.7 years, respectively, including loans obtained in Brazil and denominated in Reais. Excluding Vivo s debt and the interest cost associated with the equity swap over PT Multimedia shares, PT s average cost of debt was 3.7% in 2007. The maturity of the net debt excluding Brazil also amounted to 6.7 years at 31 December 2007.

Debt ratings

	Current	Outlook	Last change
Standard & Poor s	BBB-	Stable	16 March 2007
Moody s	Baa2	Stable	5 March 2007
Fitch Ratings	BBB	Negative	5 March 2007

Ratings _ Following the failure of the tender offer, rating agencies confirmed PT s rating of BBB- (S&P), Baa2 (Moody s) and BBB (Fitch).

Post retirement benefits

PBO _ As at 31 December 2007, the projected benefit obligations (PBO) of PT s post retirement benefits, including pensions, healthcare obligations and salaries to pre-retired and suspended employees, amounted to Euro 4,203 million. The PBO was computed based on a discount rate of 5.25% for pension and healthcare obligations, and 4.75% for the obligations related to the payment of salaries to pre-retired and suspended employees. PT s post retirement benefits plans are closed to new participants since 1994 for pensions and 2000 for healthcare.

Post retirement benefits obligations Euro million

	2007	2006	Change
Pension obligations	2,762.1	3,073.8	(311.7)
Salaries to suspended and pre-retired employees	985.7	997.7	(12.0)
Healthcare obligations	455.3	491.1	(35.8)
Projected benefit obligation (PBO)	4,203.0	4,562.6	(359.6)
Market value of funds	(2,899.1)	(2,908.1)	9.0
Gross unfunded obligation	1,304.0	1,654.4	(350.5)
Unrecognised prior years service gains	25.9	19.1	6.8
Net liability for post retirement benefits	1,329.9	1,673.5	(343.6)
After-tax unfunded obligations	958.4	1,216.0	(257.6)

Change in plans _ In 2007, following the introduction of changes to the Social Security rules (DL 187/2007 and Law 52/2007) and adjustments introduced by PT to the growth rate used to calculate pension complements, the PBO was reduced by Euro 122 million. The impact of this reduction includes Euro 110 million related to vested rights that were recognised as prior year service gains and Euro 11 million related to unvested rights, which are deferred and amortised over the average working life of active employees. In addition, PT settled the Marconi Melhoria plan, which resulted in a reduction of unfunded liabilities by Euro 14 million, recognised as curtailment gains. In summary, gross unfunded obligations amounted to Euro 1,304 million at the end of 2007, whilst after tax unfunded obligations stood at Euro 958 million.

Change in gross unfunded obligations Euro million

	2007	2006	Change	Change (%)
Gross unfunded obligations (initial balance)	1,654.4	2,635.9	(981.4)	**(37.2)%**
Changes in the consolidation perimeter	0.0	2.5	(2.5)	
Post retirement benefits costs (PRBs) (1)	(63.1)	(72.1)	9.0	
Prior years service gains not recognized in net income	(11.1)	(19.1)	7.9	
Curtailment cost (2)	293.2	7.4	285.8	
Contributions and payments (3)	(284.2)	(580.8)	296.6	
Net actuarial losses	(285.2)	(319.4)	34.2	
Gross unfunded obligations (final balance)	1,304.0	1,654.4	(350.4)	**(21.2)%**
After-tax unfunded obligations	958.4	1,216.0	(257.6)	**(21.2)%**

(1) In 2007, the post retirement benefits gain recorded in the income statement amounted to Euro 65 million, including a gain of Euro 2 million related to the amortisation of prior years service gains on unvested rights. (2) In 2007 curtailment cost recorded in the income statement amounted to Euro 276 million, and excludes Euro 15 million related to the spin-off of PTM which were recorded under discontinued operations and includes a gain of Euro 2 million related to the extraordinary recognition of deferred prior years service gains. (3) In 2007 this caption included: (i) Euro 38 million of regular contributions; (ii) Euro 175 million of payments of salaries to pre-retired and suspended employees and other; (iii) Euro 61 million of net refunds related to healthcare benefits, and (iv) Euro 117 million of an extraordinary contributions to the pensions funds.

Gross unfunded obligations _ The decrease in the gross unfunded obligations by Euro 351 million in 2007 to Euro 1,304 million is primarily explained by: (1) the net actuarial gains booked in the period in the amount of Euro 285 million; (2) the reduction and settlement of benefits in the amount of Euro 135 million, and (3) the Euro 117 million extraordinary contribution made in 2007, notwithstanding the Euro 291 million work force reduction costs incurred in the period.

Net actuarial gains _ Net actuarial gains in 2007 include the impacts of the changes in actuarial assumptions (Euro 151 million) and of the differences between those actuarial assumptions and real data (Euro 134 million). The change in actuarial assumptions corresponds to the net effect of: (i) the increase in the discount rate from 4.75% to 5.25% for pension liabilities and from 4.25% to 4.75% for salary liabilities, reflecting the evolution of market yields; (ii) the reduction in the salary growth rate from 2.25% to 2.00%; and (iii) the increase in the inflation rate from 1.75% to 2.00%.

Post retirement benefits costs Euro million

	2007	2006
Service cost	17.8	28.7
Interest cost	208.9	217.5
Expected return on assets	(179.4)	(167.7)
Prior years service gains (1)	(112.3)	(150.6)
Post retirement benefits costs	(65.1)	(72.1)
Curtailment costs related to PRBs		
PBO related	291.7	227.8
Recognition of deferred prior years service gains	(2.3)	0.0
Settlement of benefits	(13.8)	(208.9)
Curtailment costs, net	275.6	19.0

(1) In 2007, this item includes Euro 110 million related to vested rights and Euro 2 million related to the amortisation of prior years service gains on unvested rights.

Post retirement benefit costs _ Post retirement benefit costs were Euro 65 million negative (gain) in 2007, compared with a gain of Euro 72 million in 2006, mainly as a result of the decrease in prior years service gains of Euro 40 million recorded in the period. The decrease in service cost in 2007 is explained primarily by the reduction in healthcare obligations that occurred at the end of 2006, while the decrease in net interest cost is explained by the narrowing of the unfunded gap.

Shareholders equity (excluding minority interests)

Shareholders equity _ As at 31 December 2007, shareholders' equity excluding minority interests amounted to Euro 1,338 million, a decrease of Euro 917 million during 2007.

Change in shareholders equity (excluding minority interests) Euro million

	2007
Equity before minority interests (initial balance)	2,255.2
Net income	741.9
Currency translation adjustments (1)	204.1
Net actuarial gains, net of tax effect	209.6
Dividends paid	(516.5)
Spin-off of the Multimedia business	(405.3)
Acquisition of treasury stock (2)	(1,158.3)
Market value of the exchangeable bond option	57.1
Hedge accounting of financial instruments and change in the fair value of available for sale investments (3)	(20.3)
Other (4)	(29.4)
Equity before minority interests (final balance)	1,338.2
Change in equity before minority interests	(917.0)
Change in equity before minority interests (%)	(40.7)%

(1) This item is primarily related to the appreciation of the Real against the Euro from 2.8118 as at 31 December 2006 to 2.5963 as at 31 December 2007. (2) This item is related to the notional amount of equity swaps contracted during the period over 117.7 million own shares. (3) In 2007, this item includes Euro 36 million corresponding to the offset of the gain obtained on the disposal of the investment in the shares of Banco Espírito Santo recorded in the income statement in 2Q07. (4) This item includes primarily Euro 28 million related to price resets on existing equity swap contracts on own shares.

Distributable reserves _ Pursuant to Portuguese legislation, the amount of distributable reserves is determined according to the standalone financial statements of the company prepared in accordance with Portuguese GAAP. Distributable reserves decreased from Euro 2,728 million in 2006 to Euro 1,856 million in 2007.

Change in distributable reserves Euro million

	2007
Distributable reserves (initial balance)	2,727.8
Dividends paid	(516.5)
Spin-off of the Multimedia business	(374.7)
Net income under Portuguese GAAP	613.5
Share capital restructuring	440.3
Acquisition of treasury shares (1)	(1,050.3)
Other	16.5
Distributable reserves (final balance)	1,856.5
Change in distributable reserves in the period	(871.3)
Change in distributable reserves in the period (%)	(31.9)%

(1) In 3Q07, PT acquired 103 million own shares for a total amount of Euro 1,050 million, through the exercise of the physical settlement option of equity swaps contracted under the share buyback programme currently being executed.

02 Business performance

Domestic market

Wireline

Operating revenues _ Wireline operating revenues decreased by 5.3% y.o.y in 2007 to Euro 1,962 million, with the reduction in retail revenues more than offsetting the increase in wholesale and data and corporate revenues in the period.

Wireline income statement (1)

Euro million

	2007	**2006**	**y.o.y**
Operating revenues	1,962.4	2,071.8	(5.3)%
Retail	1,023.2	1,173.5	(12.8)%
Voice	841.1	993.2	(15.3)%
Data and other	182.1	180.3	1.0%
Wholesale	486.9	464.2	4.9%
Data and corporate	265.6	250.5	6.0%
Other wireline revenues	186.7	183.6	1.7%
Operating costs, excluding D&A	953.6	998.9	(4.5)%
Wages and salaries	252.9	272.0	(7.0)%
Post retirement benefits	(65.3)	(71.6)	(8.7)%
Direct costs	354.0	356.1	(0.6)%
Commercial costs	90.8	83.3	9.0%
Other operating costs	321.2	359.1	(10.5)%
EBITDA (2)	1,008.8	1,072.9	(6.0)%
EBITDA, excluding exceptional items (3)	898.5	922.3	(2.6)%
Depreciation and amortisation	323.6	355.5	(9.0)%
Income from operations (4)	685.2	717.3	(4.5)%
EBITDA margin	51.4%	51.8%	(0.4pp)
EBITDA margin, excluding exceptional items	45.8%	44.5%	1.3pp
Capex (5)	292.1	238.5	22.5%
Capex as % of revenues	14.9%	11.5%	3.4pp
EBITDA minus Capex	716.7	834.3	(14.1)%

(1) Includes intragroup transactions.

(2) EBITDA = income from operations + depreciation and amortisation.

(3) Adjusts for prior years service gains related to vested rights in the amount of Euro 110 million in 2007 and Euro 151 million in 2006.

(4) Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs.

(5) Includes the capitalisation of Euro 43 million related with transponder satellite capacity for the DTH offer.

Retail revenues _ Retail revenues fell by 12.8% y.o.y in 2007 on the back of continued competition from other fixed operators as well as increasing competition from mobile operators, both in voice and broadband. Voice revenues decreased by 15.3% y.o.y in 2007, as a result of line loss and increasing pricing pressure, particularly in unbundled local loop (ULL) areas. Data revenues increased by 1.0% y.o.y, notwithstanding the drecrease in ADSL retail customers, due to the database cleanup undertaken at the end of the year, and the increasing pricing pressure in broadband, from both fixed and mobile operators.

Wholesale revenues _ Wholesale revenues increased by 4.9% y.o.y in 2007, primarily as a result of the growth in wholesale line rental and ULL on the back of increasing ULL accesses (+48.7% y.o.y).

Data and corporate revenues _ Data and corporate revenues increased by 6.0% y.o.y in 2007, as a result of continued focus on providing corporate customers more advanced and customised solutions combining telecoms and IT. The growth in the period was underpinned by the increase in revenues from VPN and circuits, as well as from outsourcing, network management and IT/SI solutions.

Other revenues _ Other revenues increased by 1.7% y.o.y in 2007, with the the growth in portal revenues (+49.2% y.o.y) and in equipment sales (+23.6% y.o.y) more than offsetting the decrease in directories (-9.9% y.o.y).

EBITDA _ EBITDA amounted to Euro 1.009 million in 2007, decreasing by 6.0% y.o.y. The reduction in EBITDA is explained primarily by decrease in prior years service gains from Euro 151 million in 2006 to Euro 110 million in 2007. Excluding the impact of this exceptional item, underlying EBITDA would have decreased by 2.6% y.o.y, with the 1.3pp improvement in underlying EBITDA margin resulting from the continued reduction in personnel-related and other operating costs. In effect, in 2007, wages and salaries decreased by 7.0% y.o.y while other operating costs decreased by 10.5% y.o.y. The net reduction in headcount in 2007 reached 827 employees, improving the efficiency ratio to 657 lines per employee in 2007 from 613 in 2006.

Capex _ Capex amounted to Euro 292 million in 2007, equivalent to 14.9% of operating revenues, and included Euro 43 million related to the capitalisation of the long-term contracts for transponder satellite capacity for the DTH offer, which will be made available in the Summer of 2008. Capex was directed mainly towards: (1) network upgrades to provide greater bandwidth to customers; (2) network capacity and information systems to provide IPTV services (soft launch in the second quarter of 2007), and (3) client-related capex as a result of investments in terminal equipment for both residential and corporate clients. EBITDA minus Capex amounted to Euro 717 million in 2007.

ADSL _ ADSL retail accesses decreased to 652 thousand in 2007, as a result of the database cleanup (mainly related to inactive prepaid broadband customers) of 103 thousand. Adjusting for this impact, ADSL net additions in the period reached 70 thousand. Voice lines fell by 9.2% y.o.y to 3,010 thousand, as a result of 136 thousand net disconnections of traffic-generating lines (an improvement over 2006 with net disconnections of 285 thousand) and the 170 thousand net disconnections of carrier press-selection lines. In terms of competitors   lines, voice-only lines (carrier pre-selection + wholesale line rental) decreased by 172 thousand in 2007, while ULL lines increased by 95 thousand. The growing presence of GSM-based fixed offers and wireless broadband has contributed further to fixed-mobile migration, while the increase in voice net additions of cable competitors, on the back of aggressively priced and promoted triple-play offers, continued to impact line loss.

IPTV _ In terms of triple-play services, PT launched its IPTV-based offer at the end of June 2007. At the end of 2007, PT had added a total of 21 thousand IPTV customers. The triple-play offer includes 42 pay-TV channels (of which 10 are a la carte), a broadband access of up to 8Mbps and unlimited fixed-to-fixed calls. Additionally, customers can buy premium services, such as SportTV (premium sports), premium movie channels and VOD services. This triple-play service is provided using ADSL 2+. PT was the first operator in Portugal to introduce HDTV and has the most extensive VOD offer in the market.

Wireline operating data

	2007	**2006**	**y.o.y**
Main accesses (000)	4,176	4,404	(5.2)%
Retail accesses	3,682	4,001	(8.0)%
PSTN/ISDN	3,010	3,317	(9.2)%
Traffic-generating lines	2,772	2,909	(4.7)%
Carrier pre-selection	238	408	(41.7)%
ADSL retail (1)	652	685	(4.9)%
TV subscribers	21	0	n.m.
Wholesale accesses	494	403	22.6%
Unbundled local loops	291	196	48.7%
Wholesale line rental	140	142	(1.4)%
ADSL wholesale	62	65	(3.5)%
Net additions (000)	(227)	(74)	n.m.
Retail accesses	(319)	(353)	(9.8)%
PSTN/ISDN	(306)	(453)	(32.3)%
Traffic-generating lines	(136)	(285)	(52.2)%
Carrier pre-selection	(170)	(168)	1.4%
ADSL retail	(33)	100	n.m.
TV subcribers	21	0	n.m.
Wholesale accesses	91	279	(67.4)%
Unbundled local loops	95	124	(22.9)%
Wholesale line rental	(2)	142	n.m.
ADSL wholesale	(2)	13	n.m.
ARPU (Euro)	30.4	30.1	1.1%
Voice	24.5	25.0	(2.2)%
Data and other	5.9	5.0	17.5%
Total traffic (million minutes)	12,502	13,442	(7.0)%
Retail traffic	5,217	5,575	(6.4)%
Wholesale traffic	7,285	7,867	(7.4)%
Retail MOU (minutes / month)	159	158	0.6%
Employees	6,354	7,181	(11.5)%

(1) Includes a database cleanup (related to inactive prepaid broadband customers) of 103 thousand.

Fixed-mobile convergent products _ In addition, PT has begun to rollout fixed-mobile convergent products to its SME/SoHo and residential segments as a means to increase revenues and improve customer loyalty. After having developed a mobile OfficeBox offer in the first half of 2007, PT has now integrated fixed voice and broadband, as well as a PC, into an upgraded version of the OfficeBox product (see description in domestic mobile section - TMN for further detail). With regards to the residential segment, PT launched a wireless broadband offer also using the brand Sapo Mobile (Sapo is the fixed ADSL brand). Customers can opt between a monthly flat rate or alternatively a daily usage rate in case they also subsribe to a fixed ADSL monthly package, thus benefiting from a fixed and mobile bundle and increasing the perceived value attributed to the fixed broadband offer.

ARPU _ Blended ARPU, which was not impacted by the database cleanup undertaken at the end of the year, increased by 1.1% y.o.y in 2007 to Euro 30.4 driven by the growth in data ARPU, which increased by 17.5% y.o.y. The increased penetration of data services, including corporate VoIP and IPTV, more than offset the reduction in voice and broadband ARPU.

Traffic _ Although retail traffic fell by 6.4% y.o.y. in 2007, as a result of line loss, retail MOU increased by 0.6% y.o.y in the period to 159 minutes, reflecting the positive impact of the rollout of flat-rate pricing plans. The 7.4% y.o.y reduction in wholesale traffic in 2007 is explained primarily by the 58.8% y.o.y decrease in dial-up Internet traffic, as a result of the continued migration to broadband.

Domestic mobile - TMN

Operating revenues _ Operating revenues increased by 2.7% y.o.y in 2007 to Euro 1,543 million, supported by the growth of service revenues (+2.2% y.o.y) and equipment sales (+9.3% y.o.y), as a result of the successful TMN s campaigns, namely the Summer and Christmas campaigns. Customer revenues increased by 2.6% y.o.y to Euro 1,146 million on the back of strong customer growth, particularly in postpaid and wireless broadband.

Interconnection revenues grew 0.3% y.o.y. in 2007 to Euro 247 million, notwithstanding the negative impact from the reduction of mobile termination rates (MTR). Excluding this impact (Euro 14 million), service revenues would have increased by 3.2% y.o.y in 2007.

Domestic mobile income statement (1)

Euro million

	2007	2006	y.o.y
Operating revenues	1,542.9	1,502.4	2.7%
Services rendered	1,393.1	1,363.2	2.2%
Customer	1,146.2	1,117.0	2.6%
Interconnection	246.9	246.2	0.3%
Sales	141.8	129.7	9.3%
Other operating revenues	8.1	9.4	(14.3)%
Operating costs, excluding D&A	864.0	843.7	2.4%
Wages and salaries	52.7	56.0	(5.8)%
Direct costs	282.6	292.9	(3.5)%
Commercial costs	318.3	306.6	3.8%
Other operating costs	210.4	188.2	11.8%
EBITDA (2)	679.0	658.7	3.1%
Depreciation and amortisation	223.6	220.1	1.6%
Income from operations (3)	455.4	438.6	3.8%
EBITDA margin	44.0%	43.8%	0.2pp
Capex (4)	198.0	188.6	5.0%
Capex as % of revenues	12.8%	12.6%	0.3pp
EBITDA minus Capex	481.0	470.1	2.3%

(1) Includes intragroup transactions.

(2) EBITDA = income from operations + depreciation and amortisation.

(3) Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs.

(4) Includes Euro 15 million related to the capitalisation of a long-term telecom contract with PT Comunicações and excludes the commitments under the terms of the UMTS licence (Euro 242 million in 2007).

Mobile termination rates _ Mobile termination rates currently stand at Euro 11 cents per minute, following the reduction on 1 October 2006. A final decision concerning the draft proposal issued by the telecom regulator for the MTR schedule for 2008 is still pending. The draft decision proposed a reduction to Euro 8 cents per minute on 1 January 2008, followed by quarterly cuts of Euro 0.5 cents until reaching Euro 6.5 cents per minute on 1 October 2008. This proposal, reintroduces asymmetry in fixed-to-mobile rates, after having eliminated it in 2005, and introduces asymmetry in mobile-to-mobile rates, a flat 20% premium for the third operator on the prices referred above, subject to a review at the end of 2008.

EBITDA _ EBITDA increased by 3.1% y.o.y to Euro 679 million in 2007, notwithstanding significantly higher commercial activity. In spite of the increase in commercial activity, mainly focused on prepaid to postpaid migration and wireless broadband sales, the decrease in unitary SARC (-14.9% y.o.y) and the focus on the reduction of addressable costs, namely staff, resulted in an EBITDA margin improvement of 0.2pp y.o.y to 44.0% in 2007. The negative impact of MTR cuts amounted to Euro 7 million in 2007. Excluding this impact, EBITDA would have increased by 4.2% y.o.y in 2007.

Capex _ Capex increased from Euro 189 million in 2006 to Euro 198 million in 2007, equivalent to 12.8% of operating revenues. Capex was directed primarily towards network capacity, as a result of increased voice and data usage, and 3G/3.5G coverage (approximately 82% of network capex). EBITDA minus Capex amounted to Euro 481 million in 2007, representing an increase of 2.3% from 2006.

Domestic mobile operating data (1)

	2007	2006	y.o.y
Customers (000)	6,261	5,704	9.8%
Net additions (000)	558	391	42.5%
MOU (minutes)	121	120	0.3%
ARPU (Euro)	19.8	21.0	(5.7)%
Customer	15.8	16.6	(4.5)%
Interconnection	3.5	3.8	(7.5)%
Roamers	0.5	0.6	(24.9)%
ARPM (Euro cents)	16.4	17.5	(6.0)%
Data as % of service revenues (%)	16.0	13.3	2.8pp
SARC (Euro)	46.9	55.1	(14.9)%
Employees	1,144	1,140	0.4%

(1) Includes MVNO subscribers.

Customers _ Total customers increased by 9.8% y.o.y to 6,261 thousand, which includes MVNO subscribers, with net additions in 2007 reaching 558 thousand (+42.5% y.o.y), as a result of the successful TMN s campaign both for voice and data offers and including the strong take-up of wireless broadband supported by the information society initiatives. In early October, TMN celebrated the 6 million customer mark, thus consolidating its leadership position in the market. TMN continued to focus on postpaid, particularly on the corporate segment, and on prepaid to postpaid migration. As a result, approximately 70% of net additions in the period were postpaid, which accounted for 23.8% of total customers at the end of 2007.

Handset portfolio _ TMN launched several initiatives during the Christmas campaign, using the TMN and the UZO brands, aimed at stimulating usage. In terms of handsets, TMN continued to focus on having a balanced and broad portfolio, with an important component of exclusive handsets, which allows for greater pricing flexibility and thus better control of SARC. Additionally, TMN reinforced its offering of the Blackberry email to corporate, SME and SoHo segments. For the Summer campaign, TMN launched 25 new handsets, of which 8 were exclusive, and for the Christmas campaign, TMN offered 16 new handsets, of which 6 were exclusive.

Broadband _ The rollout of broadband data remained a key priority during the quarter. Demand for the service internetnotelemovel , which was the first flat-rate offer for Internet and email access on mobile handsets launched in Portugal, has been picking up, whilst wireless broadband take-up remains strong. The wireless broadband take-up has been underpinned by the e-escolas programme, a part of the Government s Plano Tecnológico initiative, which aims to provide laptop computers with wireless broadband connectivity, at certain discounts, to schools, teachers, students and info-excluded individuals. This project is being developed as part of TMN s commitment to the development of the information society, as per the UMTS licence terms. At the end of 2007, TMN had already delivered approximately 70 thousand laptops bundled with broadband subscriptions.

Fixed-mobile convergent offers _ TMN has also been developing fixed-mobile convergent offers with the objective of providing more comprehensive and integrated solutions for its customers. OfficeBox , which targets the SME and SoHo segments, is an off-the-shelf product aimed at covering the full telecommunication needs of small businesses. It includes fixed-line and mobile voice, fixed and mobile Internet access, mobile handset and a PC. Its minimum price is a flat rate of Euro 70 per month per workstation.

ARPU _ ARPU decreased by 5.7% y.o.y in 2007 to Euro 19.8, mainly as a result of the increasing penetration in lower segments of the market and the growing number of users with multiple SIM cards, as well as lower roaming prices. Nevertheless, the growth in the average customer base more than offset the dilution in ARPU, allowing service revenues to grow by 2.2% y.o.y in 2007. Roamers ARPU decreased by 24.9% y.o.y as a result of the adjustments TMN has been making to its roaming pricing plans, following EU-imposed changes to wholesale roaming prices, which came into effect as of 1 September 2007. Blended MOU increased by 0.3% y.o.y in 2007 to 121 minutes, as a result of the growth in outgoing voice MOU.

Data services _ Data services continued to contribute strongly to top line growth, with data revenues having increased by 23.5% y.o.y in 2007 and already accounting for 16.0% of service revenues at the end of the period, which compares favourably with 13.3% in 2006.

The increase in data service revenues is primarily based on non-SMS data revenues, which grew by 84.6% y.o.y and already accounted for 34.4% of total data revenues in 2007. This growth in non-SMS data was driven by a strong performance in terms of mobile Internet and wireless broadband. Data usage, measured in kilobytes, increased by more than five times in 2007 when compared to 2006. The number of SMS in 2007 reached approximately 180 messages per month per active SMS user. The number of active SMS users reached 50% of total customers at the end of the 2007.

International market

Brazilian mobile - Vivo

Operating revenues _ Vivo s operating revenues, as stated in Brazilian Reais and in accordance with IFRS, increased by 14.2% y.o.y in 2007 to R$ 13,133 million, primarily as a result of the strong growth in service revenues (+17.6% y.o.y), which was underpinned by the growth in customers and in ARPU. This strong performance more than offset the decrease in equipment sales and in other operating revenues.

Brazilian mobile income statement (1)

R$million

	2007	2006	y.o.y
Operating revenues	13,133.0	11,498.0	14.2%
Services rendered	11,502.8	9,777.5	17.6%
Sales	1,376.1	1,391.7	(1.1)%
Other operating revenues	254.1	328.9	(22.7)%
Operating costs, excluding D&A	9,960.2	8,787.3	13.3%
Wages and salaries	686.8	631.0	8.8%
Direct costs	2,284.4	1,359.6	68.0%
Commercial costs	3,535.4	3,277.1	7.9%
Other operating costs	3,453.5	3,519.5	(1.9)%
EBITDA (2)	3,172.8	2,710.8	17.0%
EBITDA~, excluding exceptional items (3)	3,107.7	2,746.0	13.2%
Depreciation and amortisation	2,789.2	2,763.4	0.9%
Income from operations (4)	383.6	(52.7)	n.m.
EBITDA margin	24.2%	23.6%	0.6pp
EBITDA margin, excluding exceptional items	23.7%	23.9%	(0.2pp)
Capex	1,919.0	2,113.0	(9.2)%
Capex as % of revenues	14.6%	18.4%	(3.8pp)
EBITDA minus Capex	1,253.8	597.7	109.8%

(1) Information prepared in accordance with IFRS.

(2) EBITDA = income from operations + depreciation and amortisation.

(3) Adjusts for the one-off provision related to bad debt booked in 2Q06 in the amount of R$ 162 million.

(4) Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs.

EBITDA _ EBITDA increased by 17.0% y.o.y to R$ 3,173 million in 2007. Part of this improvement is explained by an extraordinary provision for bad debts booked in the second quarter of 2006 (R$ 162 million). Nevertheless, the strong underlying performance in terms of top line resulted in an EBITDA (excluding exceptionals items) increase of 13.2% y.o.y. to R$ 3,108 million in 2007, notwithstanding the higher commercial activity. As a result of the measures implemented over the past year and a half to control bad debt, Vivo provisions for doubtful receivables in 2007 fell to approximately 4% of gross revenues. Unitary SARC fell by 16.1% y.o.y to R$ 110 in 2007. As a result, EBITDA margin increased by 0.6pp in 2007 to 24.2%.

Capex _ Capex decreased by 9.2% y.o.y to R$ 1,919 million in 2007, equivalent to 14.6% of operating revenues. Capex in 2007 was directed towards: (1) the implementation of the GSM/EDGE overlay, and

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(2) network coverage and quality. The GSM/EDGE network overlay was implemented in record time and already covers 2,318 municipalities. All of the capex related to the initial GSM/EDGE rollout, as announced in July 2006, has been already invested. EBITDA minus Capex increased from R$ 598 million in 2006 to R$ 1,254 million in 2007.

Acquisitions _ On 2 August, Vivo reached an agreement to acquire Telemig Celular and Amazonia Celular. Anatel has already approved the acquisition of Telemig Celular. On 20 December, Vivo reached an agreement with Oi (Telemar Norte Leste) to sell Tele Norte Celular, the controlling company of Amazonia Celular. Additionally, on 25 September, Vivo acquired 1.9 GHz frequencies in all of the regions where it did not operate, in particular in the Northeast states. Vivo has thus achieved full nationwide coverage in Brazil, which has been a long-standing objective of the Company and should consolidate its leadership position in the mobile market. In December, Vivo participated in the bidding process of 3G frequencies and succeeded in achieving a nationwide coverage having offered R$ 1.1 billion for the band J licenses.

Brazilian mobile operating data (1)

	2007	**2006**	**y.o.y**
Customers (000)	33,484	29,053	15.2%
Net additions (000)	4,430	(752)	n.m.
MOU (minutes)	77	74	4.9%
ARPU (R$)	30.4	27.1	12.2%
Customer	17.3	15.7	10.3%
Interconnection	13.1	11.5	14.7%
Data as % of service revenues (%)	7.9	6.8	1.1pp
SARC (R$)	109.7	130.7	(16.1)%
Employees	5,600	5,896	(5.0)%

(1) Operating data calculated using Brazilian GAAP.

Customers _ Vivo s customer base increased by 15.2% y.o.y to 33,484 thousand, with net additions reaching 4,430 thousand in 2007 on the back of significantly higher commercial activity when compared to 2006. GSM accounted for approximately 65% of total gross additions in 2007, bringing the total number of GSM customers to more than 11.2 million at the end of the year, equivalent to 33.6% of total customers. As part of the continued focus on improving customer satisfaction and usage, Vivo launched a set of postpaid plans, called Vivo Escolha , in the third quarter of 2006. More than one year after introducing the new family of plans, approximately 67% of the postpaid customer base (excluding corporates) has already moved to a Vivo Escolha plan. Vivo s focus on providing the best network quality and the best service offering has been resulting in improved customer satisfaction levels, as evidenced by recent consumer surveys.

MOU _ Vivo s blended MOU increased by 4.9% y.o.y in 2007 to 77 minutes, reflecting the growth in outgoing traffic, as a result of successful campaigns aimed at increasing consumption in the prepaid segment, notwithstanding the strong growth of the subscriber base throughout 2007.

ARPU _ Vivo s blended ARPU reached R$ 30.4 in 2007, an increase of 12.2% y.o.y, driven by the strong growth in customer and interconnection ARPU, which increased by 10.3% y.o.y and 14.7% y.o.y respectively, on the back of higher penetration of data services.

Data revenues _ Data revenues increased by 35.5% y.o.y in 2007, representing 7.9% (+1.1pp y.o.y) of service revenues. In terms of data services, Vivo has leveraged on being the only operator using two technologies, positioning CDMA/EVDO as the best solution for mobile data. As a result, Vivo has continued to experience strong growth in its WAP and ZAP (EVDO data cards) offers. Recently it introduced innovative services such as Vivo Play (downloads and video streaming) and Vivo Flash (residential wireless broadband access for desktops).

Other international investments

Highlights of main assets in Africa and Asia (2007) (1) (2)

thousand (customers), million (financials)

	Stake	Customers	Rev. local	y.o.y	EBITDA local	y.o.y	Margin	Rev. Euro	EBITDA Euro
Médi Télécom (3)	32.18%	6,669	4,926	5.0%	2,271	9.3%	46.1%	438.4	202.1
Unitel (3) (5)	25.00%	3,307	891	37.2%	536	23.6%	60.2%	648.9	390.6
MTC (4) (5)	34.00%	800	1,140	16.4%	599	2.0%	52.6%	117.7	61.9
CVT (4) (5)	40.00%	221	7,458	6.9%	4,705	6.4%	63.1%	67.6	42.7
CTM (3)	28.00%	533	2,289	9.0%	967	19.2%	42.2%	207.4	87.6
CST (4) (5)	51.00%	38	156,321	12.4%	53,062	9.2%	33.9%	8.3	2.8
Timor Telecom (4)	41.12%	81	32	35.4%	15	58.7%	46.0%	23.0	10.6
UOL	29.00%	1,690	525	9.2%	153	12.5%	29.2%	197.0	57.5

(1) All information prepared in accordance with local GAAP.

(2) Figures account for 100% of the company. PT has management contracts in Médi Télécom, CVT and Timor Telecom.

(3) Equity consolidation method.

(4) Full consolidation method.

(5) These stakes are held by Africatel, which is controlled 78% by PT.

Morocco - Médi Télécom

Médi Télécom revenues increased by 5.0% y.o.y in 2007 to MAD 4,926 million, while EBITDA increased by 9.3% y.o.y to MAD 2,271 million. The mobile customer base increased by 28.9% y.o.y to 6,665 thousand, with net additions in 2007 totalling 1,496 thousand, driven by the sale of SIM-only packages. At the end of December 2007, Médi Telecom s market share stood at 33.5%, having increased 0.4pp over the end of

September 2007. MOU decreased by 4.6%

y.o.y in 2007 to 49 minutes. ARPU totalled MAD 69.3 in 2007, a decrease of 23.1% over 2006, mainly due to the significant growth of the customer base, the increasing proportion of lower ARPU customers and the increased competition in the market.

Angola - Unitel

Unitel s revenues and EBITDA increased by 37.2% and 23.6% y.o.y respectively in 2007, underpinned by strong customer growth, both in Luanda and in the main districts of the Angola. EBITDA margin reached 60.2% in 2007. Net additions totalled 1,258 thousand in 2007, with the total customer base reaching 3,307 thousand at the end of December 2007, an increase of 61.4% over the same period of last year. Unitel s MOU decreased by 16.1% y.o.y in 2007 to 118 minutes. ARPU totalled USD 27.6 in 2007, a decrease of 19.5% over 2006 , as a result of the strong growth in the customer base.

Namibia - MTC

MTC s revenues and EBITDA increased by 16.4% and 2.0% y.o.y respectively in 2007. The EBITDA growth was impacted by the increase in commercial costs, as a result of higher commercial activity particularly in postpaid, higher leased line costs related to network rollout and higher personnel costs. Net additions totalled 191 thousand in 2007, with total customers reaching 800 thousand at the end of December 2007, an increase of 31.3% over the same period of 2006. Postpaid customers increased by 38.5% y.o.y, representing 8.9% of total customer base. ARPU totalled NAD 134 in 2007, a decrease of 15.2% y.o.y, primarily as a result of the growth in the customer base in 2007.

Cape Verde - CVT

CVT s revenues and EBITDA increased by 6.9% and 6.4% y.o.y respectively in 2007, mainly due to the strong growth in mobile customers, which increased by 35.9% y.o.y to 148 thousand customers. Mobile MOU reached 82 minutes, an increase of 3.4% y.o.y in 2007. Mobile ARPU in 2007 was CVE 2,766, a decrease of 10.0% y.o.y. EBITDA Margin reached 63.1% in 2007.

Macao - CTM

CTM s revenues increased by 9.0% y.o.y to MOP 2,289 million in 2007, as a result of the increase in the number of mobile and broadband customers. EBITDA improved by 19.2% y.o.y to MOP 967 million in 2007. In the mobile division, customers increased by 17.0% y.o.y to 349 thousand at the end of December 2007. CTM s mobile ARPU decreased by 12.4% y.o.y to MOP 219 in 2007, as a result of the growth in the customer base.

São Tomé e Príncipe - CST

CST s revenues increased by 12.4% y.o.y to STD 156,321 million in 2007, with EBITDA growing by 9.2% y.o.y to STD 53,062 million. In the mobile division, CST added 12 thousand customers in 2007, bringing the total number of customers to 30 thousand at the end of

December 2007, an increase of 63.4% y.o.y. Mobile MOU decreased by 23.6% y.o.y in 2007, reaching 62 minutes, as a result of the growth in the customer base. Mobile ARPU was STD 299 thousand in 2007, a decrease of 22.2% over 2006.

East Timor - Timor Telecom

Timor Telecom s revenues and EBITDA increased by 35.4% and 58.7% y.o.y respectively, mainly as a result of the strong increase in the number of mobile customers. Timor Telecom s net additions reached 29 thousand, bringing the total customer base to 78 thousand at the end of December 2007, an increase of 59.3% y.o.y. Mobile MOU decreased by 4.1% y.o.y to 101 minutes. Mobile ARPU was USD 33 in 2007, a decrease of 7.4% over 2006.

Brazil - UOL

UOL s revenues increased by 9.2% y.o.y to R$ 525 million in 2007, as a result of the growth in the customer base and in advertising revenues. EBITDA increased by 12.5% y.o.y to R$ 153 million in 2007, corresponding to an EBITDA margin of 29.2%, underpinned by the strong growth in brand advertising and subscription revenues coupled with a strict cost control. UOL s subscriber base totalled 1,690 thousand at the end 2007, including 973 thousand broadband customers, which represented an increase of 23% over 2006. In December 2007, page views and unique visitors increased by 19% and 29% y.o.y respectively.

03 Employees

Number of employees and productivity ratios

	2007	2006	Δ y.o.y	y.o.y
Domestic employees	10,338	11,336	(998)	(8.8)%
Wireline	6,354	7,181	(827)	(11.5)%
Domestic mobile • TMN	1,144	1,140	4	0.4%
Other	2,840	3,015	(175)	(5.8)%
International employees	18,300	19,346	(1,046)	(5.4)%
Brazilian mobile • Vivo (1)	2,800	2,948	(148)	(5.0)%
Other	15,500	16,398	(898)	(5.5)%
Total Group employees	28,638	30,682	(2,044)	(6.7)%
Fixed lines per employee	657	613	44	7.2%
Mobile cards per employee				
TMN	5,473	5,003	470	9.4%
Vivo	5,979	4,928	1,052	21.3%

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(1) The number of employees in the Brazilian mobile business corresponds to 50% of the employees of Vivo.

At the end of 2007, the number of staff employed by PT totalled 28,638 employees, of which 36.1% were based in Portugal. In the wireline business, the ratio of fixed lines per employee improved by 7.2% y.o.y in 2007 to 657 lines, reflecting the ongoing workforce rationalisation programme, while in TMN the ratio of mobile cards per employee rose by 9.4% to 5,473 cards. At the end of December 2007, the total number of employees of Vivo decreased by 5.0% y.o.y to 5,600 employees, with the ratio of mobile cards per employee increasing by 21.3% to 5,979 cards.

As part of the cost rationalisation programme, PT continued with its workforce reduction programme, with headcount decreasing by 1,004 employees in 2007, of which 827 were in the wireline business.

04 Capital markets

Shareholder remuneration

In terms of shareholder remuneration, PT returned approximately Euro 3.4 billion to shareholders in 2007, through a combination of the following:

- Share buyback of Euro 1,185 million. On 20 December 2007, PT cancelled 103,056,500 of its own shares, equivalent to 9.13% of its share capital, and reduced its share capital from Euro 33,865,695 to Euro 30,774,000. As of 31 December 2007, PT had equity swap contracts on its own shares totalling Euro 135 million.

- The distribution of 180.6 million shares of PT Multimédia to PT shareholders, equivalent to Euro 1.7 billion, assuming the weighted average market price of PT Multimédia on the Euronext Lisbon as at 6 Novembrer 2007 (Euro 9.18 per share).

- Remuneration of Euro 517 million corresponding to the payment of the May 2007 dividend equal to 47.5 cents per share for the fiscal year 2006.

Subject to Shareholders approval at the AGM.

Regarding dividends for the fiscal year 2007 to be paid in 2008, PT s Board of Directors will propose the submission for shareholders approval at the next AGM, to be held on 28 March 2008, the payment of a cash dividend of 57.5 cents per share, representing an increase of 21.1% over the previous year.

In global terms, considering the shareholder remuneration of 2006, through the payment of dividends in the amount of Euro 526 million, PT had already returned to its shareholders around 66% of the total remuneration package approved for the period 2006-2009, which corresponds to approximately Euro 3.9 billion.

In addition, as at the date of this report, PT had contracted equity swaps to acquire 63,391,786 PT shares, of which 20,640,000 shares were contracted under the previous share buyback programme. As part of the share buyback programme under execution, PT has acquired, directly or through equity swaps, a total of 145,808,286 own shares, equivalent to 14.21% of PT s share capital (or 12.92% of PT s share capital prior to the share capital reduction executed on 20 December 2007), amounting to Euro 1,434 million.

Shareholder structure

PT has a diversified shareholder base, with approximately 68% of its share capital being held by foreign shareholders, divided mainly among United States and Europe. The Portuguese market has been increasing its weight in PT s share capital, representing now almost a third of the total shareholder base, with Continental Europe and the US market representing approximately 23% and 26%, respectively, of PT s outstanding capital.

At the end of 2007, the holdings of the qualified shareholders represented approximately 57% of PT s share capital, as follows:

Qualified holdings 31 December 2007

Institutions	**No. of shares**	**% of capital**
Brandes Investments Partners	98,943,217	9.65%
Telefónica	93,915,644	9.16%
Espirito Santo Group	91,311,811	8.90%
Caixa Geral de Depósitos Group	65,341,768	6.37%
Ongoing Strategy Investments	60,404,969	5.89%
Telmex	38,460,000	3.75%
Fidelity	23,592,185	2.30%
Barclays Group	23,216,664	2.26%
Capital Group Companies	22,996,339	2.24%
Credit Suisse	22,683,484	2.21%
Visabeira Group	22,667,473	2.21%
Controlinveste Comunicações	22,284,551	2.17%

Share performance

PT shares registered a favourable evolution in 2007, in line with the positive performance of the European telecommunications sector in the period. PT shares closed the year 2007 at Euro 8.93, representing an increase of 8.6% over the previous year (considering a PT share price adjusted by the spin-off of PT Multimédia of Euro 8.22 for the 2006 year-end). The DJ Stoxx Telecom Europe index in 2007 also increased by 14.6% over last year, as well as the PSI-20 index which registered an increase of 16.3% in the same period. Taking into account shareholder remuneration, PT provided a total shareholder return of 11.7% in 2007.

Source: Bloomberg (local currency).

Among the major financial markets, the Bovespa registered the best performance in 2007 (+43.6%), followed by the DAX (+22.3%). The PSI-20 index also saw a postive performance in 2007, registered the second highest increase (+16.3%) among the European financial markets.

Source: Bloomberg (local currency).

Around 1,343 million PT shares were traded in 2007, equivalent to a daily average of 5.3 million shares, with the trading volume accounting for approximately 14% of the total trading volume of Euronext Lisbon. PT s average turnover increased to 119% in 2007, as compared with 107% in last year.

In 2007, PT s ADRs increased by 20.7%, closing the year at US$ 13.02. An average of approximately 100 thousand PT ADRs were traded daily in 2007 on the New York Stock Exchange. The number of ADRs outstanding at the end of 2007 was 48.7 million, of which 73%

were owned by international qualified shareholders. PT s ADR programme continues to be one of the most active among European telecom operators.

Bond performance

The key credit strength of PT in 2007 was again its ability to generate a strong operating free cash flow, as a result of leading market positions in both fixed and mobile businesses in Portugal and in mobile business in Brazil, as well as the implementation of continued cost cutting programmes. In 2007, PT maintained a strong liquidity position, given its high level of cash, its debt profile and the additional flexibility provided by its stand-by lines.

Rating

After the failure of the tender offer for Portugal Telecom, Standard & Poor s and Moody s confirmed PT s rating as BBB- and Baa2 respectively, both with stable outlook. These ratings reflect the factors mentioned above, as well as the expected increase in indebtedness resulting from the implementation of PT s shareholder remuneration package.

Bonds

In the beginning of 2007, PT s bond performance was mainly determined by the probability of success assigned to the tender offer over PT launched in 2006, as that event would result in the weakening of the Company s credit quality. Thus, after the failure of the tender offer, spreads of PT bonds tightened gradually until the end of May.

In July, the decline in the housing market in the United States, mainly linked to defaults on subprime loans, resulted in credit spreads widening across the market. This, together with its impacts on financial markets, has been the main driver for the performance of PT bonds until the end of 2007.

Source: Bloomberg

On 3 July 2007, PT launched and priced exchangeable bonds in the amount of Euro 750,000,000, due 2014, exchangeable into fully paid ordinary shares of PT. These bonds were issued by Portugal Telecom International Finance BV on 28 August 2007, carrying a coupon of 4.125% , with an exchange price of Euro 13.9859. Effective 30 October 2007, the exchange price was adjusted to Euro 11.60 as a result of the spin-off of PT Multimédia, according to the terms and conditions of the bonds.

Until the end of 2007, the price of the exchangeable bonds followed the change in the price of PT shares, reaching 105.5 at the end of the year.

Investor relations activities

PT has a policy of providing its shareholders and other members of the international financial community with clear, transparent, regular, two-way communications.

During 2007, the Company participated in several investor events, including investor roadshows, analyst and investor presentations, one-on-one meetings and conference calls, as well as investor conferences in Europe and in the US.

In 2007, PT held a total of over 200 meetings with analysts and investors. Additionally, PT held meetings in its offices, as well as conference-calls with investors and analysts on a regular basis.

During 2007, PT held three roadshows in Europe and the US. The two most significant were held in February (after the announcement of the full-year results), as well as the roadshow held between the end of November and the beginning of December.

The domestic and international financial community continued to recognise PT s efforts in terms of investor relations. This was recognised internationally by the two awards PT received at the 2007 IR Magazine Continental Europe Awards:

- Best Investor Relations Officer (Small and Medium Cap)
- Best Investor Relations in Portugal

Domestically, PT received three prizes at the 2007 Investor Relations Awards, promoted by Deloitte, Diário Económico and Semanário Económico, as follows:

- Best CEO in the Investor Relations area
- Annual Report (non-financial sector) - Honourable Mention
- Best Investor Relations Officer - Honourable Mention

05 Main events

Events of the year

Shareholder remuneration

27.APR.07 PT s shareholders approved at the Annual General Meeting (AGM) the following proposals related to the shareholder remuneration package:

- The payment of a cash dividend of Euro 0.475 per share for the fiscal year 2006. The dividend was paid on 18 May 2007.

- The free attribution (spin-off) of all the ordinary shares of PT Multimédia held by PT to its shareholders.

- The acquisition of PT s own shares, in connection with the share buyback programme announced.

28.SEP.07 Following the approval of the proposal above mentioned, PT acquired 103,056,500 own shares, corresponding to 9.13% of its share capital, by a total amount of Euro 1.05 billion, through the the exercise of the physical settlement of equity swap contracts.

Share capital

27.APR.07 PT s shareholders approved at the AGM a share capital increase to Euro 474,119,730, to be carried out by means of incorporation of legal reserve in the amount of Euro 79,019,955. At the same meeting, the shareholders approved a share capital reduction in the amount of Euro 440,254,035 to Euro 33,865,695, to be carried out through a reduction in the par value of PT shares to 3 cents.

22.MAY.07 PT executed the public deed for the referred share capital increase and reduction operations, with the resulting share capital amounting to Euro 33,865,695, comprised by 1,128,856,500 shares with a par value of 3 cents each.

20.DEC.07 As part of the execution of the share buyback programme, PT registered the reduction of its share capital in the amount of Euro 3,091,695 through the cancellation of 103,056,500 treasury shares. As a result, PT s share capital is now equivalent to Euro 30,774,000, comprised by 1,025,800,000 shares with a par value of 3 cents each.

Spin-off of PT Multimédia

21.SEP.07 PT announced that its Board of Directors approved the execution of the PT Multimédia spin-off by the end of October 2007, which was within the expected timeframe and in accordance with the terms approved by the Annual General Shareholders Meeting of 27 April 2007.

12.OCT.07 PT announced that the execution of the spin-off of its 58.43% holding in PT Multimédia would be completed on 7 November 2007, under the following terms:

- Timetable - ex-righ date: 30 October; record date: 1 November and credit date of PT Multimédia shares to PT s shareholders accounts: 7 de November.

- The allotment to each shareholder of the number of PT Multimédia shares resulting from the application of the ratio 0.176067 to the number of PT shares held on 1 November (record date), rounded down, with a cash payment for the corresponding difference.

- For tax and accounting purposes, the spin-off was considered a dividend in kind and therefore each PT shareholder was subject to withholding tax in accordance with applicable legislation.

06.NOV.07 PT announced that the reference price, to determine the cash amounts in connection with the withholding tax and the compensation for fractional shares resulting from the application of the spin-off ratio, corresponding to the weighted average market price of PT Multimédia shares on the Euronext Lisbon on 6 November 2007 was Euro 9.18 per share.

07.NOV.07 PT announced the completion of the spin-off of PT Multimédia, with a total of 154.9 million shares being transferred to the shareholders accounts, representing 50.1% of the share capital and voting rights in PT Multimédia. As a result of the application of the withholding tax and the fractional shares mechanisms, PT retained an interest of 8.3% of PT Multimédia s share capital, corresponding to 25.7 million shares. Following the sale of these PT Multimédia shares, on 13 November 2007, PT no longer holds PT Multimédia shares in its balance sheet. The buyers of such PT Multimédia shares have agreed to a 6-month lock-up period, as per US legal requirements.

Acquisition of Telemig Participações and Tele Norte Participações

O2.AUG.07 Vivo announced the signature of a stock purchase agreement with Telpart Participações to acquire control of Telemig Celular Participações and Tele Norte Celular Participações, corresponding to 22.72% and 19.34% of total share capital respectively, for an aggregate amount of R$ 1.2 billion. Assuming full acceptance of all mandatory and voluntary offers, Vivo will have acquired a beneficial interest of 58.2% in Telemig Celular and 54.6% in Amazônia Celular, for an aggregate consideration of approximately R$ 2.9 billion (including the value of the subscription rights of R$ 87 million to be acquired from Telpart). Anatel has already approved the acquisition of Telemig Celular. With this transaction Vivo reaffirms its leadership in the wireless market.

20.DEC.07 Vivo reached an agreement with Oi (Telemar Norte Leste) to sell Tele Norte Celular, the controlling company of Amazonia Celular.

Debt

05.MAR.07 Moody s confirmed its rating for PT at Baa2, with stable outlook, following the failure of the tender offer. Fitch Ratings also confirmed its rating for PT at BBB, with negative outlook.

16.MAR.07 Standard & Poor s confirmed its rating for PT at BBB-, with stable outlook, following the failure of the tender offer.

03.JUL.07 PT successfully issued a Euro 750 million exchangeable bond with a maturity of 7 years. The coupon was fixed at 4.125% and the exchange price at Euro 13.9859, which was adjusted, on 30 October 2007, to Euro 11.60 following the spin-off of PT s interest in PT Multimédia.

Corporate bodies

02.MAR.07 Approval at the Shareholders Meeting of the election of the Vice-Chairman of the General Meeting of Shareholders, Daniel Proença de Carvalho, and of the Secretary of the General Meeting of Shareholders, Francisco Leal Barona, following the termination of the term of office of the former holders of these positions, as well as the ratification of the appointment of the Director, Nuno Rocha dos Santos de Almeida, to complete the 2006/2008 term of office in both cases.

22.JUN.07 Approval at the Shareholders Meeting of the following proposals:

- Amendment to the articles of association of PT in light of the amendments to the Portuguese Companies Code, which, notably, aims at the implementation of the Anglo-Saxon governance model in PT, with the Company s supervision to be carried out by an

Audit Committee composed of members of the Board of Directors and by a statutory auditor.

- Change in the composition of the Board of Directors from 21 to 23 members and election of Rafael Mora Funes and José Xavier de Basto as members of the Board of Directors to complete the 2006-2008 term of office.

- Election of the directors João Mello Franco (Chairman), Thomaz Paes de Vasconcellos and José Xavier de Basto as members of the Audit Committee for the 2006-2008 term of office.

- Election of the company P. Matos Silva, Garcia Jr., P. Caiado & Associados, SROC, represented by Pedro Matos Silva as Statutory Auditor, and of the company Ascenção, Gomes, Cruz & Associado SROC, represented by Mário Gomes as alternate Statutory Auditor, for the 2006-2008 term of office.

- Election of Eduardo Vera-Cruz Pinto as the new Vice-Chairman of the General Meeting of Shareholders, following the resignation of the former Vice-Chairman, to complete the 2006-2008 term of office.

- Election of Álvaro Pinto Correia, João Mello Franco and Francisco Esteves de Carvalho as members of the Compensation Committee in substitution of the resigning members.

21.SET.07 PT s Board of Directors announced the appointment of Zeinal Bava, Deputy CEO of PT, as CEO of PT Portugal and of PT Comunicações, in addition to his role as CEO of TMN, following the resignation of Rodrigo Costa as Vice-President of PT and CEO of the Wireline division.The Chairman and CEO of PT, Henrique Granadeiro, announced that he will propose to the Board of Directors, following the Annual General Meeting to approve accounts, the appointment of Zeinal Bava as CEO of PT, while remaining as Chairman of the Board.

Competition Authority fine

02.AUG.07 The Portuguese Competition Authority sanctioned PT for alleged abuse of dominant position by refusing to provide access to its ducts and applied a fine of Euro 38 million. Supported by legal opinions, PT has decided not to accrue for this contingency, as it considers that the outcome will be ultimately favourable for PT.

Public tender offer

12.JAN.07 PT published an update to the report of the Board of Directors regarding the public tender offer announced by Sonaecom. On the same date, PT was notified by the Portuguese Securities Commission (CMVM) of its decision to register the offer.

20.FEB.07 PT published an update to the report of the Board of Directors, following the revision of the offer price announced by Sonaecom on 15 February 2007.

27.FEB.07 PT issued a clarification on the shareholder remuneration package included in the update to the Board of Directors report on the revision of the offer price published on 20 February 2007.

01.MAR.07 Following the amendment to the prospectus on the tender offer launched by Sonaecom SGPS and Sonaecom BV, the Board of Directors of PT considered that the offerors amendments to the prospectus did not change the consideration and terms of the revised offer that has been announced, only clarified the conditions of the financing of the offer, namely the sale of assets and the allocation of PT s results through dividends to service the debt assumed by the offerors. Therefore, the Board of Directors reiterated the position and the commitments expressed in its report of 20 February 2007.

02.MAR.07 PT s shareholders rejected, by the majority of the votes cast at the general meeting, the proposal related to the removal of the voting limitation in the bylaws of the Company, whose approval was a condition of the tender offer launched by Sonaecom. Thus, and in accordance with the understanding of the CMVM, the tender offer launched by Sonaecom for PT and PT Multimédia shares, and their effects, lapsed.

Subsequent events

Corporate bodies

18.JAN.08 PT announced that Armando António Martins Vara resigned from his office as non-executive member of the company s Board of Directors.

31.JAN.08 PT announced that António Viana-Baptista and Fernando Abril-Martorell resigned from their office as non-executive members of the company s Board of Directors.

12.FEB.08 PT announced the appointment of Francisco Manuel Marques Bandeira, José María Álvarez-Pallete López and Santiago Fernández Valbuena as non-executive members of the Company s Board of Directors, to complete the 2006-2008 term of Office, thus replacing Armando António Martins Vara, António Viana-Baptista and Fernando Abril-Martorell respectively.

Shareholder remuneration

13.FEB.08 PT announced that, as part of the share buyback programme, it has the right to acquire 63,391,786 shares through equity swap agreements, which includes 20,640,000 shares contracted under the previous share buyback programme. As a result,as part of the share buyback programme under execution, PT has acquired a total of 145,808,286 own shares, equivalent to 12.92% of PT s share capital prior to the share capital reduction executed on 20 December 2007, by a total amount of Euro 1,434 million.

06 Outlook

Portugal Telecom will continue to explore the growth potential of its asset portfolio, both domestically and internationally. In the domestic market, PT aims to explore full telecommunications and multimedia opportunities through fixed-mobile convergent offers and through multimedia integrated propositions. Internationally, PT intends to continue developing its mobile asset in Brazil, taking advantage of the potential growth of the Brazilian market, and to exploit opportunities in growth markets where PT has clear competitive advantages.

PT will continue to operate in a highly competitive and regulated environment that will pose continued risks and threats to its existing businesses, placing the profitability of its assets under pressure.

In order to anticipate these challenges, PT s strategy in the domestic market will be based upon the development of fixed-mobile convergent services for all segments of the market aimed at improving customer loyalty and decreasing retention costs, while using the various brands in an integrated manner. PT s strategy will also be based on the deployment of new services aimed at providing a pay-TV offering with distinctive and customised content tailored to meet the customer needs. A multi-platform strategy will be designed to provide nationwide coverage of these services. PT will continue to contribute to the development of the information society in Portugal and to promoting the info-inclusion of all Portuguese citizens not only in the urban areas, but also in the more remote and rural regions of Portugal. PT will continue streamlining its businesses by rationalising its cost structure through productivity increases and business process reengineering.

Internationally, PT aims to continue exploring the growth potential of Vivo, its Brazilian mobile asset, leveraging on Brazil s attractive economic growth prospects, favourable demographics and the opportunity for the fixed-mobile migration. PT will also take advantage of the nationwide coverage of Brazil recently achieved, an opportunity that was never available to date, in order to regain market share in key market segments, namely corporate and high-end. The upcoming launch of 3G services and the existing know-how of Vivo in the data segment should contribute to further exploit the mobile broadband and data opportunity. PT also aims to continue increasing its exposure to high-growth markets in Africa by selectively considering value-creating opportunities and taking full advantage of its existing portfolio and partnerships.

In line with its remuneration commitment, PT should continue to provide an attractive shareholder remuneration profile combined with above-average growth prospects, provided by its international portfolio.

07 Statement by the persons responsible

For the purposes of subparagraph 1, c) of article 245 of the Portuguese Securities Code, the members of the Board of Directors of Portugal Telecom, SGPS, S.A. identified hereunder declare, in the capacity and within their functions as described therein, that, to the best of their knowledge and grounded on the information to which they had access within such Board of Directors and/or Executive Committee, as applicable, while in office:

- The management report, the financial statements, the auditor s opinion and the other financial statements and documents required by law or regulation concerning the financial year ended on 31 December 2007 were prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and profit or loss of Portugal Telecom, SGPS, S.A. and the undertakings included in the consolidation taken as a whole;

- The management report concerning such financial year includes a fair review of the development of the business and the performance and position of Portugal Telecom, SGPS, S.A. and the undertakings included in the consolidation taken as a whole, including an accurate description of the principal risks and uncertainties that they face.

Lisbon, 27 February 2008

Henrique Granadeiro, Chairman of the Board of Directors and Chief Executive Officer

Zeinal Bava, Deputy Chief Executive Officer

Luís Pacheco de Melo, Executive Director, Chief Financial Officer

João Pedro Baptista, Executive Director

António Caria, Executive Director

Rui Pedro Soares, Executive Director

Santiago Fernández Valbuena, Non-Executive Director

José María Álvarez-Pallete López, Non-Executive Director

Joaquim Goes, Non-Executive Director

Amílcar de Morais Pires, Non-Executive Director

Francisco Marques Bandeira, Non-Executive Director

Jorge Tomé, Non-Executive Director

Nuno de Almeida e Vasconcellos, Non-Executive Director

Rafael Mora Funes, Non-Executive Director

João de Mello Franco, Non-Executive Director

Thomaz Paes de Vasconcellos, Non-Executive Director

José Xavier de Basto, Non-Executive Director

Franquelim Alves, Non-Executive Director

Gerald McGowan, Non-Executive Director

Francisco Pereira Soares, Non-Executive Director

Fernando Soares Carneiro, Non-Executive Director

Luís de Azevedo Coutinho, Non-Executive Director

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PORTUGAL TELECOM, SGPS, SA

CONSOLIDATED INCOME STATEMENT

FOR THE YEARS ENDED 31 DECEMBER 2007 AND 2006

(Amounts stated in Euro)

	Notes	2007	2006
CONTINUING OPERATIONS			
REVENUES			
Services rendered	6	5,625,495,438	5,245,888,869
Sales	6	442,466,483	426,230,971
Other revenues	6	80,447,271	93,167,779
		6,148,409,192	**5,765,287,619**
COSTS, EXPENSES, LOSSES AND (INCOME)			
Wages and salaries	8	638,072,873	633,477,183
Post retirement benefits	9.5	(65,076,144)	(72,114,978)
Direct costs	10	907,297,176	724,870,453
Costs of products sold	11	656,149,583	580,619,498
Support services		233,571,798	202,072,507
Marketing and publicity		147,246,817	138,301,415
Supplies and external services	12	945,616,627	928,511,310
Indirect taxes	14	201,825,104	175,910,937
Provisions and adjustments	39	127,033,719	216,636,355
Depreciation and amortisation	33 and 34	1,123,064,739	1,130,713,808
Curtailment costs, net	9.5	275,619,171	18,962,004
Gains on disposals of fixed assets, net		(2,795,990)	(5,149,008)
Other costs, net	15	45,071,936	115,399,995
		5,232,697,409	**4,788,211,479**
Income before financial results and taxes		**915,711,783**	**977,076,140**
Net interest expense	16	197,368,292	220,073,341
Net foreign currency exchange losses (gains)		12,427,018	(4,467,691)
Net gains on financial assets and other investments	17	(248,783,007)	(18,333,763)
Equity in earnings of associated companies, net	31	(126,127,657)	(130,605,856)
Net other financial expenses	18	48,316,434	51,778,746
		(116,798,920)	**118,444,777**
Income before taxes		**1,032,510,703**	**858,631,363**
Income taxes	19	243,277,665	(21,364,371)
Net income from continuing operations		**789,233,038**	**879,995,734**
DISCONTINUED OPERATIONS			

Net income from discontinued operations	20	45,474,124	74,132,079
NET INCOME		**834,707,162**	**954,127,813**
Attributable to minority interests	21	92,847,426	87,368,156
Attributable to equity holders of the parent	**23**	**741,859,736**	**866,759,657**
Earnings per share from total operations			
Basic	23	0.71	0.78
Diluted	23	0.67	0.73
Earnings per share from continued operations			
Basic	23	0.69	0.74
Diluted	23	0.66	0.69

The accompanying notes form an integral part of these financial statements.

PORTUGAL TELECOM, SGPS, SA

CONSOLIDATED BALANCE SHEET

31 DECEMBER 2007 AND 2006

(Amounts stated in Euro)

	Notes	2007	2006
ASSETS			
Current Assets			
Cash and cash equivalents		664,642,854	548,464,617
Short-term investments	24	1,170,293,202	1,535,233,729
Accounts receivable - trade	25	1,307,429,771	1,181,912,412
Accounts receivable - other	26	128,745,389	218,912,177
Inventories	27	160,592,407	130,280,564
Taxes receivable	28	239,111,584	211,747,572
Prepaid expenses	29	106,526,815	121,714,749
Other current assets	30	38,979,994	50,405,004
Total current assets		**3,816,322,016**	**3,998,670,824**
Non-Current Assets			
Accounts receivable - trade		1,289,741	916,813
Accounts receivable - other	26	4,352,233	15,237,939
Taxes receivable	28	148,340,234	124,531,128
Prepaid expenses		6,822,888	2,628,424
Investments in group companies	31	538,080,641	499,098,279
Other investments	32	27,235,420	132,391,079
Intangible assets	33	3,383,123,427	3,490,881,263
Tangible assets	34	3,585,397,171	3,942,033,190
Post retirement benefits	9.3	134,060,599	134,060,519
Deferred taxes	19	992,880,357	1,167,007,154
Other non-current assets	30	484,266,159	663,792,688
Total non-current assets		**9,305,848,870**	**10,172,578,476**
Total assets		**13,122,170,886**	**14,171,249,300**
LIABILITIES			
Current Liabilities			
Short-term debt	35	1,256,085,485	1,372,724,030
Accounts payable	36	1,108,882,163	1,115,089,223
Accrued expenses	37	641,050,928	680,217,532
Deferred income	38	286,056,467	215,738,311
Taxes payable	28	381,956,714	316,962,828
Provisions	39	123,340,200	105,151,491
Other current liabilities	40	67,308,947	82,495,889
Total current liabilities		**3,864,680,904**	**3,888,379,304**
Non-Current Liabilities			
Medium and long-term debt	35	4,960,675,814	4,467,537,132
Taxes payable	28	31,172,618	25,787,484
Deferred income		1,413,069	380,097
Provisions	39	111,833,374	102,633,567
Post retirement benefits	9.3	1,463,932,239	1,807,570,587

Deferred taxes	19	84,880,140	90,377,817
Other non-current liabilities	40	521,772,540	682,545,374
Total non-current liabilities		**7,175,679,794**	**7,176,832,058**
Total liabilities		**11,040,360,698**	**11,065,211,362**
SHAREHOLDERS EQUITY			
Share capital	41	30,774,000	395,099,775
Capital issued premium	41		
Treasury shares	41	(323,178,913)	(187,612,393)
Legal reserve	41	6,773,139	82,706,881
Reserve for treasury shares	41	3,091,695	
Accumulated earnings	41	1,620,761,976	1,965,055,467
Equity excluding minority interests		**1,338,221,897**	**2,255,249,730**
Minority interests	21	743,588,291	850,788,208
Total equity		**2,081,810,188**	**3,106,037,938**
Total liabilities and shareholders equity		**13,122,170,886**	**14,171,249,300**

The accompanying notes form an integral part of these financial statements.

PORTUGAL TELECOM, SGPS, SA

CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSES

FOR THE YEARS ENDED 31 DECEMBER 2007 AND 2006

(Amounts stated in Euro)

	Notes	2007	2006
Income and expenses recognised directly in shareholders equity			
Post retirement benefits			
Net actuarial gains	9.6	285,237,065	319,415,213
Tax effect	19	(75,588,720)	(100,691,917)
Financial instruments and investments			
Hedge accounting			
Change in fair value		3,685,028	32,537,381
Transferred to profit and loss	42	(8,287,000)	(6,938,643)
Investments available for sale:			
Changes in fair value	32	15,682,412	19,831,643
Transferred to profit and loss on sale	17	(38,650,508)	
Tax effect	19	7,306,068	(12,223,825)
Foreign currency translation adjustments (i)		204,087,132	(76,506,877)
Other expenses recognised directly in shareholders equity, net (ii)		(1,830,620)	(3,353,908)
		391,640,857	**172,069,067**
Income recognised in the consolidated income statement		**834,707,162**	**954,127,813**
Total income recognised		**1,226,348,019**	**1,126,196,880**
Attributable to minority interests		92,847,426	87,368,156
Attributable to equity holders of the parent		**1,133,500,593**	**1,038,828,724**

(i) Gains recorded in 2007 are mainly related to the appreciation of the Real against the Euro from 2.8118 as at 31 December 2006 to 2.5963 as at 31 December 2007, while losses recorded in 2006 are primarily related to the devaluation of the Real against the Euro from 2.744 as at 31 December 2005 to 2.8118 as at 31 December 2006.

(ii) In 2007 and 2006, current income taxes recognised directly in shareholders equity amounted to Euro 4,437,430 and Euro 2,667,726, respectively (Note 28), and are related to the tax effect on the gains obtained on the equity swaps over Portugal Telecom s own shares.

The accompanying notes form an integral part of these financial statements.

PORTUGAL TELECOM, SGPS, SA

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEARS ENDED 31 DECEMBER 2007 AND 2006

(Amounts stated in Euro)

	Notes	2007	2006
OPERATING ACTIVITIES			
Collections from clients		7,070,397,265	6,763,769,410
Payments to suppliers		(3,653,519,418)	(3,277,388,237)
Payments to employees		(654,757,374)	(653,682,324)
Payments relating to income taxes	44.a	(206,528,920)	(51,626,295)
Payments relating to post retirement benefits	9.4	(284,159,570)	(580,789,898)
Payments relating to indirect taxes and other	44.b	(610,407,039)	(572,755,719)
Cash flow from operating activities from continued operations		1,661,024,944	1,627,526,937
Cash flow from operating activities from discontinued operations	20	198,182,708	194,134,513
Cash flow from operating activities (1)		1,859,207,652	1,821,661,450
INVESTING ACTIVITIES			
Cash receipts resulting from			
Short-term financial applications	44.c	25,017,800,206	20,265,198,328
Financial investments	44.d	239,646,906	2,435,335
Tangible and intangible assets		15,424,276	12,456,930
Interest and related income		246,999,708	237,362,095
Dividends	44.e	94,799,920	34,267,817
Other investing activities	44.f	130,710,004	54,285,892
		25,745,381,020	20,606,006,397
Payments resulting from			
Short-term financial applications	44.c	(24,652,859,679)	(18,501,169,649)
Financial investments	44.g	(3,342,537)	(93,174,205)
Tangible fixed assets		(756,401,882)	(723,195,587)
Other investing activities		(17,214,795)	(29,382,265)
		(25,429,818,893)	(19,346,921,706)
Cash flow from investing activities related to continued operations		315,562,127	1,259,084,691
Cash flow from investing activities related to discontinued operations	20	(79,620,931)	(122,394,941)
Cash flow from investing activities (2)		235,941,196	1,136,689,750
FINANCING ACTIVITIES			
Cash receipts resulting from			
Loans obtained	44.h	9,032,800,130	16,282,847,588
Subsidies		1,781,572	1,823,692
Other financing activities		220,786	39,292
		9,034,802,488	16,284,710,572
Payments resulting from			
Loans repaid	44.h	(8,809,340,609)	(18,016,333,731)
Lease rentals (principal)		(17,089,599)	(12,790,988)
Interest and related expenses		(491,753,664)	(552,211,935)
Dividends	44.i	(552,726,968)	(552,208,352)
Acquisition of treasury shares	41.3	(1,050,271,924)	
Other financing activities	44.j	(46,962,926)	(81,046,857)

		(10,968,145,690)	(19,214,591,863)
Cash flow from financing activities related to continued operations		(1,933,343,202)	(2,929,881,291)
Cash flow from financing activities related to discontinued operations	20	(20,267,540)	(85,489,101)
Cash flow from financing activities (3)		(1,953,610,742)	(3,015,370,392)
Cash and cash equivalents at the beginning of the period		548,464,617	612,158,485
Change in cash and cash equivalents (4)=(1)+(2)+(3)		141,538,106	(57,019,192)
Effect of exchange differences		23,442,726	(6,674,676)
Cash and cash equivalentes of PT Multimédia as of the date of the spin-off		(48,802,595)	
Cash and cash equivalents at the end of the period		664,642,854	548,464,617

The accompanying notes form an integral part of these financial statements.

Portugal Telecom, SGPS, SA

Notes to the Consolidated Financial Statements

As at 31 December 2007

(Amounts stated in Euros, except where otherwise stated)

1. Introduction

a) Parent company

Portugal Telecom, SGPS, SA (formerly Portugal Telecom, SA, Portugal Telecom) and subsidiaries (Group , Portugal Telecom Group , or the Company), are engaged in rendering a comprehensive range of telecommunications and multimedia services in Portugal and other countries, including Brazil.

Portugal Telecom was incorporated on 23 June 1994, under Decree-Law 122/94, as a result of the merger, effective 1 January 1994, of Telecom Portugal, SA (Telecom Portugal), Telefones de Lisboa e Porto (TLP), SA (TLP) and Teledifusora de Portugal, SA (TDP). On 12 December 2000, Portugal Telecom, SA changed its name to Portugal Telecom, SGPS, SA, and became the holding company of the Group.

As a result of the privatization process, between 1 June 1995 and 4 December 2000, Portugal Telecom s share capital is mainly owned by private shareholders. As at 31 December 2007, the Portuguese State owned, directly or indirectly, 8.44% of the total ordinary shares and all of the A Shares of Portugal Telecom (Note 41.1).

The shares of Portugal Telecom are traded on the Euronext Lisbon Stock Exchange and on the New York Stock Exchange.

b) Corporate purpose

Continued operations

Portugal Telecom Group is engaged in rendering a comprehensive range of telecommunications services in Portugal and abroad, including Brazil.

In Portugal, fixed line services are rendered by PT Comunicações, SA (PT Comunicações), under the provisions of the Concession Agreement entered into with the Portuguese State on 20 March 1995 in accordance with Decree-Law 40/95, for an initial period of thirty years, subject to renewal for subsequent periods of fifteen years. On 11 December 2002, according to the terms of the Modifying Agreement to the Concession Contract, PT Comunicações acquired the property of the Basic Network of Telecommunications and Telex (Basic Network).

Data transmission services are rendered through PT Prime - Soluções Empresariais de Telecomunicações e Sistemas, SA (PT Prime), which is also an Internet Service Provider (ISP) for large clients.

ISP services for residential clients and small and medium companies are rendered through PT.com Comunicações Interactivas, SA (PT.com), which also provides services relating to the conception, design and exhibit of publicity and information space on Internet portals.

Mobile services in Portugal are rendered by TMN - Telecomunicações Móveis Nacionais, SA (TMN), under a GSM license granted by the Portuguese State in 1992 (period of 15 years), renewed in 2007 until 16 March 2022, and a UMTS license obtained in 19 December 2000 (period of 15 years).

In Brazil, the Group renders mobile telecommunications services through Brasilcel NV (Brasilcel or Vivo), a joint venture incorporated in 2002 by Portugal Telecom (through PT Móveis, SGPS, SA PT Móveis) and Telefónica (through Telefónica Móviles, SA) to join the mobile operations of each group. Currently, Brasilcel, through its company Vivo, SA, provides mobile services in the Brazilian states of São Paulo, Paraná, Santa Catarina, Rio de Janeiro, Espírito Santo, Bahia, Sergipe, Rio Grande do Sul, and eleven states in the Midwestern and Northern regions of Brazil. On 3 August 2007, Vivo Participações, SA (a holding company listed on São Paulo stock exchange that is held by Brasilcel and controls Vivo, SA) signed a stock purchase agreement with Telpart Participações S.A. (Telpart) to acquire control of Telemig Celular Participações S.A. (Telemig Celular) and Tele Norte Celular Participações S.A. (Tele Norte Celular), providers of mobile telecommunication services in the Brazilian State of

Minas Gerais and in the Amazon region Under this purchase agreement, Vivo Participações, S.A. will acquire 22.72% and 19.34% of total capital of Telemig Celular and Tele Norte Celular, respectively, for an aggregate amount of R$ 1.2 billion, subject to certain price adjustments. In addition, Vivo Participações, SA will acquire from Telpart certain subscription rights for an aggregate amount of R$ 87 million. The conclusion of the transaction is subject to ANATEL (the Brazilian telecom regulator) approval and relating to Telepart s share capital to ratification by general shareholders meetings of Vivo and Telpart, among other customary closing conditions, which were not in place as at 31 December 2007.

Discontinued operations (Note 20)

PT Multimédia Serviços de Telecomunicações e Multimédia, SGPS, SA (PT Multimedia recently renamed ZON Multimédia, Serviços de Telecomunicações e Multimédia, SGPS, SA) was the Group s subsidiary for multimedia operations. Through its subsidiary TV Cabo Portugal, SA, PT Multimedia renders cable and satellite television services and voice and internet access services in mainland Portugal, Madeira and Azores. PT Multimedia also renders other multimedia services in Portugal, namely the editing and selling of DVD and movies through Lusomundo Audiovisuais, SA and the distribution and exhibition of movies through Lusomundo Cinemas, SA. At the last Annual General Meeting of Portugal Telecom held on 27 April 2007, it was approved the free allotment (spin-off) of all ordinary shares of PT Multimedia held by Portugal Telecom to its shareholders.

On 7 November 2007 Portugal Telecom concluded the distribution to its shareholders of its interest in PT Multimédia.

The net income of this business in 2006 and in 2007 until the conclusion of the spin-off was presented in the consolidated income statement under the caption Net income from discontinued operations (Note 20).

The consolidated financial statements for the year ended 31 December 2007 were approved by the Board of Directors and authorized for issue on 27 February 2008.

2. Basis of presentation

Consolidated financial statements are presented in Euros, which is the currency of the majority of the Portugal Telecom s operations. Financial statements of foreign subsidiaries are translated to Euros according to the accounting principles described in Note 3.q).

The consolidated financial statements of Portugal Telecom have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), and include all interpretations of the International Financial Reporting Interpretation Committee (IFRIC) as at 31 December 2007. For Portugal Telecom, no differences have been identified between IFRS as adopted by the EU and applied by Portugal Telecom, and IFRS as published by the International Accounting Standards Board.

Consolidated financial statements have been prepared assuming the continuity of operations, based on the accounting records of all subsidiaries (Exhibit I).

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reported periods (Note 3).

a) Consolidation principles

Controlled entities

Portugal Telecom has fully consolidated the financial statements of all controlled entities. Control is achieved where the Group has the majority of the voting rights or has the power to govern the financial and operating policies of an entity. In any case, where the Group does not have the majority of the voting rights but in substance controls the entity, the financial statements of the entity are fully consolidated (See Exhibit I).

The interest of any third party in the equity and net income of fully consolidated companies is presented separately in the consolidated balance sheet and consolidated income statement, under the caption Minority interests (Note 21).

Losses applicable to the minorities in excess of the minority s interest in the subsidiary s equity are allocated against the interest of the Group, except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses. Any future gains reported by the subsidiary are allocated against the interest of the Group, until the excess losses recognised by the Group are covered.

Assets, liabilities and contingent liabilities of an acquired subsidiary are measured at fair value at acquisition date. Any excess amount to the identifiable net assets is recognised as goodwill. If the acquisition cost is lower than the fair value of identifiable net assets acquired, the difference is recognised as a gain in the net income for the period the acquisition occurs. Minority interests are presented proportionally to the fair value of identifiable net assets.

The results of subsidiaries acquired or disposed during the period are included in the consolidated income statement from the effective date of the acquisition or up to the effective date of disposal, as appropriate.

All intra-group transactions, balances, income and expenses are eliminated in the consolidation process. Gains obtained in intra-group transactions are also eliminated in the consolidation process.

Where necessary, adjustments are made to the financial statements of subsidiaries to adjust their accounting policies in line with those adopted by the Group.

Interests in joint ventures

Portugal Telecom has proportionally consolidated the financial statements of jointly controlled entities beginning on the date the joint control is effective. Under this method, assets, liabilities, income and expenses of the entity are added, on a proportional basis, to the corresponding consolidated caption. Financial investments are classified as jointly controlled entities if the joint control agreement clearly demonstrates the existence of joint control.

All transactions and balances with jointly controlled entities are eliminated to the extent of the Group s interest in the joint venture.

Jointly controlled entities are presented in Exhibit III.

Investments in associates

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policies of the entity but not to control or jointly control those policies.

Financial investments in associated companies are accounted for under the equity method (Exhibit II). Under this method, investments in associated companies are carried in the consolidated balance sheet at cost, adjusted periodically for the Group s share in the results of the associated company, recorded as part of financial results under the caption Equity in earnings of associated companies, net (Note 31). In addition, these financial investments are adjusted for any impairment losses that may occur.

Losses in associated companies in excess of the cost of acquisition are not recognised, except where the Group has assumed any commitment to cover those losses.

Any excess of the cost of acquisition over the Group s share of the fair value of net assets acquired and contingent liabilities of the associate recognised at the date of acquisition is recorded as goodwill. The goodwill is included within the carrying amount of the investment and is assessed annually for impairment as part of the investment. If the acquisition cost is lower than the fair value of identifiable net assets, the difference is recorded as a gain in the net income for the period the acquisition occurs.

Dividends received from associated companies are recorded as a reduction in the value of financial investments.

Profits and losses occurring in transactions with associated companies are eliminated to the extent of the Group s interest in the associate, and recorded against the corresponding financial investment.

Non-current assets held for sale and disposal groups

Non-current assets and disposal groups are classified as held for sale or as discontinued operation when the asset or the group of assets will be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets will be transferred in the transaction. This condition is regarded as met, only when: (i) the subject transaction is highly probable, and the asset or group of assets is available for immediate sale or to be transferred in its present condition; (ii) the Group has assumed a commitment to the subject of transaction; and (iii) the transaction is expected to be completed within one year. Non-current assets classified as held for sale are measured at the lower of the assets previous carrying amount or the fair value less costs to sell.

Goodwill

Goodwill represents the excess of the cost of acquisition over the Group s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary, jointly controlled or associated entity recognised at the date of acquisition, in accordance with IFRS 3. Considering the exception of IFRS 1, the Group used the provisions of IFRS 3 only for acquisitions that occurred after 1 January 2004. Goodwill related to acquisitions made up to 1 January 2004 was recorded at the carrying amount of those acquisitions as of that date, and is subject to annual impairment tests thereafter.

Goodwill related to foreign investments is carried at the reporting currency of the investment, being translated to Euros at the exchange rate prevailing at the balance sheet date. Exchange gains or losses are recognised in the Statement of Recognised Income and Expenses under the caption Cumulative foreign currency translation adjustments .

Goodwill related to associated companies is recognised under the caption Investments in group companies (Note 31), and goodwill related to subsidiaries and jointly controlled entities is recognized under the caption Intangible assets (Note 33). Goodwill is not amortised, but tested, on an annual basis, for impairment losses, which are recognised in net income in the period they occur, and cannot be reversed in a subsequent period.

On disposal of a subsidiary, jointly controlled entity or associate, the goodwill allocated to that investment is included in the determination of the gain or loss on disposal.

b) Changes in the consolidated Group

During 2007, there were no significant changes in the consolidated Group except for the spin-off of PT Multimedia mentioned above.

During 2006 the main change in the consolidated Group was the inclusion of Mobile Telecommunications Limited (MTC), following the acquisition of a 34% stake in the share capital of this company in September 2006. In connection with this transaction, Portugal Telecom entered into an agreement with the remaining shareholders of

MTC, under which Portugal Telecom has the power to set and control financial and operating policies of this company. Accordingly, Portugal Telecom consolidated MTC s assets, liabilities and results as from the date the control has been transferred (September 2006). Portugal Telecom s consolidated financial statements include MTC s assets and liabilities as at 31 December 2007 and 2006 and its results for the year ended 31 December 2007 and for the four months period from 1 September 2006 to 31 December 2006. The assets and liabilities from MTC as at 1 September 2006, when it was included for the first time in the consolidation, are as follows:

	Fair value of net assets acquired	Fair value of intangible assets identified (i)	Total
ASSETS			
Current assets	66,062,847		66,062,847
Intangible assets	7,037,337	7,085,832	14,123,169
Tangible assets	47,680,742		47,680,742
Other non-current assets	605,639		605,639
Total assets	**121,386,565**	**7,085,832**	**128,472,397**
LIABILITIES			
Current liabilities	11,240,416		11,240,416
Other non-current liabilities	14,795,400	2,480,041	17,275,441
Total liabilities	**26,035,816**	**2,480,041**	**28,515,857**
Total net assets acquired			**99,956,540**
			34%
PT s share of net assets acquired			**33,985,224**

(i) In the purchase price allocation, Portugal Telecom has identified intangible assets not included in MTC s financial statements, related to the license that allows MTC to operate in the Namibian telecommunications market. The related tax effect amounted to Euro 2,480,041.

Portugal Telecom has made the following purchase price allocation related to the acquisition of MTC:

Shareholders agreement (i)	34,163,176
PT s share of net assets acquired	33,985,224
Goodwill	40,499,689
Purchase price	**108,648,089**

(i) This caption relates to the agreement entered into with the other shareholders of MTC, which allows Portugal Telecom to set and control financial and operating policies of this company. The fair value of this agreement was determined based on the comparison between the purchase price of Portugal Telecom s acquisition of a 34% stake in MTC s share capital and the payable price of a previous transaction with former shareholders of MTC, since the main difference between those transactions is related to the power to control this company.

3. Summary of significant accounting policies, judgments and estimates

a) Current classification

Assets to be realized and liabilities to be settled within one year from the date of the balance sheet are classified as current.

b) Inventories

Inventories are stated at average acquisition cost. An adjustment to the carrying value of inventories is recognised when the net realizable value is lower than the average cost, recorded in net income of the period the loss occurs under the caption Cost of products sold . Usually these losses are related to technological obsolescence and lower rotation.

c) Tangible assets

Tangible assets are stated at acquisition cost, net of accumulated depreciation, investment subsidies and accumulated impairment losses, if any. Acquisition cost includes: (1) the amount paid to acquire the asset; (2) direct expenses related to the acquisition process; and (3) the estimated cost of dismantling or removal of the assets (Notes 3.g and 39). Under the exception of IFRS 1, revaluation of tangible assets made in accordance with Portuguese legislation applying monetary indices, prior to 1 January 2004, was not adjusted and was included as the deemed cost of the asset for IFRS purposes.

Tangible assets are depreciated on a straight-line basis from the month they are available for use, during its expected useful life. The amount of the asset to be depreciated is reduced by any residual estimated value. The depreciation rates correspond to the following estimated average economic useful lives:

	Years
Buildings and other constructions	3 50
Basic equipment:	
Network installations and equipment	4 - 40
Switching equipment	5 - 10
Telephones, switchboards and other	5 - 10
Submarine cables	15 - 20
Satellite stations	15
Other telecommunications equipment	3 - 10
Other basic equipment	4 - 20
Transportation equipment	4 - 8
Tools and dies	4 - 10
Administrative equipment	3 - 10
Other tangible fixed assets	3 - 10

Estimated losses resulting from the replacement of equipments before the end of their economic useful lives are recognised as a deduction to the corresponding asset s carrying value, against results of the period, as well as any impairment of these assets. The cost of recurring maintenance and repairs is charged to net income as incurred. Costs associated with significant renewals and betterments are capitalized if any future economic benefits are expected and those benefits can be reliably measured.

From the moment certain tangible assets meet the criteria for being classified as held for sale , no additional amortization is recognized and those assets are classified as current assets availab le for sale The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the assets and is recognised in the income statement under the caption Gains on disposals of fixed assets, net when occurred.

d) Intangible assets

Intangible assets are stated at acquisition cost, net of accumulated amortisation and accumulated impairment losses, if any. Intangible assets are recognised only if any future economic benefits are expected and those benefits as well as the cost of the asset can be reliably measured.

Intangible assets include mainly goodwill (Note 2.a), telecommunications licenses and related rights and software licenses.

Internally-generated intangible assets, namely research and development expenditures, are recognised in net income when incurred. Development expenditures can only be recognised initially as an intangible asset if the Company demonstrates the ability to complete the project and put the asset in use or make it available for sale.

Intangible assets, except goodwill, are amortised on a straight-line basis from the month they are available for use, during the following periods:

Telecommunications licenses:	
• Band A and Band B licenses held by Vivo	Period of the license
• Property of the Basic Network held by PT Comunicações	Period of the concession (until 2025)
• UMTS license owned by TMN	Period of the license (until 2015)
Satellite capacity acquisition rights	Period of the contracts (until 2015)
Software licenses	3 6
Other intangible assets	3 - 8

Following the business combination of MTC undertaken at the end of 2006 (Note 2.b), Portugal Telecom has identified an intangible asset related to the agreement entered into with the other shareholders of MTC, which allows Portugal Telecom to control this company. This agreement does not have a definite useful life and therefore this intangible asset is not amortized but is subject to annual impairment tests. The main factors considered to determine that this intangible does not have a definite useful life were as follows:

(a) The expected use of the asset by the entity is directly related to the shareholders agreements duration, which is indefinite;

(b) The shareholders agreement relates only to the life of the operations of MTC, which is also considered indefinite, as provided for in MTC s by-laws. There is no relation between the expected useful life of another group of assets and the useful life of the intangible asset; and

(c) There were no legal, regulatory, or contractual provisions stipulated in the agreement that would limit its useful life.

e) Investment property

Investment property includes primarily buildings and land held to earn rentals and/or capital appreciation, and not for use in the normal course of the business (exploration, service render or sale).

Investment property is stated at its acquisition cost plus transaction costs and reduced by accumulated depreciation and accumulated impairment losses, if any. Expenditures incurred (maintenance, repairs, insurance and real estate taxes) and any income obtained are recognised in income statement of the period.

f) Impairment of tangible and intangible assets, excluding goodwill

The Group performs impairment tests for its tangible and intangible assets if any event or change results in an indication of impairment. In case of any such indication, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss.

Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. The primary cash-generating units identified in the Group correspond to the wireline and mobile businesses in Portugal and mobile in Brazil. The recoverable amount is the higher of fair value less cost to sell and the value in use. In assessing fair value less cost to sell, the amount that could be received from an independent entity is considered, reduced by direct costs related with the sale. In assessing the value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the specific risk to the asset.

If the recoverable amount of an asset is estimated to be less than its carrying amount, an impairment loss is recognised immediately in the profit and loss statement.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior periods. A reversal of an impairment loss is recognised immediately in net income.

g) Provisions and contingent liabilities

Provisions are recognised when the Group has a present obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where any of the above mentioned criteria does not exist, or is not accomplished, the Group discloses the event as a contingent liability, unless the cash outflow is remote.

Provisions for restructuring are only recognised if a detail and formal plan exists and if the plan is communicated to the related parties.

Provisions for dismantling and removal costs are recognised from the day the assets are in use and if a reliable estimate of the obligation is possible (Notes 3.c) and 39). The amount of the provision is discounted, being the corresponding effect of time recognised in net income, under the caption Net interest expense .

Provisions are updated on the balance sheet date, considering the best estimate of the Group s management.

h) Pension benefits

Under several defined benefit plans, PT Comunicações and PT Sistemas de Informação, SA (PT SI) are responsible to pay to a group of employees a pension or a pension supplement. In order to fund these obligations, various pension funds were incorporated by PT Comunicações (Note 9.1).

The amount of the Group s liabilities with respect to pensions and pension supplements is estimated based on actuarial valuations, using the Projected Unit Credit Method . The Group has elected to apply the option in IAS 19 to recognise actuarial gains and losses directly in shareholders equity.

Plan amendments related to reduction of the benefits granted to employees are recorded as prior years service gains or losses. Prior years service gains or losses related to vested rights are recognised under the caption Post retirement benefits when they occur. Those related to unvested rights are recognised on a straight-line basis until they become vested, which usually corresponds to the retirement date. Gains obtained with the settlement of any plan is recognized when incurred under the caption Curtailment costs, net .

Pension and pension supplement liabilities stated in the balance sheet correspond to the difference between the Projected Benefit Obligation (PBO) related to pensions deducted from the fair value of pension fund assets and any prior years service gains or losses not yet recognised.

Contributions made by the Group to defined contribution pension plans are recognised in net income when incurred.

i) Post retirement health care benefits

Under a defined benefit plan, PT Comunicações and PT SI are responsible to pay, after the retirement date, health care expenses to a group of employees and relatives. This health care plan is managed by Portugal Telecom Associação de Cuidados de Saúde (PT-ACS). In 2004, the Group established PT Prestações Mandatária de Aquisições e Gestão de Bens, SA (PT Prestações) to manage an autonomous fund to finance these obligations (Note 9.2).

The amount of the Group s liabilities with respect to these benefits after retirement date is estimated based on actuarial valuations, using the Projected Unit Credit Method . The Group has elected to apply the option in IAS 19 to recognise actuarial gains and losses directly in shareholders equity.

Plan amendments related to reduction of the benefits granted to employees are recorded as prior years service gains or losses. Prior years service gains or losses related to vested rights are recognised under the caption Post retirement benefits when they occur and those related to unvested rights are recognised on a straight-line basis until they become vested, which usually corresponds to the retirement date. Gains obtained with the settlement of any plan is recognized when incurred under the caption Curtailment costs, net .

Accrued post retirement health care liabilities stated in the balance sheet correspond to the present value of obligations from defined benefit plans, deducted from the fair value of fund assets and any prior years service gains or losses not yet recognised.

j) Pre-retirement and suspended employees

In connection with the programs related to employees that are under a suspended contract agreement, or that have pre-retired, the Group recognizes a liability in the balance sheet, which is recorded in the income statement under the caption Curtailment costs, net . This liability reflects the total responsibilities for the payment of salaries up to the retirement date and for pensions, pension supplements and health care expenses after that date, which are determined based on actuarial studies (Note 9).

k) Grants and subsidies

Grants and subsidies from the Portuguese Government and from the European Union are recognised at fair value when the receivable is probable and the Company can comply with all requirements of the subsidy s program.

Grants and subsidies to training and other operating activities are recognised in net income when the related expenses are recognised.

Grants and subsidies to acquire assets are deducted from the carrying amount of the related assets (Note 3.c).

l) Financial assets and liabilities

Financial assets and liabilities are recognised on the Group s balance sheet when the Group becomes a party to the contractual provisions of the instrument.

(i) Loans and receivables (Notes 25 and 26)

Trade receivables, loans granted and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as receivables or loans granted.

Trade receivables do not have any implicit interest and are presented at nominal value, net of allowances for estimated non-recoverable amounts, which are computed basically based on (a) the aging of the receivables and (b) the credit profile of specific customers.

(ii) Available for sale investments (Note 32)

Available for sale investments are those related to listed or quoted shares held by the Group and in connection with which the Company does not have a strategic interest. Available for sale investments are classified as non-current assets (Note 32).

All acquisitions and disposals of these investments are recognised on the date the agreement or contract is signed, independently of the settlement date. Investments are initially recognised by their acquisition cost, including any expenses related to the transaction.

Subsequent to the initial recognition, available for sale investments are measured at fair value through equity, except for available for sale investments not listed in any active market and where an estimate of fair value is not reliable which are recognised at acquisition cost, net of any impairment losses. On disposal of an impaired or an available for sale investment, accumulated changes in the fair value of the investment previously recognised in equity are transferred to net income.

(iii) Financial liabilities and equity instruments

Financial liabilities and equity instruments issued by the Group are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

Equity instruments issued by the Group are recognised based on the proceeds, net of any costs of issuance.

Exchangeable bonds issued by Portugal Telecom are recognised as compound instruments, comprising the following elements: (i) the present value of the debt, estimated using the prevailing market interest rate for similar non-convertible debt and recorded under debt liabilities; and (ii) the fair value of the embedded option for the holder to convert the bond into equity, recorded directly in shareholders equity. As of the balance sheet date, the debt component is recognised at amortised cost.

(iv) Bank loans (Note 35)

Bank loans are recognised as a liability based on the related proceeds, net of any transaction cost. Interest cost, which is computed based on the effective interest rate and including premiums paid upfront, is recognised when incurred.

(v) Accounts payable (Note 36)

Trade payables are recognised at nominal value, which is substantially similar to their fair value.

(vi) Derivative financial instruments and hedge accounting (Note 42)

The activities of the Group are primarily exposed to financial risks related with changes in foreign currency exchange rates and changes in interest rates. The Group s policy is to contract derivative financial instruments to hedge those risks, subject to analysis and Executive Board approval.

Derivative financial instruments are initially measured at fair value on the contract date, and are remeasured to fair value at subsequent reporting dates.

Hedge accounting

The provisions and requirements of IAS 39 must be met in order to qualify for hedge accounting. Currently, Portugal Telecom for accounting purposes classify certain derivative financial instruments as fair value and cash flow hedges.

Changes in the fair value of derivative financial instruments classified as fair value hedges are recognised in net income of the period, together with the changes in the value of the covered assets or liabilities related with the hedged risk.

The effective portion of the changes in fair value of derivative financial instruments classified as cash flow hedges is recognised directly in shareholders equity, and the ineffective portion is recognised as financial results. When changes in the value of the covered asset or liability are recognised in net income, the corresponding amount of the derivative financial instrument previously recognised under Hedge accounting is transferred to net income.

Changes in fair value of derivative financial instruments that, in accordance with internal policies, were contracted to economically hedge an asset or liability but do not comply with the provisions and requirements of IAS 39 to be accounted for as hedges, are classified as derivatives held for trading and recognised in net income.

(vii) Treasury shares (Note 41)

Treasury shares are recognised as a deduction to shareholders equity, under the caption Treasury shares at acquisition cost, and gains or losses obtained in the disposal of those shares are recorded under Accumulated earnings .

Equity swaps on own shares that include an option exercisable by Portugal Telecom for physical settlement are recognised as a financial liability and a corresponding reduction of equity, and are accounted for as an acquisition of treasury shares on the inception date of the contract.

(viii) Cash and cash equivalents and short term investments (Note 24)

Cash and cash equivalents comprise cash on hand and demand bank deposits, due within three months or less from the date of acquisition that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

In the consolidated cash flow statement, cash and cash deposits also includes overdrafts recognised under the caption Short-term debt .

Short term investments comprise investments for the purpose of generating investment returns, and they are therefore not classified as cash equivalents.

(ix) Qualified Technological Equipment transactions

In previous years, the Company entered into certain Qualified Technological Equipment transactions (QTE), whereby some telecommunications equipment was sold to certain foreign entities. Simultaneously, those foreign entities entered into leasing contracts with respect to the equipment with special purpose entities, which entered into conditional sale agreements to resell the related equipment to the Company. The Company maintains the legal possession of this equipment.

These transactions correspond to a sale and lease-back transaction, and the equipment continued to be recorded on the Company s consolidated balance sheet. The Company obtained the majority of the economic benefits of the special purpose entities, and therefore those entities were fully consolidated in the Company s financial statements. Consolidated non-current assets include an amount equivalent to the proceeds of the sale of the equipment (Note 30), and non-current liabilities include the future payments under the leasing contract (Note 40). As at the balance sheet date, those amounts are measured at fair value.

Up-front fees received from this transaction are recognised in net income on a straight-line basis during the period of the contracts.

m) Own work capitalized

Certain internal costs (materials, work force and transportation) incurred to build or produce tangible assets are capitalized only if:

- the tangible assets are identifiable;
- the tangible assets will generate future economic benefits which can be reliably estimated; and
- development expenses can be reliably measured.

The amounts capitalized are deducted from the corresponding operating costs incurred and no internally generated margin is recognised. When any of the above mentioned criteria is not met, the expense is recognised in net income.

Financial costs are not capitalised and expenses incurred during investigation are recognised in net income when incurred.

n) Leasings (the company as a lessee)

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases (Note 13). The classification of leases depends on the substance of the transaction and not on the form of the contract.

Assets acquired under finance leases and the corresponding liability to the lessor, are accounted for using the finance method, in accordance with the lease payment plan (Note 35). Interest included in the rents and the depreciation of the assets are recognised in net income in the period they occur.

Under operating leases, rents are recognised on a straight-line basis during the period of the lease (Note 13).

o) Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax. Income tax is recognised in accordance with IAS 12.

Portugal Telecom has adopted the tax consolidation regime in Portugal (currently known as the special regime for the taxation of groups of companies). The provision for income taxes is determined on the basis of the estimated taxable income for all the companies in which Portugal Telecom holds at least 90% of the share capital and that are domiciled in Portugal and subject to Corporate Income Tax (IRC). The remaining Group companies not covered by the tax consolidation regime of Portugal Telecom are taxed individually based on their respective taxable income, at the applicable tax rates.

The tax currently payable is based on taxable income for the period, and the deferred tax is based on differences between the carrying amounts of assets and liabilities of the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method.

Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is reasonably likely that taxable income will be available against which deductible temporary differences can be used, or when there are deferred tax liabilities whose reversal is expected in the same period in which the deferred tax assets reverse. The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that is no longer probable that sufficient taxable income will be available to allow for all or part of the asset to be recovered.

Deferred tax is charged to net income, except when it relates to items charged or credited directly to shareholders equity, in which case the deferred tax is also recognised directly in shareholders equity.

p) Revenue recognition

Revenues from fixed line telecommunications are recognised at their gross amounts when services are rendered. Billings for these services are made on a monthly basis throughout the month. Unbilled revenues or revenues not billed by other operators but accrued or incurred as of the date of the financial statements are recorded based on estimates. Differences between accrued amounts and the actual unbilled revenues, which ordinarily are not significant, are recognised in the following period.

Revenues from international telecommunications services are divided with the operators in the country in which calls are terminated based on traffic records of the country of origin and rates established in agreements with the various telecommunications operators. The operator of the country of origin of the traffic is responsible for crediting the operator of the destination country and, if applicable, the operators of the transit countries.

Revenues from telephone line rentals are recognised as an operating lease in the period to which they apply, under the caption Other revenues .

Revenues from ISP services result essentially from monthly subscription fees and telephone traffic when the service is used by customers. These revenues are recognised when the service is rendered.

Advertising revenues from telephone directories and related costs are recognised in the period in which the directories are effective. PT Comunicações has a contract with Páginas Amarelas whereby the latter is responsible for production, publishing and distribution of PT Comunicações s telephone directories, as well as for selling advertising space in the directories. The total cost to be paid by PT Comunicações for such services is set at a fixed 64% of its gross revenues from the sale of advertising space in telephone directories. The prices of advertising space are fixed, not contingent, and based on the expected volume of the distributed directories (approximately one to every telephone number). Revenues from the sale of advertising space are invoiced directly by PT Comunicações to its corporate clients during the one-year advertising period. These revenues are recognized in earnings on a monthly basis during the period for the respective directory.

Revenues from mobile telephony services result essentially from the use of the wireless network, by customers or other operators. The moment in which revenues are recognised and the corresponding caption are as follows:

Nature of the revenue	Caption	Moment of recognition
Use of the network	Services rendered	In the month the service is rendered
Interconnection fees	Services rendered	In the month the service is rendered
Roaming	Services rendered	In the month the service is rendered
Pre-paid cards	Services rendered	When the service is rendered
Terminal equipment and accessories	Sales	When the sale occurs

Revenues from bundling services or products are allocated to each of its components based on its fair value and are recognised separately in accordance with the methodology adopted to each component.

Revenues from the Pay-TV result essentially from and are recognised as follows: (i) monthly subscription fees for the use of the service are recognised in the period the service is rendered; (ii) rental of equipment is recognised in the period it is rented; and (iii) sale of equipment is recognised at the moment of sale.

q) Foreign currency transactions and balances

Transactions denominated in foreign currencies are translated to Euros at the exchange rates prevailing at the time the transactions are made. At the balance sheet date, assets and liabilities denominated in foreign currencies are adjusted to reflect the exchange rates prevailing at such date. The resulting gains or losses on foreign exchange transactions are recognised in net income. Exchange differences on non-monetary items, including goodwill, and on monetary items representing an extension of the related investment and where settlement is not expected in the foreseeable future, are recognized directly in shareholders equity under the caption Foreign currency translation adjustments , and included in the Statement of Recognised Income and Expenses.

The financial statements of subsidiaries operating in other countries are translated to Euros, using the following exchange rates:

- Assets and liabilities at exchange rates prevailing at the balance sheet date;
- Profit and loss items at average exchange rates for the reported period;

- Cash flow items at average exchange rates for the reported period, where these rates approximate the effective exchange rates (and in the remaining cases, at the rate effective on the day the transaction occurred); and

- Share capital, reserves and retained earnings at historical exchange rates.

The effect of translation differences is recognised in shareholders equity under the caption Foreign currency translation adjustments and included in the Statement of Recognised Income and Expenses.

The Group adopted the exception under IFRS 1 relating to cumulative translation adjustments as of 1 January 2004 and transferred this amount from Foreign currency translation adjustments to Accumulated earnings . As from 1 January 2004, the Group has been recognizing all translation adjustments directly in shareholders equity and therefore these amounts are transferred to net income only if and when the related investments are disposed of.

r) Borrowing costs

Borrowing costs related to loans are recognised in net income when incurred. The Group does not capitalise any borrowing costs related to loans to finance the acquisition, construction or production of any asset.

s) Cash flow statement

The consolidated statement of cash flows is prepared under IAS 7, using the direct method. The Group classifies all highly liquid investments purchased, with original maturity of three months or less, as cash and cash equivalents. The Cash and cash equivalents item presented in the statement of cash flows also includes overdrafts, classified in the balance sheet under Short-term debt .

Cash flows are classified in the statement of cash flows according to three main categories, depending on their nature: (1) operating activities; (2) investing activities; and (3) financing activities. Cash flows from operating activities include primarily collections from clients, payments to suppliers, payments to employees, payments relating to post retirement benefits and net payments relating to income taxes and indirect taxes. Cash flows from investing activities include primarily the acquisitions and disposals of investments in associated companies, dividends received from associated companies and purchase and sale of property, plant and equipment. Cash flows from financing activities include primarily borrowings and repayments of debt, payments of lease rentals, payments relating to interest and related expenses, acquisition and sale of treasury shares and payments of dividends to shareholders.

t) Subsequent events (Note 47)

Events that occur after the balance sheet date that could influence the value of any asset or liability as of that date are considered when preparing the financial statements for the period. Those events are disclosed in the notes to the financial statements, if material.

Critical judgments and estimates

The preparation of the consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the application of policies and reported amounts. Estimates and judgements are continually evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circunstances on which the estimate was based, or as a result of new information or more experience. The main accounting judgments and estimates reflected in the consolidated financial statements, are as follows:

(a) Post retirement benefits The present value of the post retirement obligation is computed based on actuarial methodologies, which use certain actuarial assumptions. Any changes in those assumptions will impact the carrying amount of post retirement obligations. The key assumptions for post retirement obligations are disclosed in Note 9.

(b) Goodwill impairment analysis Portugal Telecom tests annually whether goodwill has suffered any impairment. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. The use of this method requires the estimate of future cash flows expected to arise from the continuing operation of the cash generating unit and the choice of a suitable discount rate in these estimates.

(c) Valuation and useful life of intangible assets Portugal Telecom has made assumptions in relation to the potencial future cash flows resulting from separable intangible assets acquired as part of business combinations, which include expected future revenues, discount rates and useful life of such assets.

(d) Recognition of provisions and adjustments Portugal Telecom is party to various legal claims for which, based on the opinion of its legal advisors, a judgment is made to determine whether a provision should be recorded for these contingencies (Note 46). Adjustments for accounts receivable are computed based primarily on the aging of the receivables, the risk profile of the customer and its financial condition. These estimates related to adjustments for accounts receivables differ from business to business.

(e) Assessment of the fair value of financial instruments Portugal Telecom chooses an appropriate valuation technique for financial instruments not quoted in an active market based on its best knowledge of the market and of the assets. In this process, Portugal Telecom applies the valuations techniques commonly used by market practitioners and uses assumptions based on market rates.

Estimates used are based on the best information available during the preparation of consolidated financial statements, although future events, neither controlled nor foreseeable by the Company, could occur and have an impact on the estimates. Changes to the estimates used by management, that occur after the date of the consolidated financial statements are recognised in net income, in accordance with IAS 8, using a prospective methodology.

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4. Changes in accounting policies and estimates

During the year 2007, no changes occurred in the accounting policies used by the Group, when compared to those ones used in 2006.

The only new standard adopted by Portugal Telecom during the year ended 31 December 2007 was IFRS 7 Financial instruments . The impact of adopting this standard consisted in including additional disclosures related to financial instruments (Note 42).

In addition, when the Board of Directors approved these financial statements, the following standards and interpretations, not yet adopted by Portugal Telecom, had been issued, but their application is only being required in subsequent years:

- IAS 23 (revised) - Borrowing costs (years started on or after 1 January 2009);
- IFRS 8 - Segment reporting (years started on or after 1 January 2009);
- IFRIC 11 - Treasury share transactions (years started on or after 1 March 2007);
- IFRIC 12 - Concession contracts (years started on or after 1 January 2008);
- IFRIC 13 - Loyalty programs (years started on or after 1 July 2008);
- IFRIC 14 - Defined benefits (years started on or after 1 January 2008);
- IAS 1 (revised) - Presentation of financial statements (years started on or after 1 January 2009);
- IAS 27 (revised) - Consolidated and seperate financial statements (years started on or after 1 July 2009);
- IAS 28 (revised) - Investments in associates (years started on or after 1 July 2009);

- IAS 31 (revised) - Interests in joint ventures (years started on or after 1 July 2009);

- IAS 32 (revised) - Financial instruments: presentation (years started on or after 1 January 2009);

- IFRS 2 (revised) - Share-based payments (years started on or after 1 January 2009); and

- IFRS 3 (revised) - Business combinations (years started on or after 1 July 2009).

The possible impact of adopting the above standards and interpretations in future years has not been fully assessed by Portugal Telecom.

5. Exchange rates used to translate foreign currency financial statements

As at 31 December 2007 and 2006, assets and liabilities denominated in foreign currencies were translated to Euros using the following exchange rates:

Currency	2007	2006
Argentine peso	4.6386	4.0474
Australian dollar	1.6757	1.6691
Botswana pula	8.9056	7.9313
Brazilian real	2.5963	2.8118
British pound	0.73335	0.6715
Canadian dollar	1.4449	1.5281
Cape Verde Escudo	110.2650	110.2650
CFA franc	655.9570	655.9570
Chinese Yuan Renmimbi	10.7524	10.009
Danish krone	7.4583	7.456
Hong Kong dollar	11.48	10.2409
Hungarian forint	253.7300	251.7700
Japanese yen	164.9300	156.9300
Kenyan shilling	93.552	91.6632
Macao pataca	11.8244	10.5481
Moroccan dirham	11.4042	11.1354
Mozambique metical	34.8300	34.4700
Namibian dollar	10.0298	9.2124
Norwegian krone	7.9580	8.2380
São Tomé Dobra	20,947.9	17,222.3
South African rand	10.0298	9.2124
Swedisk krone	9.4415	9.0404
Swiss franc	1.6547	1.6069
Ugandan shilling	2,499.6	2,292.2
US Dollar	1.4721	1.317

During the years 2007 and 2006, income statements of subsidiaries expressed in foreign currencies were translated using the following average exchange rates to the Euro:

Currency	**2007**	**2006**
Argentine peso	4.3073	3.8875
Botswana pula	8.4729	7.3955
Brazilian real	2.6661	2.7315
Cape Verde Escudo	110.2650	110.2650
CFA franc	655.9570	655.9570
Chinese Yuan Renmimbi	10.4294	10.3807
Hungarian forint	251.3667	264.1325
Kenyan shilling	92.6231	90.8083
Macao pataca	11.037	10.0475
Moroccan dirham	11.2352	11.0362
Mozambique metical	35.5658	32.1779
Namibian dollar	9.6837	7.7668
São Tomé Dobra	18,737.3	15,735.4
Swiss franc	1.6438	1.5731
Ugandan shilling	2,369.8	2,310.2
US Dollar	1.3732	1.2557

6. Revenues

Consolidated revenues by reportable segment in 2007 and 2006, are as follows:

	2007	**2006**
Wireline (Note 7.a)	1,843,549,443	1,952,996,699
Services rendered (Note 3.p)	1,784,077,277	1,903,558,954
Sales (i)	40,062,027	32,105,763
Other revenues (ii)	19,410,139	17,331,982
Domestic Mobile - TMN (Note 7.b)	1,464,603,409	1,426,182,034
Services rendered (Note 3.p)	1,321,677,241	1,290,765,345
Sales (i)	135,300,250	126,042,387
Other revenues (ii)	7,625,918	9,374,302
Brazilian Mobile - Vivo (Note 7.c)	2,462,940,843	2,104,711,912
Services rendered (Note 3.p)	2,157,218,441	1,789,759,729
Sales (i)	258,068,670	254,752,333
Other revenues (ii)	47,653,732	60,199,850
Other businesses (iii)	377,315,497	281,396,974
Services rendered	362,522,479	261,804,841
Sales	9,035,536	13,330,488
Other revenues	5,757,482	6,261,645
	6,148,409,192	5,765,287,619

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(i) These captions include mainly the sales of terminal equipment (fixed telephones and modems) of the wireline business and terminal mobile equipments of TMN and Vivo.

(ii) Other revenues include mainly the benefits from contractual penalties imposed to customers, rentals of equipment and of other own infra-structures, and revenues resulting from consultancy projects.

(iii) This caption is related to services rendered and sales primarily from MTC (mobile operator in Namíbia), Mobitel (call center operation in Brazil) and Cabo Verde Telecom (telecommunications operator).

Consolidated revenues in 2007 and 2006 by geographic area, are as follows:

	2007	2006
Portugal	3,397,647,288	3,460,826,637
Brazil	2,528,111,431	2,165,975,225
Other countries	222,650,473	138,485,757
	6,148,409,192	5,765,287,619

7. Segment reporting

Portugal Telecom s primary basis of business segmentation is related to the nature of the services rendered and the type of technology used by its operating companies. This is the manner in which the Board of Directors oversees and controls the business and also the manner in which financial information is internally organized and communicated. Accordingly, the business segments from the continuing operations as at 31 December 2007 and 2006 are as follows:

a. Wireline (including Retail, Wholesale and Data and Corporate);

b. Domestic Mobile (TMN); and

c. Brazilian Mobile (Vivo).

The Wireline segment includes PT Comunicações, PT Prime, PT.com and PT Corporate.

In relation to the mobile businesses, Portugal Telecom has identified two different business segments, the Domestic Mobile and Brazilian Mobile , due to the differences between licenses and technologies of both. In terms of technology, GSM/UMTS is the technology used by TMN, while CDMA is the main technology used by Vivo. Also, the telecommunications markets in Portugal and Brazil are substantially different in terms of economic and regulatory environment, classes of customers, suppliers and marketing strategies, which support Portugal Telecom s decision to establish the two different businesses.

Portugal Telecom s secondary basis of segmentation is geographical, under which it distinguishes three segments:

a. Portugal;

b. Brazil; and

c. Other countries.

Segment information for the years 2007 and 2006 is presented below.

a) Wireline

Income statements of this reportable segment for the years 2007 and 2006 are as follows:

	2007	**2006**
REVENUES		
Services rendered - external customers (Note 6)	1,784,077,277	1,903,558,954
Services rendered - inter-segment	106,630,112	108,723,206
Sales - external customers (Note 6)	40,062,027	32,105,763
Sales - inter-segment	472,987	679,411
Other revenues - external customers (Note 6)	19,410,139	17,331,982
Other revenues - inter-segment	11,764,082	9,382,218
	1,962,416,624	2,071,781,534
COSTS, EXPENSES, LOSSES AND (INCOME)		
Wages and salaries	252,859,780	271,970,593
Post retirement benefits (i)	(65,301,000)	(71,553,000)
Direct costs	354,011,295	356,128,163
Costs of products sold	37,632,031	32,678,000
Marketing and publicity	36,247,639	39,630,306
Support services	114,137,429	116,995,350
Supplies and external services	213,355,242	210,004,952
Indirect taxes	5,480,850	5,891,200
Provisions and adjustments	5,203,944	37,183,186
Depreciation and amortisation	323,606,387	355,521,631
Work force reduction program costs (ii)	274,849,277	6,091,803
Net gains on disposals of fixed assets	(9,290,728)	(2,617,722)
Other costs, net	16,814,997	14,015,578
	1,559,607,143	1,371,940,040
Income before financial results and taxes	402,809,481	699,841,494
Net interest expenses (income)	2,081,218	(93,455)
Net foreign currency exchange losses	1,106,563	1,740,579
Net gains on financial assets and other investments	(1,415,656)	(1,445,020)
Net other financial expenses	1,390,107	967,217
	3,162,232	1,169,321
Income before taxes	399,647,249	698,672,173
Minus: Income taxes	115,696,441	209,608,152
Net income	283,950,808	489,064,021

(i) Post retirement benefits were negative in 2007 and 2006 due to the the recognition of prior years service gains of Euro 110,336,000 and Euro 150,556,684, respectively, related to plan ammendmnents occurred during these years (Note 9).

(ii) The increase in this caption is mainly due to the recognition of a gain amounting to Euro 220,417,000 in 2006 related to the impact of the termination of the Protocol with the national healthcare system under the Health Care Plan (Note 9.2) and higher costs with the work force reduction program in 2007.

Total assets and liabilities of this segment as at 31 December 2007 and 2006 are as follows:

	2007	2006
Assets	3,937,770,341	4,203,333,498
Liabilities	3,012,740,702	3,152,213,639

Capital expenditures in tangible and intangible assets for this reportable segment for the years 2007 and 2006 were Euro 292 million and Euro 239 million, respectively. The increase in capital expenditures is primarily explained by a contract entered into by PT Comunicações for the acquisition of satellite capacity until 2015 for an aggregate amount of Euro 42.6 million (Note 33).

As at 31 December 2007 and 2006, the total staff in the wireline business was 6,354 and 7,181 employees, respectively.

b) Domestic Mobile TMN

Income statements of this reportable segment for the years 2007 and 2006 are as follows:

	2007	2006
REVENUES		
Services rendered - external customers (Note 6)	1,321,677,241	1,290,765,345
Services rendered - inter-segment	71,379,851	72,468,785
Sales - external customers (Note 6)	135,300,250	126,042,387
Sales - inter-segment	6,485,902	3,636,530
Other revenues - external customers (Note 6)	7,625,918	9,374,302
Other revenues - inter-segment	469,979	68,881
	1,542,939,141	1,502,356,230
COSTS, EXPENSES, LOSSES AND (INCOME)		
Wages and salaries	52,728,072	56,002,890
Direct costs	282,600,676	292,852,093
Costs of products sold	179,705,328	170,555,611
Marketing and publicity	34,387,480	30,350,283
Support services	46,523,659	35,393,808
Supplies and external services	225,351,681	224,154,024
Indirect taxes	29,746,098	22,670,064
Provisions and adjustments	12,920,301	11,679,529
Depreciation and amortisation	223,605,934	220,113,746
Work force reduction costs	627,947	669,084
Net losses on disposals of fixed assets	1,212,349	25,558
Other costs	1,876,062	2,179,235
	1,091,285,587	1,066,645,925
Income before financial results and taxes	451,653,554	435,710,305
Net interest income	(10,489,597)	(5,283,072)
Net foreign currency exchange losses	73,674	516,813
Equity in losses (earnings) of affiliated companies, net	2,614	(3,385)
Net other financial expenses	1,038,056	941,236
	(9,375,253)	(3,828,408)
Income before taxes	461,028,807	439,538,713
Minus: Income taxes	123,025,875	121,484,647
Net income	338,002,932	318,054,066

Total assets and liabilities of this segment as at 31 December 2007 and 2006 are as follows:

	2007	2006
Assets	2,433,369,333	2,496,628,387
Liabilities	1,425,678,744	1,205,928,371

Capital expenditures in tangible and intangible assets for this reportable segment for the years 2007 and 2006 were Euro 440 million and Euro 189 million, respectively. The increase in capital expenditures for this reportable segment is primarily explained by an amount of Euro 242 million (Note 33) capitalized in 2007, and is related to the

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commitments assumed by TMN under the UMTS license based on the agreement signed by TMN with the Portuguese Government in 2007 which determined the initiatives that will be undertaken (Note 33).

As at 31 December 2007 and 2006, the total staff in this segment was 1,144 and 1,140 employees, respectively.

c) Brazilian Mobile

Income statements of this reportable segment for the years 2007 and 2006 are as follows:

	2007	**2006**
REVENUES		
Services rendered - external customers (Note 6) (i)	2,157,218,441	1,789,759,729
Sales - external customers (Note 6)	258,068,670	254,752,333
Other revenues - external customers (Note 6)	47,653,732	60,199,850
Other operating revenues - inter-segment	15,351	
	2,462,956,194	2,104,711,912
COSTS, EXPENSES, LOSSES AND (INCOME)		
Wages and salaries	128,804,738	115,504,566
Direct costs (i)	428,423,619	248,871,761
Costs of products sold	449,411,844	385,151,405
Marketing and publicity	65,964,388	63,767,476
Support services	186,507,248	158,990,603
Supplies and external services	352,103,602	345,117,155
Indirect taxes	151,446,132	126,913,606
Provisions and adjustments	105,270,191	164,187,221
Depreciation and amortisation	523,077,105	505,846,599
Net losses (gains) on disposals of fixed assets	5,736,801	(2,431,564)
Other costs (ii)	2,354,339	56,528,474
	2,399,100,007	2,168,447,302
Income before financial results and taxes	63,856,187	(63,735,390)
Net interest expense (iii)	64,187,559	92,429,146
Net foreign currency exchange gains	(2,249,366)	(8,530,559)
Net losses (gains) on financial assets and other investments	(1,738,911)	4,103,236
Net other financial expenses	25,784,002	31,602,515
	85,983,284	119,604,338
Income before taxes	(22,127,097)	(183,339,728)
Minus: Income taxes	(631,639)	(156,886,220)
Net income	(21,495,458)	(26,453,508)

(i) The increase in services rendered and in direct costs is primarily explained by the changes in the interconnection regulatory regime in Brazil (termination of the Bill & Keep regime), which led to the gross recognition of interconnection revenues and costs (Note 10).

(ii) In 2006, this caption includes approximately Euro 51 million (Note 15) related to the adjustment of the realizable amount of CDMA equipments due to technological obsolescence.

(iii) The change in this caption is mainly related to a gain recorded in 2006 amounting to Euro 134 million (Note 19), related to the recognition of deferred tax assets related to tax losses from previous periods, which recoverability was only achieved in 2006.

Capital expenditures in tangible and intangible assets for this reportable segment for the years 2007 and 2006 were Euro 360 million and Euro 387 million, respectively.

A summarized balance sheet of 50% of the assets and liabilities of Vivo as at 31 December 2007 and 2006 is presented below:

	2007	2006
Current assets	1,193,252,087	902,752,315
Intangible assets	2,303,677,393	2,245,254,964
Tangible assets	1,200,360,228	1,131,810,840
Deferred taxes	384,944,524	351,507,323
Other non-current assets	167,866,145	142,454,925
Total assets	5,250,100,377	4,773,780,367
Current liabilities	1,331,838,063	1,059,188,211
Medium and long-term debt	462,660,429	517,255,183
Other non-current liabilities	104,569,993	87,071,963
Total liabilities	1,899,068,485	1,663,515,357

As at 31 December 2007 and 2006, the total staff in this segment (50% of Vivo) was 2,800 and 2,948 employees, respectively.

d) Reconciliation of revenues, net income, assets and liabilities

In 2007 and 2006, the reconciliation between revenues of reportable segments and consolidated revenues is as follows:

	2007	2006
Total relating to reportable segments	5,968,311,959	5,678,849,676
Total relating to other businesses (i)	668,097,060	549,720,637
Elimination of intragroup revenues	(487,999,827)	(463,282,694)
Total consolidated revenues	6,148,409,192	5,765,287,619

(i) The increase in this caption is mainly related to the consolidation of MTC from September 2006, which contributed with Euro 120 million and Euro 41 million to Portugal Telecom s consolidated operating revenues in 2007 and 2006, respectively.

In 2007 and 2006, the reconciliation between net income of reportable segments and consolidated net income, is as follows:

	2007	2006
Total relating to reportable segments	600,458,282	780,664,579
Total relating to other businesses (i)	22,762,416	(38,875,968)
Other items not included in reportable segments:		
Net interest expense related with loans obtained at group level	(141,589,112)	(133,020,722)
Net foreign currency exchange gains	(13,496,147)	(1,805,476)
Net gains on financial assets and other investments (ii)	245,628,440	20,991,979
Equity in earnings of affiliated companies	126,130,271	130,602,471
Income tax not included in reportable segments (iii)	(5,186,988)	195,570,950
Consolidated net income	834,707,162	954,127,813

(i) The improvement in this caption is mainly related to: (1) the increase of MTC s contribution to Portugal Telecom s consolidated income before financial results and taxes, from Euro 19 million in 2006 to Euro 50 million in 2007, since this company was only acquired on September 2006; and (2) the reduction in expenses incurred by Portugal Telecom with the tender offer launched by Sonae, from Euro 35 million in 2006 to Euro 7 million in 2007 (Note 15).

(ii) In 2007, this caption includes primarily (a) the gain of Euro 110,955,318 (Note 17) related to the disposal of a 22% stake in Africatel, the holding company that aggregates all of Portugal Telecom s interests in sub-Sahariana Africa, (b) gains of Euro 38,650,508 (Note 17) related to the disposal of available for sale investments, (c) the gain of Euro 77,428,725 (Note 42) related to the change in the fair value of the equity swaps over PT Multimedia shares up to its settlement date, and (d) the gain of Euro 32,188,194 (Note 17) related to the financial settlement of equity swaps over own shares.

(iii) In 2006, this caption includes mainly (a) the recognition of a tax credit amounting to Euro 53 million (Note 19) related to the liquidation of a subsidiary, and (b) a gain of Euro 142 million (Note 19) resulting from the reduction of deferred tax liabilities following the adoption by the Company of the voluntary taxation regime for certain gains on the disposals of investments made in previous years, whose taxation was deferred at that time in accordance with the tax legislation.

As at 31 December 2007 and 2006, the reconciliation between assets of reportable segments and consolidated assets is as follows:

	2007	2006
Total assets relating to reportable segments (i)	11,621,240,051	12,625,567,751
Total assets relating to other businesses and eliminations	906,038,480	894,074,388
Other items not included in reportable segments:		
Investments in group companies and other investments (ii)	541,578,046	585,838,311
Goodwill (Note 33)	53,314,309	65,768,850
Total consolidated assets	13,122,170,886	14,171,249,300

(i) As at 31 December 2006, this caption includes Euro 1,151,825,499 (Note 20) related to PT Multimédia segment, which following the conclusion of its spin-off on November 2007 (Note 1) is no longer part of the Portugal Telecom Group as at 31 December 2007.

(ii) The reduction in this caption is primarily explained by the disposal of the investment in Banco Espírito Santo, which as at 31 December 2006 amounted to Euro 95,340,000 (Note 32).

As at 31 December 2007 and 2006, the reconciliation between liabilities of reportable segments and consolidated liabilities is as follows:

	2007	**2006**
Total liabilities relating to reportable segments (i)	6,337,487,931	6,572,770,085
Total liabilities relating to other businesses and eliminations	(311,183,699)	(252,389,174)
Other items not included in reportable segments:		
Loans obtained at a group level	5,014,056,466	4,744,830,451
Total consolidated liabilities	11,040,360,698	11,065,211,362

(i) As at 31 December 2006, this caption includes Euro 551,112,718 (Note 20) related to PT Multimédia segment, which following the conclusion of its spin-off on November 2007 (Note 1) is no longer part of the Portugal Telecom Group as at 31 December 2007.

Total assets, liabilities, tangible assets and intangible assets by geographic area as at 31 December 2007 and 2006 and capital expenditures for tangible and intangible assets in 2007 and 2006 are as follows:

			2007		
	Total assets	**Total liabilities**	**Tangible assets (Note 34)**	**Inangible assets (Note 34)**	**Capital expenditures for tangible and intangible assets (iv)**
Portugal (i)	6,801,516,786	5,178,641,633	2,251,017,698	926,355,217	732,917,156
Brazil (ii)	5,465,930,992	1,947,534,215	1,215,150,692	2,309,185,592	366,870,020
Other (iii)	854,723,108	3,914,184,850	119,228,781	147,582,618	41,246,244
	13,122,170,886	11,040,360,698	3,585,397,171	3,383,123,427	1,141,033,420

			2006		
	Total assets	**Total liabilities**	**Tangible assets (Note 34)**	**Inangible assets (Note 34)**	**Capital expenditures for tangible and intangible assets (iv)**
Portugal (i)	8,502,616,584	6,131,463,187	2,685,753,152	1,148,693,900	447,662,366
Brazil	4,866,913,022	1,690,551,545	1,145,651,310	2,249,235,370	392,932,179
Other (iii)	801,719,694	3,243,196,630	110,628,728	92,951,993	27,132,211
	14,171,249,300	11,065,211,362	3,942,033,190	3,490,881,263	867,726,756

(i) The reduction in assets, liabilities, tangible and intangible assets from domestic businesses is primarily related to the contribution of the PT Multimedia segment to these captions as at 31 December 2006, which amounted to Euro 1,151,825,499, Euro 551,112,718, Euro 297,282,364 (Note 34) and Euro 413,567,344 (Note 33), respectively. As at 31 December 2007, PT Multimédia is no longer part of the Portugal Telecom Group, following the conclusion of its spin-off on November 2007 (Note 1).

(ii) The increase in assets and liabilities is mainly related to the appreciation of the Brazilian Real.

(iii) As at 31 December 2007, assets and liabilities of other geographic areas include Euro 194,140,064 and Euro 3,834,321,109 respectively, related to PT Finance, the group finance subsidiary incorporated in the Netherlands. The assets of PT Finance correspond mainly to short-term investments and the liabilities correspond mainly to loans obtained in financial markets, which are then used to finance the Company s businesses primarily in Portugal. As at 31 December 2006, assets and liabilities of other geographic areas include Euro 195,242,342 and Euro 3,158,205,855 respectively, related to PT Finance.

(iv) In 2007, capital expenditures from domestic businesses include an amount of Euro 241,746,603 (Note 33) related to the commitments assumed by under the UMTS license.

8. Wages and salaries

During the years 2007 and 2006, this caption consists of:

	2007	2006
Salaries	504,988,145	501,631,356
Employee Benefits	101,273,912	94,461,544
Health care	10,833,038	14,453,749
Trainning	6,909,253	7,464,074
Social care	5,981,553	7,923,609
Insurance	4,844,672	4,309,507
Other	3,242,300	3,233,344
	638,072,873	633,477,183

9. Post retirement benefits

9.1. Pension benefits

As referred to in Note 3.h, PT Comunicações is responsible for the payment of pensions and pension supplements to retired, suspended and active employees. These liabilities, which are estimated based on actuarial valuations, are as follows:

a) Retirees and employees of Telecom Portugal (Plan CGA) hired prior to 14 May 1992, or who were retired on that date, are entitled to receive a pension benefit from PT Comunicações. Employees hired after that date are covered by the general Portuguese Government social security system. Suspended employees are also entitled to receive a benefit payment normally equal to approximately 90% of salary prior to leaving service (with an annual increase in some cases).

b) Retirees and employees of TLP hired prior to 23 June 1994 are entitled to receive a pension supplement from PT Comunicações, which complements the pension paid by the Portuguese social security system. Pre-retired employees are also entitled to receive benefit payments (equal to 25% to 80% of their base salaries at the time of pre-retirement) until they reach the Portuguese social security retirement age. After that date, these former employees become entitled to the pension supplement. Suspended employees are also entitled to receive a benefit payment normally equal to 90% of salary prior to leaving service (with an annual increase in some cases).

c) Retirees and employees of TDP hired prior to 23 June 1994 are entitled to receive a pension supplement from PT Comunicações, which complements the pension paid by the Portuguese social security system. Pre-retired employees are also entitled to receive benefit payments (equal to 25% to 80% of their base salaries at the time of the pre-retirement) until they reach the Portuguese social security retirement age. After that date, these employees have the right to this pension supplement. Suspended employees are also entitled to receive a benefit payment normally equal to approximately 90% of salary prior to leaving service (with an annual increase in some cases).

d) Retirees and employees of Companhia Portuguesa Rádio Marconi, SA (Marconi , a company merged into PT Comunicações in 2002) hired prior to 1 February 1998 are entitled to a pension benefit from Caixa Marconi and to a supplemental pension benefit (Marconi Complementary Fund). In addition, PT Comunicações contributes to Fundo de Melhoria Marconi with 1.55% of salaries paid to these employees, which is responsible to pay the additional pension supplement.

e) On retirement, PT Comunicações pays a lump sum gratuity of a fixed amount which depends on the length of service completed by the employee. Employees hired by PT Comunicações or any of its predecessor companies after the dates indicated above are not entitled to these benefits, as they are covered by the general Portuguese Government social security system.

PT SI employees who were transferred from PT Comunicações and Marconi and were covered by any of the pension plans described above maintain the right to such benefits.

The actuarial valuations for these plans, as at 31 December 2007 and 2006, were computed based on the projected unit credit method and considered the following actuarial assumptions and rates:

	2007	2006
Rate of return on long-term fund assets	6.00%	6.00%
Pensions liabilities discount rate	5.25%	4.75%
Salaries liabilities discount rate	4.75%	4.25%
Salary growth rate	2.00%	2.25%
Pension growth rate	Linked to GDP Growth	1.75%
Inflation rate	2.00%	1.75%

The discount rate for pension liabilities was computed based on long-term yield rates of high-rating bonds as of the balance sheet date for maturities comparable to those liabilities.

The rate of return on long-term fund assets was estimated based on historical information on the return of portfolio assets, the expected portfolio in future years (defined in accordance with the expected maturity of the liabilities) and certain financial market performance indicators usually considered in market analysis.

Salary growth rate was established in accordance with PT Comunicações policy for wages and salaries.

The demographic assumptions considered as at 31 December 2007 and 2006 were as follows:

Mortality table:

Employees (while in active service):	
Males	AM (92)
Females	AF (92)
Pensioners:	
Males	PA (90)m adjusted
Females	PA (90)f adjusted

Disability table: Swiss Reinsurance Company

Turnover of employees: Nil

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Demographic assumptions considered by Portugal Telecom are based on mortality tables generally accepted for actuarial valuation purposes, with these tables being periodically adjusted to reflect the mortality experience occurred in the closed universe of the plan participants.

During 2007, benefits granted under pension plans were amended or settled as follows:

a) Dec-Law 187/2007 and Law 52/2007 introduced certain changes to pension formulas in order to guarantee the long-term financial sustainability of the Portuguese social security system. These changes are also applied to some of PT Comunicações plans, which led to a reduction in the total pension liability.

b) PT Comunicações, based on advice of legal counsel, introduced additional changes to pension supplement plans, namely the reduction of the supplement annual growth rate.

c) PT Comunicações, based on advice of legal counsel, cancelled contributions to Fundo Melhoria Marconi that were being made above the 1.55% mandatory contribution. Following this decision, this plan was no longer treated for accounting purposes as a defined benefits plan and the related accrued liability as at 31 December 2007, amounting to Euro 12,841,000 (Note 9.5), was derecognized.

d) The pension plan of DCSI was settled, following the liquidation of this company on December 2007, and Euro 362,721 was paid to the beneficiaries and the excess accrued liability as at the settlement date of Euro 329,178 was recognized as a gain under the caption Curtailment costs, net (Note 9.5).

The impact of the above mentioned changes to benefits, reduced Portugal Telecom s pension liability by Euro 134,863,178 from which (a) Euro 110,336,000 recognized as a prior year service gain, since it was related to vested rights, (b) Euro 11,357,000 related to unvested rights and therefore were deferred up to the retirement date (Note 3.h) and (c) Euro 12,841,000 and Euro 329,178 related to the settlement of the Fundo de Melhoria and DCSI Plans, respectively, which were recognized as curtailment gains.

Based on the actuarial studies, the benefit obligation and the fair value of the pension funds as at 31 December 2007 and 2006 were as follows:

	2007	2006
Projected benefit obligation:		
Pension, pension supplements and gratuities	2,762,077,000	3,073,825,333
Salaries to pre-retired and suspended employees	985,739,338	997,670,254
	3,747,816,338	4,071,495,587
Pension funds assets at fair value	(2,316,814,232)	(2,263,925,000)
Unfunded pension obligations	**1,431,002,106**	**1,807,570,587**
Prior years' service gains (i)	9,660,000	
Present value of unfunded pension obligations (Note 9.3)	**1,440,662,106**	**1,807,570,587**

(i) This caption refers to the component of the prior years service gain resulting from the changes in the benefits granted under pension plans introduced during 2007, related to unvested rights. This amount will be recognized in earnings during the estimated period in which those benefits will be earned by employees (15 years).

As at 31 December 2007 and 2006, the portfolio of pension funds was as follows:

	2007		2006	
	Amount	%	Amount	%
Equities (i)	1,132,131,173	48.9%	1,024,536,020	45.3%
Bonds	744,044,644	32.1%	726,262,119	32.1%
Property (ii)	176,727,406	7.6%	264,172,280	11.7%
Cash, treasury bills, short-term stocks and other current assets	263,911,009	11.4%	248,954,581	11.0%
	2,316,814,232	**100.0%**	**2,263,925,000**	**100.0%**

(i) As at 31 December 2007 and 2006, this caption included investments in Portugal Telecom s shares and in shares of related parties, as follows:

	2007		2006	
	Number of shares	Amount	Number of shares	Amount
Banco Espírito Santo	3,107,904	196,618,560	13,107,904	178,529,652
Telefónica	8,928,305	198,386,937	8,928,305	143,924,277
Portugal Telecom	3,887,262	34,713,250	3,887,262	38,250,658
		429,718,747		**360,704,587**

(ii) As at 31 December 2007, this caption included certain properties that have been rented to PT Group companies, which represented approximately 95% of the value of property investments held by the funds. In addition, during 2007, a building was disposed of at market value to a property investment fund held by a related party.

Portugal Telecom is exposed to risks related to the changes in the fair value of the plan assets associated with Portugal Telecom s post retirement defined benefit plans. The main purpose of the established investment policy is capital preservation through five main principles:
(1) diversification; (2) stable strategic asset allocation and

disciplined rebalancing; (3) lower exposure to currency fluctuations; (4) specialized instruments for each class of assets; and (5) cost control.

During the years 2007 and 2006, the movement in the plan assets was as follows:

	2007	2006
Opening balance of the plan assets	**2,263,925,000**	**2,200,172,000**
Actual return on assets	79,991,229	158,277,996
Payments of benefits	(165,557,000)	(163,959,000)
Contributions made by the Company (Note 9.4)	155,231,003	59,844,004
Participants contributions	9,665,000	9,590,000
Asset settlement (i)	(26,441,000)	
Closing balance of the plan assets	**2,316,814,232**	**2,263,925,000**

(i) This amount corresponds to the market value of the Fundo Melhoria Marconi , which was settled following the decision of PT Comunicações of not make contributions above the mandatory 1.55% contribution.

A summary of the components of the net periodic pension cost recorded in 2007 and 2006 is presented below:

	2007	2006
Service cost	15,147,000	21,793,000
Interest cost	185,913,899	176,964,706
Expected return on plan assets	(141,491,000)	(130,803,000)
Prior years service gains	(111,285,000)	(23,301,000)
Sub total (Note 9.5)	**(51,715,101)**	**44,653,706**
Work force reduction program (Note 9.3) (i)	280,163,727	197,304,200
Settlement of Fundo Melhoria Marconi (Note 9.5)	(12,841,000)	
Settlement of DCSI Plan (Note 9.3)	(329,178)	
Pension cost	**215,278,448**	**241,957,906**

(i) This amount includes Euro 7,863,478 (Note 20) related to the pre-retirement of employees under the spin-off process which was recorded under the caption Discontinued operations , while the remaining amount of Euro 272,300,249 (Note 9.5) was recorded under the caption Curtailment costs, net .

Actuarial gains and losses resulting essentially from changes in actuarial assumptions or differences between those actuarial assumptions and actual data, are recognised directly in shareholders equity. During the years 2007 and 2006, the movement in accumulated net actuarial losses was as follows:

	2007	2006
Opening balance (Note 41.6)	**1,404,159,583**	**1,653,137,579**
Change in actuarial assumptions (Note 9.6)	(132,842,395)	(208,250,000)

Differences between actual data and actuarial assumptions (Note 9.6):		
Pension benefit obligation related	(180,390,281)	(13,253,000)
Asset related	61,499,771	(27,474,996)
Closing balance (Note 41.6)	**1,152,426,678**	**1,404,159,583**

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During the year 2007, the change in actuarial assumptions corresponds to the net effect of: (i) the increase in the discount rate from 4.75% to 5.25% for pension liabilities and from 4.25% to 4.75% for salary liabilities, reflecting the evolution of market yields; (ii) the reduction in the salary growth rate from 2.25% to 2.00%; and (iii) the increase in the inflation rate from 1.75% to 2.00%. During 2006, the change in actuarial assumptions corresponds to the net effect of: (i) the increase in the discount rate from 4.5% to 4.75% for pension liabilities and from 3.5% to 4.25% for salary liabilities; (ii) the reduction in the salary growth rate from 3.0% to 2.25%; (iii) the reduction in the pension growth rate and inflation rate from 2.0% to 1.75%; and (iv) the adjustment in mortality tables (PA (90), from less three years to less four years).

Differences between actual data and actuarial assumptions related to the PBO, results mainly from the early retirement age for pre-retired employees being earlier than expected and from salaries and pension increases being lower than the assumptions used.

9.2. Health care benefits

As referred to in Note 3.i, PT Comunicações is responsible for the payment of post retirement health care benefits to certain active employees, suspended employees, pre-retired employees, retired employees and their eligible relatives. Health care services are rendered by PT-ACS, which was incorporated with the only purpose of managing the Company s Health Care Plan.

This plan sponsored by PT Comunicações includes all employees hired by PT Comunicações until 31 December 2003 and by Marconi until 1 February 1998. Certain employees of PT SI who were transferred from PT Comunicações are also covered by this health care plan.

The financing of the Health Care Plan in assured by defined contributions made by participants to PT-ACS and the remainder by PT Comunicações, which incorporated an autonomous fund in 2004 for this purpose.

The health care plan of DCSI was settled during the year 2007 following the liquidation of this company, and an amount of Euro 434,172 was paid to the beneficiaries. The remaining accrued liability amounting to Euro 677,785 was recognized as a gain under the caption Curtailment costs, net (Note 9.5).

In the second half of 2006, PT Comunicações made some changes to the Health Care Plan in order to maintain its long-term sustainability and financing. These changes included mainly a reduction in the amount that PT Comunicações pays for each medical act and an increase in participants contributions (from 1.7% of salary in 2007 until 2.1% of salary in 2009), with these effects leading to a reduction in health care benefit obligations at the end of 2006 and to a reduction in future service costs.

In addition, in December 2006 PT Comunicações and SNS agreed to terminate the Protocol entered into in 2004 related to the Health Care Plan. In connection with this Protocol, SNS paid to PT Comunicações an annual amount per participant, and PT Comunicações paid the health care expenses incurred by its participants in SNS s hospitals network. Historically, this Protocol presented a deficit situation for PT Comunicações, with this trend being included in the unfunded health care benefit obligations.

The actuarial valuations for these plans, as at 31 December 2007 and 2006, were computed based on the projected unit credit method and considered the following actuarial assumptions and rates:

	2007	**2006**
Rate of return on long-term fund assets	6.00%	6.00%
Health care liabilities discount rate	5.25%	4.75%
Health care cost trend rate:		
Next two years	3.50%	3.50%
Years thereafter	3.00%	2.75%
Salary growth rate	2.00%	2.25%
Inflation rate	2.00%	1.75%

The discount rate for health care liabilities was computed based on long-term yield rates of high-rating bonds as of the balance sheet date for maturities comparable to those liabilities.

The rate of return on long-term fund assets was estimated based on historical information on the return of portfolio assets, the expected portfolio in future years (defined in accordance with the expected maturity of the liabilities) and certain financial market performance indicators usually considered in market analysis.

Health care cost trend rate was estimated based on specific indicators for this sector and historical information, with the long-term rate being computed also based on the inflation rate.

The demographic assumptions considered as at 31 December 2007 and 2006 were as follows:

Mortality table:

Employees (while in active service):	
Males	AM (92)
Females	AF (92)
Pensioners:	
Males	PA (90)m adjusted
Females	PA (90)f adjusted

Disability table: Swiss Reinsurance Company

Turnover of employees: Nil

Demographic assumptions considered by Portugal Telecom are based on mortality tables generally accepted for actuarial valuation purposes, with these tables being periodically adjusted to reflect the mortality experience occurred in the closed universe of the plan participants.

Based on the actuarial studies, the benefit obligation and the fair value of health care funds and prior year s service gains not yet recognized as at 31 December 2007 and 2006 are as follows:

	2007	2006
Accumulated health care benefit obligation	455,308,816	491,102,185
Plan assets at fair value	(582,330,282)	(644,224,704)
Excessive funding of pension obligations	**(127,021,466)**	**(153,122,519)**
Prior years service gains (i)	16,231,000	19,062,000
Present value of excessive funding of pension obligations (Note 9.3)	**(110,790,466)**	**(134,060,519)**

(i) This caption refers to the component of the prior years service gain resulting from the changes in the health care plan occurred in 2006 related to those benefits that are not yet vested. This amount will be recognized in earnings during the estimated period in which those benefits will be earned by employees (18 years).

As at 31 December 2007 and 2006, the portfolio of the Company s autonomous fund to cover post retirement health care benefit obligations was as follows:

	2007		2006	
	Amount	**%**	**Amount**	**%**
Equities	246,927,446	42.4%	289,205,401	44.9%
Bonds	246,542,590	42.3%	260,860,332	40.5%
Cash, treasury bills, short-term stocks and other current assets	88,860,246	15.3%	94,158,971	14.6%
	582,330,282	**100.0%**	**644,224,704**	**100.0%**

During the years 2007 and 2006, the movement in the plan assets was as follows:

	2007	2006
Opening balance of the plan assets	**644,224,704**	**315,576,000**
Actual return on assets	24,783,000	26,320,417
Refund of expenses paid on account by PT Comunicações (Note 9.4)	(86,677,422)	
Contributions made by PT Comunicações		302,328,287
Closing balance of the plan assets	**582,330,282**	**644,224,704**

A summary of the components of the net periodic post retirement health care cost in 2007 and 2006 is presented below:

	2007	2006
Service cost	2,608,000	6,868,000
Interest cost	22,998,957	40,554,000
Expected return on plan assets	(37,940,000)	(36,935,000)
Prior years service gains	(1,028,000)	(127,255,684)
Sub total (Note 9.5)	**(13,361,043)**	**(116,768,684)**
Work force reduction program costs (Note 9.5)	9,653,813	11,609,762
Settlement of DCSI Plan (Note 9.3)	(677,785)	
Termination of SNS Protocol (Notes 7.a) and 9.5)		(220,417,000)
	(4,385,015)	**(325,575,922)**

Actuarial gains and losses, resulting essentially from changes in actuarial assumptions or differences between those actuarial assumptions and actual data, are computed periodically by the actuary and are recognised directly in shareholders equity. During the years 2007 and 2006, the movements in accumulated net actuarial losses were as follows:

	2007	2006
Opening balance (Note 41.6)	**246,438,253**	**316,875,470**
Change in actuarial assumptions (Note 9.6)	(18,105,160)	(14,078,000)
Differences between actual data and actuarial assumptions (Note 9.6):		
Health care benefit obligation related	(28,556,000)	(66,973,800)
Assets related	13,157,000	10,614,583
Closing balance (Note 41.6)	**212,934,093**	**246,438,253**

During the year 2007, the change in actuarial assumptions corresponds to the effect of: (i) the increase in the discount rate from 4.75% to 5.25%; (ii) the increase in the long-term health care cost trend rate from 2.75% to 3.00%; (iii) the reduction in the salary growth rate from 2.25% to 2.00%; and (iv) the increase in the inflation rate from 1.75% to 2.00%. During the year 2006, the change in actuarial assumptions corresponds to the net effect of: (i) the increase in the discount rate from 4.5% to 4.75%; (ii) the reduction in the long-term health care cost trend rate from 3% to 2.75%; (iii) the reduction in the salary growth rate from 3.0% to 2.25%; and (iv) the adjustments in mortality tables (PA (90), from less three years to less four years).

Differences between actual data and actuarial assumprions related to the PBO results mainly from lower health care expenses than expected.

9.3. Responsibilities for post retirement benefits

The movements occurred in the responsibilities for post retirement benefits during the years ended 31 December 2007 and 2006 were as follows:

	Pension benefits (Nota 9.1)	**Health care benefits (Nota 9.2)**	**Total**
Balance as at 31 December 2005	**2,038,652,313**	**597,231,431**	**2,635,883,744**
Changes in consolidation perimeter (i)	1,270,982	1,241,684	2,512,666
Net periodic pension cost/(gain)	44,653,706	(116,768,684)	(72,114,978)
Work force reduction program costs (Note 9.1)	197,304,200	11,609,762	208,913,962
Termination of Protocol with SNS (Note 9.5)		(220,417,000)	(220,417,000)
Payments and contributions	(225,332,618)	(336,520,495)	(561,853,113)
Net actuarial gains	(248,977,996)	(70,437,217)	(319,415,213)
Balance as at 31 December 2006	**1,807,570,587**	**(134,060,519)**	**1,673,510,068**
Net periodic pension cost/(gain) (Note 9.5)	(51,715,101)	(13,361,043)	(65,076,144)
Work force reduction program costs (Note 9.1)	280,163,727	9,653,813	289,817,540
Settlement of the Plan Melhoria Marconi (Note 9.5)	(12,841,000)		(12,841,000)
Settlement of the DCSI Plan (Notes 9.1, 9.2 and 9.5)	(329,178)	(677,785)	(1,006,963)
Payments, contributions and refunds (Note 9.4)	(330,454,024)	61,159,228	(269,294,796)
Net actuarial losses (Note 9.6)	(251,732,905)	(33,504,160)	(285,237,065)
Balance as at 31 December 2007	**1,440,662,106**	**(110,790,466)**	**1,329,871,640**

(i) In 2006, this caption relates to the accrued post retirement liability of DCSI, a company acquired during 2006.

Certain post retirement benefit plans have a surplus position, therefore according to IAS 19 they should be presented in the balance sheet separately from those plans with a deficit position. As at 31 December 2007 and 2006, net post retirement obligations were recognized in the balance sheet as follows:

	2007	2006
Plans with a deficit position:		
Pensions	1,463,019,423	1,807,570,587
Healthcare	912,816	
	1,463,932,239	**1,807,570,587**
Plans with a surplus position:		
Pensions	(22,357,317)	
Healthcare	(111,703,282)	(134,060,519)
	(134,060,599)	**(134,060,519)**
	1,329,871,640	**1,673,510,068**

The impact of an increase or decrease by 25 bp on the discount rate actuarial assumption would be a decrease or increase of the responsibilities for post retirement benefits by approximately Euro 110 million.

9.4. Cash flow relating to post retirement benefit plans

During the years 2007 and 2006, the payments and contributions regarding post retirement benefits were as follows:

	2007	2006
Pension benefits		
Contributions to the funds (Note 9.1)	155,231,003	59,844,004
Payments of salaries to pre-retired and suspended employees	174,860,300	165,488,614
Settlement of DCSI plan (Note 9.1)	362,721	
Sub total (Note 9.3)	**330,454,024**	**225,332,618**
Health care benefits		
Refund of expenses paid on account by PT Comunicações (Note 9.2)	(86,677,422)	
Payments to PT ACS	25,084,022	34,192,208
Settlement of DCSI plan (Note 9.2)	434,172	
Contributions to the fund		302,328,287
Sub total (Note 9.3)	**(61,159,228)**	**336,520,495**
Termination payments		
Related to continued operations (Note 9.5)	7,513,072	18,936,785
Related to discontinued operations (Note 20)	7,351,702	
Sub total	**14,864,774**	**18,936,785**
	284,159,570	**580,789,898**

9.5. Post retirement benefit costs

In 2007 and 2006, post retirement benefit costs and net work force reduction program costs were as follows:

	2007	2006
Post retirement benefits:		
Pension benefits (Notes 9.1 and 9.3)	(51,715,101)	44,653,706
Health care benefits (Notes 9.2 and 9.3)	(13,361,043)	(116,768,684)
	(65,076,144)	**(72,114,978)**
Curtailment costs, net		
Work force reduction program		
Pensions (Note 9.1)	272,300,249	197,304,200
Health care (Notes 9.2 and 9.3)	9,653,813	11,609,762
Termination payments (Note 9.4)	7,513,072	18,936,785
Settlement of the Plan Melhoria Marconi (Note 9.1)	(12,841,000)	
Settlement of the DCSI Plan (Notes 9.1 and 9.2)	(1,006,963)	
Termination of Protocol with SNS (Notes 9.2 and 9.3)		(220,417,000)
Provisions for SNS receivables (Notes 26 and 39)		11,528,257
	275,619,171	**18,962,004**

The impact of an increase (decrease) by 1% in the rate of return on long-term fund assets would have led to a decrease (increase) of post retirement benefit costs in the year 2007 by approximately Euro 29 million, related to the increase (decrease) in expected return on assets.

9.6. Net actuarial gains

In 2007 and 2006, the net actuarial gains recorded in the Statement of Recognised Income and Expenses were as follows:

	2007	2006
Changes in actuarial assumptions		
Pension benefits (Notes 9.1 and 9.3)	(132,842,395)	(208,250,000)
Health care benefits (Notes 9.2 and 9.3)	(18,105,160)	(14,078,000)
	(150,947,555)	**(222,328,000)**
Differences between actual data and actuarial assumptions		
Pension benefits (Notes 9.1 and 9.3)	(118,890,510)	(40,727,996)
Health care benefits (Notes 9.2 and 9.3)	(15,399,000)	(56,359,217)
	(134,289,510)	**(97,087,213)**
	(285,237,065)	**(319,415,213)**

10. Direct costs

During 2007 and 2006, this caption consists of:

	2007	2006
Telecommunications costs (i) (ii)	739,631,643	567,776,200
Directories (Note 3.p)	67,996,560	74,391,838
Leasings of sites (ii)	57,242,913	53,728,489
Other	42,426,060	28,973,926
	907,297,176	**724,870,453**

(i) The increase in telecommunications costs is mainly related to the termination of the partial Bill & Keep interconnection regime in Brazil (Note 7.c).

(ii) During 2007 and 2006, these captions include costs related to operating leases totaling Euro 118,205,439 and Euro 104,281,651, respectively (Note 13).

11. Costs of products sold

During 2007 and 2006, this caption consists of:

	2007	2006
Costs of products sold	657,908,899	582,739,442
Increases in adjustments for inventories (Note 39)	197,841	1,159,694
Reductions in adjustments for inventories (Note 39)	(1,957,157)	(3,279,638)
	656,149,583	**580,619,498**

12. Supplies and external services

During 2007 and 2006, this caption consists of:

	2007	2006
Commissions	264,249,979	264,528,146
Specialized work	185,584,524	167,679,709
Maintenance and repairs	155,687,210	155,587,635
Electricity	77,514,893	68,183,305
Operating leases (Note 13)	59,859,136	63,897,233
Communications	20,908,106	22,766,726
Installation and removal of terminal equipment	17,337,399	16,048,406
Surveillance and security	14,463,577	13,812,361
Travelling	12,211,052	13,596,095
Fuel, water and other fluids	11,537,585	11,662,325
Office material	11,098,444	11,098,878
Transportation	10,012,616	9,669,906
Insurance	9,493,951	10,275,439
Cleaning expenses	8,858,243	8,537,635
Other	86,799,912	91,167,511
	945,616,627	**928,511,310**

13. Operating leases

During 2007 and 2006, operating lease costs were recognised under the following captions:

	2007	2006
Direct costs - capacity (Note 10)	118,205,439	104,281,651
Supplies and external services (Note 12) (i)	59,859,136	63,897,233
	178,064,575	**168,178,884**

(i) This caption is mainly related to rentals of property and leases of transportation equipment.

As at 31 December 2007, the Company s obligations under operating lease contracts mature as follows:

2008	115,872,158
2009	64,231,075
2010	56,210,593
2011	46,504,832

2012	44,032,381
2013 and foillowing years	127,457,190
	454,308,229

14. Indirect taxes

During 2007 and 2006, this caption consists of:

	2007	2006
Spectrum fees (i)	133,771,522	108,599,557
Value added tax (ii)	22,233,365	23,939,712
Other indirect taxes (iii)	45,820,217	43,371,668
	201,825,104	**175,910,937**

(i) This caption includes primarily spectrum fees from Vivo and TMN, which in 2007 amounted to Euro 103 million and Euro 28 million, respectively, while in 2006 amounted to Euro 80 million and Euro 26 million, respectively.

(ii) In 2006, this caption includes an amount of Euro 4,214,639 related to a reduction in provisions for accounts receivable, since the Company believes in the recoverability of the value added tax included in those balances (Note 39).

(iii) This caption includes mainly indirect taxes from Vivo related to Fust (fund to improve the general access to telecommunications services) and Funtel (National Telecommunications Fund), as well as other municipal, federal and state taxes in Brazil.

15. Other costs, net

During 2007 and 2006, this caption consists of:

	2007	2006
Donations	4,346,148	3,855,978
Tax fines	1,715,807	1,303,811
Other (i)	39,009,981	110,240,206
	45,071,936	**115,399,995**

(i) The decrease in this caption is primarily explained by the reduction in the expenses incurred by Portugal Telecom related to the tender offer launched by Sonae in 2006 from Euro 35 million in 2006 to Euro 7 million in 2007 (Note 7.d) and by the recognition in 2006 of an adjustment amounting to Euro 51 million (Notes 7.c and 34) to the value of certain CDMA equipments at Vivo.

16. Net interest expense

	2007	2006
Interest expense:		
Related to loans obtained and financial instruments	304,130,734	343,426,728
Other	7,142,405	7,416,137
Interest income:		
Related to cash and short-term investments and financial instruments	(96,019,309)	(102,905,642)
Other	(17,885,538)	(27,863,882)
	197,368,292	**220,073,341**

17. Net gains on financial assets and other investments

During 2007 and 2006, this caption consists of:

	2007	2006
Disposal of the 22% investment in Africatel (Note 7.d) (i)	(110,955,318)	
Derivatives financial instruments (ii)	(100,003,385)	(17,498,511)
Disposals of available for sale investments (Note 7.d) (iii)	(38,650,508)	
Real estate investments (iv)	(637,670)	(784,175)
Other, net	1,463,874	(51,077)
	(248,783,007)	**(18,333,763)**

(i) This caption is related to the disposal of a 22% stake in Africatel for an amount of Euro 116,999,817 (Note 44.d). This company includes all Portugal Telecom s investments in Sub-Saharian Africa except for Médi Télécom.

(ii) In 2007, this caption includes net gains of Euro 67,815,191 related to changes in the fair value of derivative financial instruments classified as held for trading (Note 42.2) and a gain of Euro 32,188,194 (Notes 7.d, 41.3 and 44.f) related to the financial settlement of equity swaps. In 2006, this caption includes net losses of Euro 14,422,914 related to changes in the fair value of derivative financial instruments classified as held for trading (Note 42.2), a gain of Euro 23,513,275 related to the financial settlement of equity swaps (Note 44.f) and a gain of Euro 8,408,150 related to dividends obtained by PT on the equity swap over PT Multimedia s shares.

(iii) In 2007, this caption includes the gains obtained with the disposals of the investments in Banco Espírito Santo and Telefónica amounting to Euro 35,698,600 (Notes 19 and 32) and Euro 2,951,908 (Note 32), respectively.

(iv) This caption includes gains related to rents received from real estate rented to third parties, net of the amortization of these assets (Note 32).

18. Net other financial expenses

During 2007 and 2006, this caption consists of:

	2007	2006
Bank commissions and expenses	34,009,849	29,099,186
Other	14,306,585	22,679,560
	48,316,434	**51,778,746**

19. Income taxes

From 1 January 2007, Portugal Telecom and its subsidiaries located in Portugal are subject to Corporate Income Tax (IRC) at a rate of 25%, which is increased up to a maximum of 1.5% of collectible profit through a municipal tax, leading to an aggregate tax rate of approximately 26.5%. In 2006, the Corporate Income Tax was increased up to 10%, leading to an aggregate tax rate of approximately 27.5%. In calculating taxable income, to which the above tax rate is applied, non-tax-deductible amounts are added to or subtracted from book entries. These differences between book and taxable entries can be temporary or permanent.

Portugal Telecom adopted the tax consolidation regime for groups of companies, which apply to all companies in which they hold at least 90% of the capital stock and that comply with Article 63 of the Portuguese Corporate Income Tax Law.

In accordance with Portuguese tax legislation, income tax returns are subject to review and adjustment by the tax authorities during the period of four calendar years (five years for social security, and ten years for the contributions made with respect to the years before 2001), except when there are tax losses, tax benefits were granted, or when tax inspections, claims or appeals are in progress, in which case the time periods are extended or suspended. The Board of Directors of Portugal Telecom, based on information from its tax advisors, believes that any adjustment which may result from such reviews or adjustments, as well as other tax contingencies, would not have a material impact on the consolidated financial statements as at 31 December 2007, except for the situations where provisions have been recognised (Note 39).

a) Deferred taxes

During 2007 and 2006, the movements in deferred tax assets and liabilities were as follows:

	Balance 31 Dec 2006	Changes in the consolidation perimeter (i)	Net income (ii)	Accumulated earnings	Foreign currency translation adjustments	Other	Balance 31 Dec 2007
Deferred tax assets							
Accrued post-retirement liability	443,480,168		(15,476,360)	(75,588,720)		897	352,415,985
Tax losses carryforward (iii)	272,545,978	(73,229,713)	(866,883)		16,520,489		214,969,871
Provisions and adjustments	112,663,562	(14,931,534)	(23,874,175)		4,063,172	(80,178)	77,840,847
Additional contribution to pension funds	203,542,091		(8,927,983)				194,614,108
Financial instruments	13,224,000		1,065,143		(92,486)	(43,671)	14,152,986
Other	121,551,355	(956,783)	7,896,775		9,161,811	1,233,402	138,886,560
	1,167,007,154	**(89,118,030)**	**(40,183,483)**	**(75,588,720)**	**29,652,986**	**1,110,450**	**992,880,357**
Deferred tax liabilities							
Gains on disposals of investments	3,176,409	(29,169)	659,747			29,170	3,836,157
Revaluation of fixed assets	14,342,405	(29,170)	(1,360,805)			(508)	12,951,922
Financial instruments and investments available for sale	11,660,352		(4,310,612)	(7,306,068)		(43,672)	
Other	61,198,651		8,485,140		(1,591,730)		68,092,061
	90,377,817	**(58,339)**	**3,473,470**	**(7,306,068)**	**(1,591,730)**	**(15,010)**	**84,880,140**
		(89,059,691)	**(43,656,953)**	**(68,282,652)**	**31,244,716**	**1,125,460**	

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(i) Changes in the consolidation perimeter are primarily related to deferred tax asssets and liabilities from PT Multimedia (Note 1).

(ii) The movements in deferred tax assets and liabilities recorded through net income include the recognition of a deferred tax asset of Euro 910,608 (Note 20) related to the tax effect of costs of Euro 3,436,257 related to the spin-off of PT Multimedia that have not yet been considered for corporate tax purposes.

(iii) As at 31 December 2007, this caption includes the deferred tax assets related to tax losses carryforward recognised by Vivo. Such tax losses from Vivo, amounting to Euro 632 million, have no maturity but can only be used up to a limit of 30% of tax gains for each period.

	Balance 31 Dec 2005	Changes in the consolidation perimeter	Net income (i)	Accumulated earnings	Foreign currency translation adjustments	Taxes payable (Note 28)	Change in tax rate (i) Net income	Change in tax rate (i) Accumulated earnings	Other	Balance 31 Dec 2006
Deferred tax assets										
Accrued post-retirement liability	720,255,233	690,983	(176,539,877)	(84,191,070)			(234,254)	(16,500,847)		443,480,168
Tax losses carryforward (ii)	286,876,872		135,657,268		(5,537,361)	(137,127,830)	(7,322,971)			272,545,978
Provisions and adjustments	133,288,748		(17,089,026)		(1,203,761)		(2,408,020)		75,621	112,663,562
Additional contribution to pension funds	139,990,269		71,232,656				(7,680,834)			203,542,091
Financial instruments	18,477,273		1,188,042	(6,999,804)	39,344		(536,861)		1,056,006	13,224,000
Other	88,922,614		36,064,997		(2,807,165)		(513,536)		(115,555)	121,551,355
	1,387,811,009	**690,983**	**50,514,060**	**(91,190,874)**	**(9,508,943)**	**(137,127,830)**	**(18,696,476)**	**(16,500,847)**	**1,016,072**	**1,167,007,154**
Deferred tax liabilities										
Gains on disposals of investments (iii)	271,627,295		(268,331,022)				(119,864)			3,176,409
Revaluation of fixed assets	16,530,675		(1,658,776)				(541,223)		11,729	14,342,405
Financial instruments	12,418,218		(6,867,410)	5,493,551			(170,483)	(269,530)	1,056,006	11,660,352
Other	34,290,889	17,275,441	9,993,600		1,153,834		(1,613,939)		98,826	61,198,651
	334,867,077	**17,275,441**	**(266,863,608)**	**5,493,551**	**1,153,834**		**(2,445,509)**	**(269,530)**	**1,166,561**	**90,377,817**
		(16,584,458)	**317,377,668**	**(96,684,425)**	**(10,662,777)**	**(137,127,830)**	**(16,250,967)**	**(16,231,317)**	**(150,489)**	

(i) In 2006, deferred taxes recorded through net income include a cost of Euro 12,686,904 (Note 20) which was reclassified under the caption Discontinued operations , as it is related to PT Multimedia.

(ii) During the year 2006, Vivo recorded deferred tax assets related to tax losses from previous periods amounting to Euro 134 million (Note 7.c).

(iii) The reduction in this caption is related to the adoption by the Company of the voluntary taxation regime for certain gains obtained in the disposition of investments in prior periods. As a result, the amount excluded from taxation by this regime, of Euro 141,972,529, was recorded as a gain in the income statement in 2006, as mentioned below in the reconciliation of the provision for income taxes.

As at 31 December 2007 and 2006, total deferred tax assets include Euro 394 million and Euro 355 million from foreign countries, respectively, and total deferred liabilities include Euro 19 million and Euro 18 million from foreign countries. These deferred tax assets and liabilities from foreign countries are mainly related to Vivo.

b) Reconciliation of income tax provision

During 2007 and 2006, the reconciliation between the nominal and effective income tax for the period is as follows:

	2007	**2006**
Income before taxes	1,032,510,703	858,631,363
Statutory tax rate	26.5%	27.5%
	273,615,336	236,123,625
Permanent differences (i)	(43,509,350)	11,803,881
Adjustments to the provision for income taxes of the previous year (Note 28)	(9,993,868)	(6,380,082)
Difference in tax rates	5,380,340	(8,419,634)
Increases and reductions in provisions for income tax contingencies (Notes 28 and 39)	8,808,391	8,545,381
Reversal of deferred tax liabilities related to the taxation of 50% of the gains obtained in the disposal of certain financial investments (Note 7.d)		(141,972,529)
Tax losses from previous periods (Note 7.c)		(134,470,029)
Valuation allowance for certain tax losses carryforward (ii)		54,723,658
Liquidation of a subsidiary (Note 7.d)		(53,342,681)
Change in statutory tax rate in Portugal (iii)		8,329,536
Other	8,976,816	3,694,503
	243,277,665	**(21,364,371)**
Income tax		
Income tax-current (Note 28)	198,710,104	292,449,234
Deferred taxes (iv)	44,567,561	(313,813,605)
	243,277,665	**(21,364,371)**

(i) In 2007, this caption includes primarily Euro 29,403,159 and Euro 9,460,129 resulting from the non-taxable gains amounting to Euro 110,955,318 and Euro 35,698,600 (Note 17) related to the disposals of the investments in Africatel and Banco Espírito Santo, respectively.

(ii) In 2006, this caption relates mainly to tax losses from certain holding companies of Brasilcel, which did not expect to obtain taxable profits in the future that would allow for the recovery of these tax losses. Following the corporate restructuring completed at the end of 2006, Vivo is able to fully recover its tax losses generated in the period.

(iii) This caption relates to the impact on deferred taxes of the change in the municipal tax to a maximum of 1.5% of collectable profit, as mentioned above.

(iv) The change in this caption is mainly related to: (a) the reduction of deferred tax liabilities in 2006 by Euro 268 million, following the adoption of the voluntary capital gains taxation regime, as mentioned above; and (b) a gain of Euro 134 million (Note 7.c) recorded in 2006 related to the recognition of tax losses from previous periods at Vivo.

20. Discontinued operations

During the years 2007 and 2006 PT Multimédia was classified as a discontinued operation, following the approval at the Annual General Meeting of Portugal Telecom, held on 27 April 2007, of the spin-off of all ordinary shares of PT Multimedia held by Portugal Telecom to its shareholders.

Portugal Telecom concluded the spin-off on 7 November 2007 and the impact of this transaction on the Company s financial statements was to reduce shareholders equity excluding minority interests by an amount of Euro 405,328,608 (Note 41), corresponding to the carrying value, as of the date of the spin-off, of the assets and liabilities attributable to the PT Multimédia business, net of minority interests.

Net income from discontinued operations includes the results of PT Multimédia in 2006 and in 2007 up to the conclusion of the spin-off and expenses incurred with the spin-off process, as follows:

	2007	**2006**
Results of PT Multimédia	63,150,775	74,132,079
Expenses incurred with the spin-off (net of tax) (i)	(17,676,651)	
Net income from discontinued operations	**45,474,124**	**74,132,079**

(i) Expenses incurred in 2007 with the spin-off amounted to Euro 24,049,866, and include primarily work force reduction costs of Euro 7,863,478 (Note 9.1), termination payments of Euro 7,351,702 (Note 9.4) and costs related to changes in the information systems. These costs were presented net of the related tax effect amounting to Euro 6,373,215, including Euro 5,462,607 (Note 28) and Euro 910,608 (Note 19) of current and deferred income tax, respectively.

The results of PT Multimedia in the ten-month period ended 31 October 2007 prior to the conclusion of the spin-off and in 2006 is presented below. Financial information relating to the PT Multimédia segment in 2006 was restated to be presented as a discontinued operation.

	2007	2006
Revenues	**586,736,842**	**666,482,870**
Costs:		
Wages and salaries	34,837,316	39,975,868
Direct costs	182,533,032	203,037,771
Commercial costs	45,023,522	56,865,044
Depreciation and amortization (i)	91,154,879	102,502,152
Other costs (ii)	144,042,093	153,162,816
Total costs	**497,590,842**	**555,543,651**
Income before financial results and taxes	**89,146,000**	**110,939,219**
Interest and other financial expenses, net	3,324,038	7,755,451
Income before income taxes	**85,821,962**	**103,183,768**
Provision for income taxes (iii)	(22,671,187)	(29,051,689)
Results from discontinued operations	**63,150,775**	**74,132,079**

(i) This caption includes the amortization related to contracts entered into with PT Comunicações for the acquisition of capacity on its fixed network, which in 2006 amounted to Euro 23,438,318 and were eliminated in Portugal Telecom s consolidation process.

(ii) In 2006, this caption includes primarily increases and decreases in provisions amounting to Euro 16,456,669 and Euro 14,078,590 (Note 39), respectively. The increases are primarily related to doubtful receivables and the reductions are mainly related to the reduction of the provision for estimated costs from the disposal of Lusomundo Media amounting to Euro 8,017,195.

(iii) In 2006, this caption includes deferred taxes amounting to Euro 12,686,904 (Note 19) and current income taxes amounting to Euro 16,364,785 (Note 28).

The assets and liabilities related to discontinued operations as at 31 October 2007 and 31 December 2006 are as follows:

	31 Oct 2007	31 Dec 2006
Assets of PT Multimedia:		
Current assets	186,411,081	260,045,709
Intangible assets	250,184,460	283,615,597
Tangible assets	314,358,492	297,282,365
Deferred taxes	70,665,379	89,118,029
Other non-current assets	33,498,346	45,115,850
	855,117,758	975,177,550
Goodwill on the acquisition of PT Multimedia shares	176,647,949	176,647,949
Total assets (Note 7.d)	1,031,765,707	1,151,825,499
Liabilities of PT Multimedia:		
Current liabilities	299,152,572	355,354,019
Medium and long-term debt	134,349,770	173,964,086
Other non-current liabilities	20,817,520	21,794,613
Total liabilities (Note 7.d)	454,319,862	551,112,718

The carrying value of net assets related to PT Multimédia amounting to Euro 577 million, as detailed above, net of the related minority interests amounting to Euro 172 million, was recorded as a reduction of accumulated earnings following completion of the spin-off on 7 November 2007.

The statement of cash flows of PT Multimedia in the ten-month period ended 31 October 2007 prior to the conclusion of the spin-off and in 2006 were as follows:

	2007	2006
OPERATING ACTIVITIES		
Collections from clients	727,457,467	755,138,649
Payments to suppliers	(462,184,646)	(486,697,923)
Payments to employees	(33,939,670)	(38,734,380)
Payments relating to income taxes	(2,656,318)	(2,689,546)
Payments relating to indirect taxes and other	(30,494,125)	(32,882,287)
Cash flow from operating activities	**198,182,708**	**194,134,513**
INVESTING ACTIVITIES		
Cash receipts resulting from		
Financial investments	3,340,528	4,460,469
Tangible fixed assets	2,038,056	641,268
Interest and related income	605,125	1,990,730
Dividends	1,476,409	1,843,062
Other investing activities	2,163,792	358,909
	9,623,910	9,294,438
Payments resulting from		
Financial investments	(3,462)	(1,862,172)
Tangible and intangible assets	(89,240,828)	(115,925,107)
Other investing activities	(551)	(13,902,100)
	(89,244,841)	(131,689,379)
Cash flow from investing activities	**(79,620,931)**	**(122,394,941)**
FINANCING ACTIVITIES		
Cash receipts resulting from		
Loans obtained	125,220,982	1,074,976
Other financing activities	333,367	2,714,960
	125,554,349	3,789,936
Payments resulting from		
Loans repaid	(59,595,173)	(8,459,559)
Lease rentals (principal)	(32,994,076)	(41,392,959)
Interest and related expenses	(12,058,846)	(10,146,171)
Dividends	(41,173,794)	(29,280,348)
	(145,821,889)	(89,279,037)
Cash flow from financing activities	**(20,267,540)**	**(85,489,101)**

21. Minority interests

During 2007 and 2006, the movements in minority interests were as follows:

	Balance 31 Dec 2006	**Changes in the consolidation perimeter**	**Acquisitions, disposals and share capital increases**	**Net income**	**Dividends**	**Currency translation adjustments**	**Other**	**Balance 31 Dec 2007**
Brasilcel (i)	558,432,965			14,701,694		46,746,710	340,075	620,221,444
MTC (ii)	62,619,712			22,908,611	(12,165,875)	(4,902,355)		68,460,093
Cabo Verde Telecom	37,683,845			12,542,174	(7,643,967)		(48,190)	42,533,862
Timor Telecom	4,137,046			2,502,878	(907,885)	(507,805)		5,224,234
LTM	1,475,269			746,428	(673,030)	7,350	34,574	1,590,591
CST	1,564,571			367,266	(62,603)	(293,574)	(62,604)	1,513,056
Kenya Postel Directories	1,050,462			509,358	(290,865)	(20,747)	16,828	1,265,036
Previsão	1,094,263		(184,030)	47,344	(40,128)		(134,782)	782,667
Africatel (iii)			782,026	9,956,220	(11,553,741)	(2,819,078)	1,938,726	(1,695,847)
PT Multimedia (iv)	180,460,811	(172,119,142)		29,143,593	(41,219,625)		3,734,363	
Other	2,269,264	1,915,782		(578,140)	(73,867)	(453,982)	614,098	3,693,155
	850,788,208	**(170,203,360)**	**597,996**	**92,847,426**	**(74,631,586)**	**37,756,519**	**6,433,088**	**743,588,291**

	Balance 31 Dec 2005	**Changes in the consolidation perimeter**	**Acquisitions, disposals and share capital increases**	**Net income**	**Dividends**	**Currency translation adjustments**	**Other**	**Balance 31 Dec 2006**
Brasilcel (i)	523,268,570		15,716,672	33,531,568	(1,561,159)	(14,431,325)	1,908,639	558,432,965
PT Multimedia (iv)	178,075,607			28,669,799	(35,335,177)		(375,983)	171,034,246
MTC (ii)		65,971,316		8,948,952	(11,821,024)	(479,532)		62,619,712
Cabo Verde Telecom	33,668,323			10,156,904	(6,137,449)		(3,933)	37,683,845
Cabo TV Madeirense	6,531,728		(594,619)	2,094,571	(1,766,999)			6,264,681
Timor Telecom	3,327,479			1,212,737		(403,170)		4,137,046
Cabo TV Açoreana	2,251,967			731,849	(705,868)			2,277,948
CST	1,675,209			343,821	(67,133)	(331,669)	(55,657)	1,564,571
LTM	1,493,621			770,788	(472,574)	(332,101)	15,535	1,475,269
Previsão	1,109,089			59,498	(27,584)		(46,740)	1,094,263
Kenya Postel Directories	1,015,137			339,976	(230,945)	(73,706)		1,050,462
Other	1,269,346	1,649,981		507,693	(121,540)	(145,240)	(7,040)	3,153,200
	753,686,076	**67,621,297**	**15,122,053**	**87,368,156**	**(58,247,452)**	**(16,196,743)**	**1,434,821**	**850,788,208**

(i) The minority interests in Brasilcel correspond to 50% of the interests of minority shareholders of Brasilcel s subsidiaries in their corresponding amounts of equity and net income. The increases in minority interests in 2006, which are included in the column Acquisitions, disposals and share capital increases , are related to Vivo s corporate restructuring completed in February 2006. The reduction in the income applicable to minority interests in 2007, as compared to 2006, is primarily explained by the minority s share in the tax gain recognized by Vivo in 2006 amounting to Euro 134 million (Note 19) related to tax losses from previous periods..

(ii) The investment in MTC was acquired in September 2006 (Note 2.b), and accordingly its results have been included in Portugal Telecom s consolidated results starting on that date, which primarily explains the increase in net income applicable to minority interests in 2007.

(iii) In July 2007, Portugal Telecom sold a 22% stake in this investment, which aggregates all of Portugal Telecom s interests in Africa, except for Médi Télécom (Note 17).

(iv) The minority interests in PT Multimedia correspond to the interests of minority shareholders in PT Multimedia s equity and net income, considering the application of the equity method of accounting. Following the completion of the spin off of this business on 7 November 2007 (Note 1), PT Multimédia is no longer part of the Group.

22. Dividends

On 27 April 2007, the Annual General Meeting of Portugal Telecom approved the proposal of the Board of Directors to distribute a dividend of Euro 47.5 cents per share relating to year 2006. Accordingly, dividends amounting to Euro 516,506,816 (Notes 41 and 44.i) were paid in 2007.

On 21 April 2006, the Annual General Meeting of Portugal Telecom approved the proposal of the Board of Directors to distribute a dividend of Euro 47.5 cents per share relating to year 2005. Accordingly, dividends amounting to Euro 526,402,838 (Notes 41 and 44.i) were paid in 2006.

23. Earnings per share

Earnings per share for the years 2007 and 2006 were computed as follows:

		2007	2006
Income from continued operations, net of minority interests	(1)	725,529,205	824,280,479
Income from discontinued operations, net of minority interests	(2)	16,330,531	42,479,178
Net income attributable to equity holders of the parent	**(3)**	**741,859,736**	**866,759,657**
Financial costs related with exchangeable bonds (net of tax)	(4)	9,239,015	5,272,196
Net income considered in the computation of the diluted earnings per share	**(5)**	**751,098,751**	**872,031,853**
Weighted average common shares outstanding in the period	**(6)**	**1,050,740,503**	**1,108,740,884**
Effect ot the exchangeable bonds		64,655,173	93,895,026
	(7)	**1,115,395,676**	**1,202,635,910**
Earnings per share from continued operations, net of minority interests			
Basic	(1)/(6)	0.69	0.74
Diluted	[(1)+(4)]/(7)	0.66	0.69
Earnings per share from discontinued operations, net of minority interests			
Basic	(2)/(6)	0.02	0.04
Diluted	(2)/(7)	0.01	0.04
Earnings per share from total operations, net of minority interests			
Basic	(3)/(6)	0.71	0.78
Diluted	(5)/(7)	0.67	0.73

In 2007, dilutive effects include the impact of the exchangeable bonds issued on August 2007, while in 2006 dilutive effects included the impact of these exchangeable bonds and those issued in 2001, which were repaid in December 2006.

24. Short-term investments

As at 31 December 2007 and 2006, this caption consists of:

	2007	2006
Bonds	243,127,974	492,607,644
Other short-term investments	927,165,228	1,042,626,085
	1,170,293,202	**1,535,233,729**

The reduction in this caption is primarily related to the reduction during the year 2007 of the short-term commercial paper programs entered into by Portugal Telecom (Note 35).

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Bonds are held by Portugal Telecom for short term periods. Acquisition and sale of these securities are executed under terms and conditions agreed in advance with financial intermediaries.

Short term investments have terms and conditions previously agreed with financial institutions.

25. Accounts receivable - trade

As at 31 December 2007 and 2006, this caption consists of:

	2007	2006
Current accounts receivable - trade:		
Accounts receivable from customers	1,428,941,709	1,410,621,902
Unbilled revenues	210,384,282	161,947,862
	1,639,325,991	1,572,569,764
Adjustments for doubtful accounts receivable - trade (Note 39)	(331,896,220)	(390,657,352)
	1,307,429,771	**1,181,912,412**

26. Accounts receivable - other

As at 31 December 2007 and 2006, this caption consists of:

	2007	2006
Current accounts receivable - other		
Receivables from related parties (i)	19,360,241	52,582,086
Contributions from SNS (ii)	30,341,962	35,425,856
Discounts given to retired Portuguese citizens (iii)	21,719,037	17,985,959
Trial deposits	21,022,986	16,810,729
Advances to suppliers (iv)	19,089,604	67,351,747
Unbilled interest	4,414,697	7,314,030
Other	46,390,366	53,219,004
	162,338,893	250,689,411
Adjustments for other current accounts receivable (Note 39)	(33,593,504)	(31,777,234)
	128,745,389	**218,912,177**
Other non-current accounts receivable	6,641,582	17,415,215
Adjusments for other non-current accounts receivable (Note 39)	(2,289,349)	(2,177,276)
	4,352,233	**15,237,939**

(i) The reduction in this caption is primarily explained by the dividends received from Unitel in January 2007 related to its earnings of 2005 amounting to Euro 27 million (Note 44.e). Dividends from Unitel related to its earnings of 2006 amounting to Euro 46 million (Note 44.e) were paid in October 2007.

(ii) These contributions are related to the agreement with the SNS regarding the Health Care Plan, under which this entity was obliged to make a comparticipation per beneficiary of the plan. This agreement was terminated during 2006 under a restructuring of the Health Care Plan (Note 9.2). As a result of the termination of the Protocol with SNS (Note 9.2), PT Comunicações recorded an adjustment amounting to Euro 19,953,801 to cover certain recoverability risks of these

receivables. This amount includes Euro 11,528,257 (Note 9.5) related to receivables from contributions to retired participants, which was recorded as a deduction to the gain from the termination of the Protocol with SNS; the remaining amount of Euro 8,425,544 is related to receivables from contributions to active participants and was recorded as an expense under the caption Provisions and adjustments .

(iii) This caption corresponds to discounts given to certain eligible retired Portuguese citizens, which were supposed to be reimbursed by the Portuguese State, under Decree Law 20 C/86, in accordance with the terms of the acquisition of the Basic Network at the end of 2002 and the related Modifying Agreement to the Concession Contract, which stated that this receivable balance should be paid directly by the Portuguese State, which committed to include the corresponding expense in the Annual State Budget. In 2007, the Portuguese State excluded this expense from the Annual State Budget, and no longer will reimburse PT Comunicações. As at 31 December 2007, the account receivable from the Portuguese State is related to the discounts granted during the year 2006, and since 1 January 2007 these discounts are fully paid by PT Comunicações with no right for reimbursement.

(iv) As at 31 December 2006, this caption included Euro 43 million related to advances to content providers in the PT Multimedia business (audiovisuals business).

27. Inventories

As at 31 December 2007 and 2006, this caption consists of:

	2007	**2006**
Merchandise (i)	149,942,019	131,028,707
Raw materials and consumables	17,707,009	16,747,586
Work in progress	9,319,751	7,137,219
	176,968,779	154,913,512
Adjustments for obsolete and slow-moving inventories (Note 39)	(16,376,372)	(24,632,948)
	160,592,407	**130,280,564**

(i) As at 31 December 2007, this caption includes mainly (1) mobile terminal equipments from Vivo and TMN, and (2) telephone and modems (internet access through ADSL) from the wireline business.

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28. Taxes receivable and payable

As at 31 December 2007 and 2006, this caption consists of:

	2007		2006	
	Receivable	**Payable**	**Receivable**	**Payable**
Current taxes				
Operations in Portugal				
Value-added tax	12,510,592	45,559,972	42,025,536	63,617,392
Income taxes	93,139,728	165,413,419	20,997,678	117,289,642
Personnel income tax witholdings		7,917,086		8,690,404
Social Security Contributions		6,303,572		8,291,722
Other	425,892	970,934	1,550,871	1,692,400
	106,076,212	226,164,983	64,574,085	199,581,560
Taxes in foreign countries	133,035,372	155,791,731	147,173,487	117,381,268
	239,111,584	**381,956,714**	**211,747,572**	**316,962,828**
Non-current taxes				
Taxes in foreign countries	**148,340,234**	**31,172,618**	**124,531,128**	**25,787,484**

As at 31 December 2007 and 2006, the caption Taxes in foreign countries relates basically to 50% of taxes receivable and payable by Brasilcel s subsidiaries, as follows:

	2007		2006	
	Receivable	**Payable**	**Receivable**	**Payable**
Current taxes:				
Income taxes	19,702,942	22,861,277	36,415,422	14,826,855
Indirect taxes	105,244,634	113,231,752	101,965,330	87,792,618
Other	8,087,796	19,698,702	8,792,735	14,761,795
	133,035,372	**155,791,731**	**147,173,487**	**117,381,268**
Non-current taxes:				
Income taxes (i)	100,562,243	286,977	82,813,411	
Indirect taxes (ii)	47,777,991	30,885,641	41,717,717	25,787,484
	148,340,234	**31,172,618**	**124,531,128**	**25,787,484**

(i) This caption is primarily related to withholding income taxes in connection with dividends received by the holding companies of Vivo, which are only recoverable after more than one year and only when these companies achieve taxable profits which allow them to recover those taxes.

(ii) Taxes receivable included in this caption relate mainly to indirect taxes paid in the acquisition of real state property, which under Brazilian law are only recoverable over a period of 48 months. Taxes payable included in this caption mainly relate to ICMS assessed by the Brazilian State of Paraná payable in a period of 48 months in accordance with a special agreement with the local State Government.

As at 31 December 2007 and 2006, the net balance of the caption Income taxes from operations in Portugal is made up as follows:

	2007	2006
Current income taxes of the operations in Portugal recorded in the balance sheet	(165,413,419)	(117,289,642)
Payments on account	87,354,017	7,201,228
Witholding income taxes, net	4,301,431	3,951,609
Income taxes receivable (i)	1,484,280	9,844,841
Net income tax payable from operations in Portugal	**(72,273,691)**	**(96,291,964)**

(i) As at 31 December 2006, this caption is primarily related to withholding income taxes from previous periods at Portugal Telecom that could only be recoverable when the Company started to pay income taxes after full utilization of its tax losses carriedforward, which occurred during the 2007, and therefore those withholding income taxes were recovered.

The reconciliation between current income taxes recorded in the Company s balance sheet as at 31 December 2007 and 2006 and current income tax expense for the periods then ended, is as follows:

	2007	2006
Current income taxes of the operations in Portugal recorded in the balance sheet	165,413,419	117,289,642
Foreign current income taxes of international subsidiaries (i)	42,927,250	45,631,371
Excess provision for income taxes for the previous year (Note 19)	(9,993,868)	
Increases and decreases in provisions for income tax contingencies (Notes 19 and 39)	8,808,391	8,545,381
Tax losses carriedforward used in the year (Note 19) (ii)		137,127,830
Other	1,454,949	2,887,521
	208,610,141	**311,481,745**

(i) The reduction in this caption is mainly related to Vivo, following Vivo s corporate restructuring at the end of 2006, which allows Vivo to offset losses from certain companies, with taxable profits from other companies.

(ii) As at 31 December 2006, this caption is related to the utilization of tax losses carryforward by Portugal Telecom and PT Multimedia. As at 31 December 2007, PT Multimedia is no longer part of the Portugal Telecom Group, following the completion of its spin-off, while Portugal Telecom had already fully used its tax losses carriedforward by the end of 2006.

The current income tax expense was recorded in the following captions:

	2007	2006
Profit and loss statement (Note 19)	198,710,104	292,449,234
Discontinued operations (Note 20)	5,462,607	16,364,785
Accumulated earnings	4,437,430	2,667,726
	208,610,141	**311,481,745**

29. Prepaid expenses

As at 31 December 2007 and 2006, this caption consists of:

	2007	2006
Marketing and publicity	31,445,870	25,674,326
Telephone directories	30,341,615	35,231,362
Sales of equipment (i)	17,595,322	13,561,835
Rentals	7,257,690	7,752,817
Maintenance and repairs	2,442,023	1,898,802
Interest paid in advance	895,479	831,413
Programming content (ii)		2,825,949
Other	16,548,816	33,938,245
	106,526,815	**121,714,749**

(i) Sales of mobile phones at Vivo are recognized when the final client activates the equipment. Therefore the negative margin, as well as indirect taxes, are deferred and recognized up to the activation of the customer.

(ii) These prepaid expenses were related to PT Multimedia, which as at 31 December 2007 is no longer part of the Portugal Telecom Group, following the conclusion of its spin-off in November 2007.

30. Other current and non-current assets

As at 31 December 2007 and 2006, these captions are made up as follows:

	2007	2006
Other current assets		
Accounts receivable from QTE transactions (Notes 3.l.ix) and 40) (i)	35,324,314	46,332,009
Other	3,655,680	4,072,995
	38,979,994	**50,405,004**
Other non-current assets		
Accounts receivable from QTE transactions (Notes 3.l.ix) and 40) (i)	470,140,303	627,430,804
Fair value of equity swaps over PT Multimedia shares and of interest rate derivatives classified as cash flow hedges (Note 42.2)		21,033,234
Other	14,125,856	15,328,650
	484,266,159	**663,792,688**

(i) In December 2007, certain contracts related to QTE transactions were early terminated without any cost to Portugal Telecom, therefore Portugal Telecom has derecognized the assets and liabilities related to those contracts (Notes 3.l.ix) and 40).

31. Investments in group companies

As at 31 December 2007 and 2006, this caption consists of:

	2007	2006
Investments in associated companies	273,637,325	229,455,418
Goodwill, net of impairment losses	167,552,271	164,612,372
Loans granted to associated companies and other companies	95,194,241	102,018,169
Investments in other companies	1,678,417	3,012,320
Advances for investments	18,387	
	538,080,641	**499,098,279**

As at 31 December 2007 and 2006, the caption Investments in associated companies consists of:

	2007	2006
Unitel	145,838,919	116,979,117
Universo Online, Inc (UOL) (i)	69,535,950	51,827,526
CTM - Companhia de Telecomunicações de Macau, SARL (CTM)	28,607,601	30,296,559
Médi Télécom	12,603,496	9,798,765
Banco Best, SA	7,250,840	7,362,020
Páginas Amarelas, SA (Páginas Amarelas)	3,299,170	3,721,127
Hungaro Digitel KFT	3,155,246	2,477,113
INESC - Instituto de Engenharia de Sistemas e Computadores (ii)	2,992,787	2,992,787
Guiné Telecom, SARL (ii)	2,907,534	2,907,534
Lisboa TV - Informação e Multimédia, SA (iii)		3,534,312
Other companies	3,346,103	3,458,879
	279,537,646	**235,355,739**
Adjustments for investments in associated companies (Note 39)	(5,900,321)	(5,900,321)
	273,637,325	**229,455,418**

(i) As at 31 December 2007, the fair value of our investment in UOL amounted to Euro 161 million, which compares to a carrying value of Euro 127 million, including goodwill. The fair value of this investment is based on the market price of UOL shares, which are listed on the São Paulo stock market.

(ii) As at 31 December 2007, these investments are fully adjusted for.

(iii) The investment in this company is held by PT Conteúdos, a fully owned subsidiary of PT Multimedia, which as at 31 December 2007 is no longer part of the Portugal Telecom Group, following the conclusion of its spin-off on November 2007.

As at 31 December 2007 and 2006, the caption Goodwill, net of impairment losses consists of:

	2007	2006
Páginas Amarelas	83,754,434	83,754,434
UOL	57,299,334	53,773,291
Unitel	26,498,503	26,498,503
Other companies		586,144
	167,552,271	**164,612,372**

During 2007 and 2006, there were no impairment losses recognized on the above mentioned carrying values of goodwill.

Loans granted to associated companies and other companies are primarily to finance its operations and to develop new businesses and do not have a defined maturity date. As at 31 December 2007 and 2006, this caption consists of:

	2007	2006
Médi Télécom	72,112,464	68,106,243
Sportinveste Multimédia (i)	35,318,668	35,318,668
INESC (ii)	3,292,066	3,292,066
Sport TV (iii)		12,500,000
Other companies	4,306,374	2,041,301
	115,029,572	**121,258,278**
Adjustments for loans granted to associated companies and other companies (Note 39)	(3,292,066)	(3,292,066)
Adjustments related with the equity accounting on financial investments (Note 39) (iv)	(16,543,265)	(15,948,043)
	95,194,241	**102,018,169**

(i) This caption includes Euro 30,023,168 (Note 43) of additional paid-in capital contributions and Euro 5,295,500 of shareholder loans granted to this associated company.

(ii) This loan is fully adjusted for its expected realizable value.

(iii) As at 31 December 2006, these loans were granted by PT Multimedia, which as at 31 December 2007 is no longer part of the Portugal Telecom Group, following the conclusion of its spin-off on November 2007.

(iv) This caption corresponds to accumulated losses resulting from the equity method of accounting in excess of the value of investments in associated companies, which for that reason are recorded as a reduction to the value of loans granted to those associated companies. If accumulated losses resulting from the equity method of accounting exceed the total investment amount (including loans) of any associated company, a provision is recorded under the caption Provisions for other risks and costs Other , whenever the Group has assumed responsibilities with that associated company. As at 31 December 2007 and 2006, this provision amounted to Euro 3,634,576 and Euro 4,548,077 (Note 39), respectively. As of those dates, accumulated negative equity accounting adjustments are related to the investment in Sportinveste Multimedia.

As at 31 December 2007 and 2006, the caption Investment in other companies consisted of:

	2007	2006
Guinetel	296,545	966,277
Janela Digital	900,790	586,696
Archways (i)		2,997,158
Other companies	481,082	1,277,212
	1,678,417	**5,827,343**
Adjustments for investments in group companies (Note 39)		(2,815,023)
	1,678,417	**3,012,320**

(i) This company was fully consolidated as at 31 December 2007.

During 2007 and 2006, the profit and loss caption Equity in earnings of associated companies, net consists of:

	2007	2006
Unitel	91,752,183	82,477,320
CTM	16,951,994	14,815,486
UOL	13,055,606	6,150,137
Médi Télécom	3,081,353	45,571,110
Other	1,286,521	(18,408,197)
	126,127,657	**130,605,856**

A summarized financial data of the main associated companies as at 31 December 2007 and for the year ended on that date is presented below:

	Direct percentage of ownership	Total assets	Total liabilities	Shareholders equity	Operating revenues	Net income
Unitel	25.00%	726,217,471	142,861,795	583,355,676	648,843,741	367,008,732
Médi Télécom	32.18%	1,079,180,662	1,040,015,044	39,165,618	438,440,719	9,575,367
UOL	29.00%	295,020,991	55,241,853	239,779,138	181,713,739	45,019,331
CTM	28.00%	149,053,702	46,883,698	102,170,004	207,438,458	60,542,836

A summarized financial data of the main associated companies as at 31 December 2006 and for the year ended on that date is presented below:

	Direct percentage of ownership	Total assets	Total liabilities	Shareholders equity	Operating revenues	Net income
Unitel	25.00%	657,489,749	189,573,281	467,916,468	517,082,106	329,909,280
Médi Télécom	32.18%	1,146,312,081	1,115,862,221	30,449,860	425,073,848	141,613,145
UOL	29.00%	263,143,894	84,428,287	178,715,607	165,095,125	21,207,369
CTM	28.00%	165,642,343	57,440,347	108,201,996	209,126,648	52,912,450

32. Other investments

As at 31 December 2007 and 2006, this caption consists of:

	2007	2006
Financial investments available for sale (Note 3.l.ii)		99,744,129
Real estate investments, net of accumulated amortisation	23,024,202	26,344,787
Other financial investments	4,211,218	6,302,163
	27,235,420	**132,391,079**

The fair value of financial investments available for sale was determined based on their listed price as of the balance sheet date, and the change in the fair value was recognised in accumulated earnings until the moment investments are disposed of. The movement in the fair value of financial investments available for sale during 2007, was as follows:

	Balance 31 Dec 2006	Change in fair value	Disposals (Note 44.d)	Balance 31 Dec 2007
Banco Espírito Santo (BES)	95,340,000	14,978,600	(110,318,600)	
Telefónica	4,404,129	703,812	(5,107,941)	
	99,744,129	**15,682,412**	**(115,426,541)**	

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Following the disposal of the investments in BES and Telefónica, Portugal Telecom has recorded in 2007 gains amounting to Euro 35,698,600 (Note 17) and Euro 2,951,908 (Note 17) under the caption Net gains on financial assets and other investments , respectively, corresponding to the accumulated changes in the fair value of these investments until the date of the disposal, previously recorded in shareholders equity.

Real state investments relate to land and buildings owned by PT Comunicações that are not used in its operating activities. These assets are recorded at acquisition cost net of accumulated amortization and impairment losses, if any. PT Comunicações periodically assesses impairment analysis on these assets. As at 31 December 2007, the total carrying value and fair value of real state with acquisition cost above Euro 50,000 amounted to approximately Euro 20 million and Euro 25 million, respectively.

PT Comunicações received rents from lease contracts in 2007 and 2006 amounting to Euro 1,468,871 and Euro 1,827,441 (Note 17), respectively. During the years 2007 and 2006, amortization costs amounted to Euro 831,201 and Euro 1,043,266 (Note 17) respectively, and no impairment losses were recognized.

Regarding real estate investments, investments totaling Euro 7,869,802 are installed in properties of third parties or on public property, and investments amounting to Euro 13,240,021 are not yet registered in PT Comunicações s name.

As at 31 December 2007 and 2006, other financial investments were recorded at acquisition cost net of impairment losses, if any, and consisted of the following:

	2007	**2006**
Lea Louise (i)	7,903,379	
Tagusparque	1,296,875	1,296,875
Vortal	687,514	687,514
Seguradora Internacional	617,224	704,448
Cypress (ii)		3,016,754
Other	4,734,872	6,477,901
	15,239,864	**12,183,492**
Adjustments for other investments (Note 39)	(11,028,646)	(5,881,329)
	4,211,218	**6,302,163**

(i) During 2007, Portugal Telecom has disposed 90% of its share in this company, which held investments in Congo. Following this disposal, the investment in this company is now fully provided for and is accounted for at cost, while in 2006 was fully consolidated.

(ii) The investment in this company was held by PT Multimedia as at 31 December 2006.

33. Intangible assets

During 2007 and 2006, the movements in intangible assets were as follows:

	Balance 31 Dec 2006	Changes in the consolidation perimeter	Discontinued operations	Increases	Foreign currency translation adjustments	Other	Balance 31 Dec 2007
Cost							
Industrial property and other rights	3,187,464,243	(539,867)	(207,561,435)	360,266,362	189,260,382	29,216,969	3,558,106,654
Goodwill	1,284,041,510	(9,153,926)	(254,516,010)		54,279,165		1,074,650,739
Other intangible assets	26,944,906	(286,308)		3,699,472	112,013	3,852,901	34,322,984
In-progress intangible assets	17,672,184		(277,194)	49,395,608	2,369,139	(39,881,559)	29,278,178
	4,516,122,843	**(9,980,101)**	**(462,354,639)**	**413,361,442**	**246,020,699**	**(6,811,689)**	**4,696,358,555**
Accumulated depreciation							
Industrial property and other rights	1,008,817,783	(537,016)	(48,787,295)	268,931,858	67,164,818	(5,772,013)	1,289,818,135
Other intangible assets	16,423,797	(278,764)		5,838,449	(107,485)	1,540,996	23,416,993
	1,025,241,580	**(815,780)**	**(48,787,295)**	**274,770,307**	**67,057,333**	**(4,231,017)**	**1,313,235,128**
	3,490,881,263	**(9,164,321)**	**(413,567,344)**	**138,591,135**	**178,963,366**	**(2,580,672)**	**3,383,123,427**

	Balance 31 Dec 2005	Changes in the consolidation perimeter	Increases	Foreign currency translation adjustments	Other	Balance 31 Dec 2006
Cost						
Industrial property and other rights	3,054,360,600	20,204,865	130,552,346	(56,093,523)	38,439,955	3,187,464,243
Goodwill	1,252,866,414		41,767,243	(16,912,229)	6,320,082	1,284,041,510
Other intangible assets	23,881,640		3,209,235	1,423,843	(1,569,812)	26,944,906
In-progress intangible assets	18,145,079		52,979,684	(1,715,966)	(51,736,613)	17,672,184
	4,349,253,733	**20,204,865**	**228,508,508**	**(73,297,875)**	**(8,546,388)**	**4,516,122,843**
Accumulated depreciation						
Industrial property and other rights	739,141,197	5,804,386	290,439,334	(19,709,750)	(6,857,384)	1,008,817,783
Other intangible assets	8,492,066		5,488,771	(260,331)	2,703,291	16,423,797
	747,633,263	**5,804,386**	**295,928,105**	**(19,970,081)**	**(4,154,093)**	**1,025,241,580**
	3,601,620,470	**14,400,479**	**(67,419,597)**	**(53,327,794)**	**(4,392,295)**	**3,490,881,263**

The changes in the consolidation perimeter during 2007 are mainly related to the disposals of TV Cabo Macau and Lea Louise (Exhibit I). The changes in the consolidation perimeter during 2006 are mainly related to the disposal of PrimeSys TI.

Following the approval of the spin-off of PT Multimédia at the last Annual General Meeting of Portugal Telecom held on 27 April 2007, PT Multimedia was classified as a discontinued operation (Note 20), and after the conclusion of the spin-off on 7 November 2007 PT Multimédia is no longer part of the Portugal Telecom Group as at 31 December 2007.

Increases in accumulated depreciation during 2007 are related to continued operations and were recorded under the caption Depreciation and amortization . During 2006, increases in accumulated depreciation include Euro 276,501,987 related to continued operations, which were included in the caption Depreciation and amortization , and Euro 19,426,118 related to discontinued operations, which were included in the caption Discontinued operations .

As at 31 December 2007, the caption Industrial property and other rights includes the following items:

- Euro 339,964,723 related to the acquisition of the Basic Network from the Portuguese State. This amount corresponds to the difference between the amount paid on 27 December 2002 (Euro 365 million) and: (i) the concession rent of 2002 (Euro 16,604,413), which was recorded in the income statement as a cost of the year 2002 because the acquisition occurred only at the end of the year; and (ii) the gain obtained from a QTE lease transaction (Euro 8,430,864) in 2003 with various equipment allocated to the Basic Network, which was considered in the determination of the fair value attributable to the Basic Network in connection with its acquisition by Portugal Telecom;

- Euro 1,934,591,520 related to 50% of (i) the value allocated to the Band A licenses owned by Vivo under the purchase price allocation of certain subsidiaries of Brazil which were incorporated in Vivo, and (ii) the cost of Band B mobile telecommunications licenses obtained by Vivo to operate in certain Brazilian states;

- Euro 717,007,270 related to software licenses;

- Euro 374,839,515 related to a UMTS license obtained by TMN, including Euro 133,092,912 from previous periods and Euro 241,746,603 (Note 7.d) capitalized during the year 2007. In 2000 TMN and the other mobile operators have assumed the commitment of making contributions to the information society during the period through the maturity of the license (2015). At the time it was not possible to reliable estimate how the commitments would be fulfilled, therefore Portugal Telecom did not recognize this commitment as a cost of the license and as a liability. In May 2007, pursuant to an agreement between TMN and the Portuguese State, and based on contributions already made, the outstanding commitments were valued at Euro 355 million. During the second half of 2007, TMN reached an agreement with the Government, which established that (a) Euro 260 million should be realized through the E Initiatives (an initiative lead by the government which offers to school teachers and students laptops and discounts in internet services) and (b) Euro 95 million should be realized through the subsidization of equipments, services discounts and network investments. The amount related to the E Initiatives was recognized as a license cost in 2007 for the amount of its net present value (Euro 233 million), and the Euro 95 million will be recorded when incurred as its expected that these investments will be made in the normal course of the business of TMN. In addition, TMN assumed the payment of one third of the Oniway s commitment, which amounted to Euro 8 million;

- Euro 95,998,811 related to terminal equipment rented to post-paid customers of mobile businesses, which are being amortised over the period of the related rental contracts;

- Euro 42,575,000 related to contracts signed by PT Comunicações in 2007 for the acquisition of satellite capacity until 2015, which were recorded as capital leases (Note 7.a); and

- Euro 32,278,678 resulting from the MTC s purchase price allocation and related to the value attributed to the agreement entered into with the other shareholders of MTC, which guarantees to Portugal Telecom the control of MTC.

As at 31 December 2007 and 2006, the goodwill related to subsidiaries was as follows:

	2007	2006
Vivo (i)	**750,381,297**	**692,801,517**
Wireline business		
PT.com	162,624,017	162,624,017
PT Comunicações (international carrier business)	75,634,389	75,634,389
PT Prime (Data & Corporate business)	32,126,523	32,126,523
Other	570,204	570,204
	270,955,133	**270,955,133**
PT Multimedia		
Pay TV and Cable Internet (ii)		**254,516,010**
Other businesses (Note 7.d)		
MTC	37,216,652	40,499,689
PT SI	8,956,960	8,956,960
Cabo Verde Telecom	7,124,252	7,124,252
Web-Lab (iii)		6,543,675
TV Cabo Macau (iv)		2,610,251
Other	16,445	34,023
	53,314,309	**65,768,850**
	1,074,650,739	**1,284,041,510**

(i) The increase in the goodwill of Vivo is mainly related to the Brazilian Real appreciation against the Euro in 2007 (Euro/Brazilian Real exchange rate of 2.8118 as at 31 December 2006, as compared to 2.5963 as at 31 December 2007).

(ii) Following the approval of the spin-off of PT Multimédia at the last Annual General Meeting of Portugal Telecom held on 27 April 2007, PT Multimedia was classified as a discontinued operation (Note 20).

(iii) This company was liquidated in in 2007 and the related goodwill was derecognized, with a corresponding charge to net income being recorded under the caption Other costs, net .

(iv) The investment in this company was disposed of in January 2007 for an amount of Euro 3,108,957 (Exhibit I).

For impairment analysis purposes, goodwill was allocated to cash generating units, which correspond to reportable business segments (Note 7). The Company s management has concluded, based on estimated cash flows for those segments discounted using the applicable discount rates, that as at 31 December 2007 the book value of financial investments, including goodwill, did not exceed its recoverable amount.

34. Tangible assets

During 2007 and 2006 the movements in tangible assets were as follows:

	Balance 31 Dec 2006	Changes in the consolidation perimeter	Discontinued operations	Increases	Foreign currency translation adjustments	Other	Balance 31 Dec 2007
Cost							
Land	80,701,925		(2,536,060)	69,550	916,414	(65,529)	79,086,300
Buildings and other constructions	994,010,394	(690,905)	(41,689,480)	19,985,588	4,292,819	17,158,778	993,067,194
Basic equipment	11,693,392,675	(6,580,133)	(592,065,927)	392,951,324	212,738,612	70,289	11,700,506,840
Transportation equipment	83,151,249	(140,853)	(6,719,774)	12,836,409	151,595	(11,668,384)	77,610,242
Tools and dies	22,364,493	(42,376)	(240,069)	2,537,465	411,426	297,133	25,328,072
Administrative equipment	1,040,518,167	(627,411)	(60,499,407)	63,684,649	11,548,390	918,314	1,055,542,702
Other tangible assets	68,698,713		(17,322,602)	1,561,968	(78,606)	(500,322)	52,359,151
In-progress tangible assets	202,969,026		(7,557,835)	233,416,082	15,077,570	(281,337,059)	162,567,784
Advances to suppliers of tangible assets	332,613		(663,882)	628,943	(25,042)	(5,786)	266,846
	14,186,139,255	**(8,081,678)**	**(729,295,036)**	**727,671,978**	**245,033,178**	**(275,132,566)**	**14,146,335,131**
Accumulated depreciation							
Land	12,329,972					(49,241)	12,280,731
Buildings and other constructions	561,196,222	(566,965)	(14,454,140)	49,435,848	1,043,696	1,369,195	598,023,856
Basic equipment	8,696,866,112	(5,739,792)	(360,337,269)	700,821,336	144,583,390	(222,489,094)	8,953,704,683
Transportation equipment	43,232,754	(79,185)	(4,013,203)	15,170,378	38,445	(9,802,567)	44,546,622
Tools and dies	18,458,676	(35,691)	(199,540)	1,109,858	182,551	(13,276)	19,502,578
Administrative equipment	848,234,080	(582,192)	(38,317,829)	79,965,453	7,273,738	(13,649,791)	882,923,459
Other tangible assets	63,788,249		(14,690,691)	1,791,559	5,149,474	(6,082,560)	49,956,031
	10,244,106,065	**(7,003,825)**	**(432,012,672)**	**848,294,432**	**158,271,294**	**(250,717,334)**	**10,560,937,960**
	3,942,033,190	**(1,077,853)**	**(297,282,364)**	**(120,622,454)**	**86,761,884**	**(24,415,232)**	**3,585,397,171**

	Balance 31 Dec 2005	Changes in the consolidation perimeter	Increases	Foreign currency translation adjustments	Other	Balance 31 Dec 2006
Cost						
Land	79,629,860		2,312,775	(272,885)	(967,825)	80,701,925
Buildings and other constructions	936,482,427	1,743,311	56,727,434	(2,207,897)	1,265,119	994,010,394
Basic equipment	11,217,237,559	79,181,389	455,369,922	(69,566,280)	11,170,085	11,693,392,675
Transportation equipment	76,931,737		20,068,542	(372,063)	(13,476,967)	83,151,249
Tools and dies	20,240,728	(21,360)	1,498,937	(145,963)	792,151	22,364,493
Administrative equipment	964,421,977	381,682	82,916,060	(4,694,126)	(2,507,426)	1,040,518,167
Other tangible assets	65,655,643		3,829,650	(103,776)	(682,804)	68,698,713
In-progress tangible assets	152,051,621		241,376,013	(7,353,249)	(183,105,359)	202,969,026
Advances to suppliers of tangible assets	1,359,837		(470,221)	9,898	(566,901)	332,613
	13,514,011,389	**81,285,022**	**863,629,112**	**(84,706,341)**	**(188,079,927)**	**14,186,139,255**

Accumulated depreciation						
Land	12,417,562				(87,590)	12,329,972
Buildings and other constructions	519,591,043	683,228	48,899,458	(571,856)	(7,405,651)	561,196,222
Basic equipment	8,019,715,144	33,285,575	761,886,334	(48,402,612)	(69,618,329)	8,696,866,112
Transportation equipment	39,693,211		14,742,687	(225,130)	(10,978,014)	43,232,754
Tools and dies	17,753,878	(92)	826,139	(82,138)	(39,111)	18,458,676
Administrative equipment	777,628,771	529,212	85,220,550	(2,893,519)	(12,250,934)	848,234,080
Other tangible assets	65,208,659		2,274,369	(447,067)	(3,247,712)	63,788,249
	9,452,008,268	**34,497,923**	**913,849,537**	**(52,622,322)**	**(103,627,341)**	**10,244,106,065**
	4,062,003,121	**46,787,099**	**(50,220,425)**	**(32,084,019)**	**(84,452,586)**	**3,942,033,190**

The changes in the consolidation perimeter during 2007 are mainly related to the disposals of TV Cabo Macau and Lea Louise (Exhibit I). The changes in the consolidation perimeter during 2006 are mainly related to the disposal of PrimeSys TI.

Following the approval of the spin-off of PT Multimédia at the Annual General Meeting of Portugal Telecom held on 27 April 2007, PT Multimedia was classified as a discontinued operation (Note 20), and after the conclusion of the spin-off on 7 November 2007 PT Multimédia is no longer part of the Portugal Telecom Group as at 31 December 2007.

Increases in accumulated depreciation during 2007 are related to continued operations and were recorded under the caption Depreciation and amortization . Increases in accumulated depreciation during 2006 include Euro 854,211,820 related to continued operations, which were included in the caption Depreciation and amortization , and Euro 59,637,717 related to discontinued operations, which were included in the caption Discontinued operations .

In 2007, the column Other includes respectively Euro 15 million and Euro 21 million related to the write-off and disposal of certain fixed assets at PT Comunicações, which were included under the captions of Other costs, net and Net gains on disposals of fixed assets of the wireline business. In 2006, the column Other includes (i) Euro 51 million related to adjustments to the value of certain CDMA equipments at Vivo (Note 15), (ii) Euro 11 million related to the writte-off of certain fixed assets at PT Comunicações, and (iii) Euro 6 million related to the impact of the change in the estimated useful life of certain tangible assets at PT Multimedia.

The following situations regarding tangible assets should be mentioned:

- Euro 1,103,300,380 of tangible assets of PT Comunicações are related to the Concession, under the terms of the Modification Agreement of the Concession;
- Euro 19,759,332 of tangible assets of PT Comunicações are located outside Portugal, including participations in submarine cable consortiums; and
- In previous years, PT Comunicações, PT Prime and TMN entered into QTE lease contracts, which comprised the sale of certain telecommunications equipment to foreign entities. Simultaneously, those entities entered into leasing contracts with special purpose entities, which made conditional sale agreements to sell the related equipment to PT Comunicações, PT Prime and TMN, at an amount equivalent to the initial sales price. Group companies maintained the legal ownership of those equipments, continuing to be able to sell or substitute any equipment. These transactions correspond to a sale and lease-back and, accordingly, the sale of the equipment was not recorded and the equipment continued to be included in the Company s consolidated balance sheet. On December 2007, some of these contracts were early terminated upon decision of the counterparty without any costs for Portugal Telecom (Note 30).

35. Debt

As at 31 December 2007 and 2006, this caption consists of:

	2007		2006	
	Short-term	**Long-term**	**Short-term**	**Long-term**
Exchangeable bonds		689,407,731		
Bonds	96,290,875	3,061,702,959		3,133,646,046
Bank loans				
External loans	429,216,931	940,374,402	381,866,643	1,075,326,685
Domestic loans	2,073,991	530,120	24,994,569	28,075,839
Other loans				
Commercial paper	323,688,504		749,411,565	
External loans	271,700		460,231	271,654
Commitments under the UMTS license	55,911,577	144,659,000		
Liability related to equity swaps on treasury shares (Note 41.3)	323,178,913		187,612,393	
Leasings	25,452,994	124,001,602	28,378,629	230,216,908
	1,256,085,485	**4,960,675,814**	**1,372,724,030**	**4,467,537,132**

35.1. Exchangeable bonds

On 28 August 2007, PT Finance issued exchangeable bonds totaling Euro 750,000,000, exchangeable into fully paid ordinary shares of Portugal Telecom, which had the following terms:

• Exchange price: Euro 13.9859 per ordinary share of Portugal Telecom, adjusted to Euro 11.60 on 30 October 2007, following the spin-off of PT Multimedia, according to the terms and conditions of the bonds;

• Nominal value: Euro 50,000;

• Maturity: 28 August 2014 unless previously redeemed, acquired, cancelled or converted; and

• Fixed interest rate: 4.125% per annum, paid semi-annually.

In accordance with IFRS, exchangeable bonds represent a compound instrument and accordingly the market value of the equity component as of the date the bonds were issued amounted to Euro 57,145,442 (Note 41) and was recorded in shareholders equity, while the financial liability component is recorded through the amortized cost.

As at 31 December 2007, the fair value of the exchangeable bonds amounted to Euro 791 million.

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35.2. Bonds

On 7 April 1999, PT Finance issued notes totaling Euro 1,000,000,000 under a Global Medium Term Note (GMTN) Programme, with an annual fixed interest rate of 4.625% and maturity in April 2009. The Company acquired in previous years certain of these bonds (held by the Company in treasury) with a notional amount of Euro 120,500,000, which were cancelled in November 2004. As at 31 December 2007, the notional amount of these bonds outstanding totals Euro 879,500,000.

On 1 August 2003, Vivo Participações issued bonds amounting to 500 million Brazilian Reais (Euro 96 million as at 31 December 2007 corresponding to the 50% consolidated in Portugal Telecom s balance sheet), with a maturity of five years and bearing an annual interest at a rate corresponding to 104.4% of the CDI rate.

On 1 May 2005, Vivo Participações issued bonds amounting to 1 billion Brazilian Reais (Euro 193 million as at 31 December 2007 corresponding to the 50% consolidated in Portugal Telecom s balance sheet), with a maturity of ten years and bearing an annual interest rate ranging between 103.3% and 104.2% of the CDI.

In 2005, PT Finance issued three Eurobonds under the GMTN Programme, with the following amounts and maturities:

- On 24 March 2005, issued Eurobonds totaling Euro 1,000,000,000 at an annual interest rate of 3.75% and maturity in 2012;
- On 24 March 2005, issued Eurobonds totaling Euro 500,000,000 at an annual interest rate of 4.375% and maturity in 2017;
- On 16 June 2005, issued Eurobonds totaling Euro 500,000,000 at an annual interest rate of 4.5% and maturity in 2025.

Expenses incurred at the date of these bonds were issued, which are related to roundings in defining the coupon rate and to commissions, are deferred and recorded as a deduction to these loans, and recognized in earnings through the life of the bonds. As at 31 December 2007, the balance of these prepaid expenses amounted to Euro 10,378,792.

As at 31 December 2007, the maximum possible nominal amount of outstanding notes issued under the GMTN Programme established by PT Finance amounted to Euro 7,500,000,000, of which Euro 2,879,500,000 were outstanding as at 31 December 2007.

As at 31 December 2007, the fair value of the bonds issued amounted to Euro 2,951 million.

35.3. Bank loans

As at 31 December 2007 and 2006, bank loans are denominated in the following currencies:

	2007		2006	
	Currency of the notional	**Euro**	**Currency of the notional**	**Euro**
Euro	773,402,571	773,402,571	945,336,195	945,336,195
US Dollar	13,375,741	9,086,163	28,128,423	21,357,952
Brazilian Real	1,529,060,685	588,938,368	1,505,081,850	535,273,437
Other		768,342		8,296,152
		1,372,195,444		**1,510,263,736**

In 2003, the Company entered into a Revolving Credit Facility amounting to Euro 500 million, with a maturity of 2 years and an extension option. In 2005, the maturity of this facility was renegotiated with 50% of the loan payable in February 2009 and the remainder in February 2010.

In 2004, Portugal Telecom and PT Finance obtained three other Revolving Credit Facilities totaling Euro 550 million, as follows:

- On 24 June 2004, with an initial amount of Euro 150 million, increased to Euro 300 million in 2007, and an initial maturity of four years, which was extended to six years in 2005 and to eight years in 2007;
- On 18 October 2004, with an amount of Euro 100 million and an initial maturity of three years, which was extended to five years in 2005; and
- On 22 October 2004, with an amount of Euro 150 million and a maturity of three years and six months.

As at 31 December 2007, the Group had used an amount of Euro 150 million in connection with these four standby facilities.

As at 31 December 2007, Vivo also had available standby facilities in the total amount of R$ 1,160 million, of which no amount was being used at that date.

As at 31 December 2007, loans obtained from the European Investment Bank (EIB) and KFW amounted to, respectively, Euro 605 million and Euro 5 million, maturing up to 2014.

As at 31 December 2007 and 2006, the bank loans of Portugal Telecom and its group companies bear interest at annual interest rates, equivalent to loans denominated in Euros, which vary between:

	2007	2006
Maximum	5.20%	5.46%
Minimum	3.00%	3.00%

As at 31 December 2007 , the fair value of total bank loans amounted to Euro 1,335 million.

35.4. Commercial paper

Portugal Telecom has entered into commited short-term commercial paper programs, amounting to a total of Euro 875,000,000. As at 31 December 2007, the Company had used an amount of Euro 323,688,504, with maturity in January 2008 and interest at an annual average rate of 4.60%. The fair value as at 31 December 2007 of outstanding commercial paper is similar to its carrying value.

35.5. Commitments under the UMTS license

This amount corresponds to the present value of the payments related to the commitments assumed by TMN under the UMTS license (Note 33).

35.6. Leasings

Financial leasing obligations recorded as at 31 December 2007 are mainly related to the lease of vehicles and buildings and to contracts for the acquisition of satellite capacity. The reduction occurred in this caption is primarily explained by the contribution of the multimedia business as at 31 December 2006, which amounted to approximately Euro 143 million.

35.7. Medium and long-term debt

As at 31 December 2007, long-term debt mature on the following years:

2009	1,122,489,793
2010	226,250,963
2011	159,840,002
2012	1,282,203,996
2013 and following years	2,169,891,060
	4,960,675,814

35.8. Covenants

As at 31 December 2007, the Company had several covenants related to its indebtedness, which have been fully complied with as at that date, as follows:

- **Change in control**

The exchangeable bonds, the credit facilities amounting to Euro 1,050 million and certain loans obtained from EIB totaling Euro 598 million as at 31 December 2007, grant the right to the lenders of demanding the repayment of all amounts due in the case of any change in the control of Portugal Telecom.

- **Credit rating**

Certain loan agreements with the EIB, totaling Euro 343 million as at 31 December 2007, stated that Portugal Telecom may be asked to present a guarantee acceptable by the EIB if, at any time, the long-term credit rating assigned by the rating agencies to Portugal Telecom was reduced to BBB/Baa2 or less. As a result of Portugal Telecom s downgrade on 3 August 2006 to BBB- by S&P, to Baa2 by Moody s and to BBB by Fitch, the Company negotiated with EIB revised terms and conditions for these loans. The agreement between the two entities, signed on 23 February 2007, allows PT to present the guarantee only in the case of a downgrade from the current rating (BBB- by S&P, Baa2 by Moody s and BBB by Fitch).

- **Control/disposal of subsidiaries**

The credit facility amounting to Euro 500 million states that Portugal Telecom must, directly or indirectly, maintain majority ownership and control of each material subsidiary. Material subsidiaries are those companies whose total assets are equal or exceed 10% of total consolidated assets or whose total revenues are also equal or exceed 10% of total consolidated revenues. As of the date of this filling there are no outstanding amounts related to this credit facility.

- **Disposals of assets**

The credit facility amounting to Euro 100 million and certain EIB loans totaling Euro 599 million as at 31 December 2007 include certain restrictions regarding the disposal of assets by Portugal Telecom. Following the agreement signed with EIB on 23 February 2007 mentioned above, the bank waived its rights related to this covenant solely for the PT Multimedia spin-off.

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- **Financial ratios**

The facility of Euro 500 million and the facility of Euro 150 million state that the ratio Consolidated Net Debt/EBITDA should not be higher than 3.5. The credit facility of Euro 100 million, states that the ratio Consolidated Net Debt/EBITDA should not be higher than 4.0. In addition, the conditions (spread and maturity) applicable to the facility of Euro 500 million and to the Euro 300 million facility obtained in June 2004 may be changed if the ratio Consolidated Net Debt/EBITDA is higher than, respectively, 2.5 and 2.25. As at 31 December 2007, this ratio stood at 1.9.

- **Negative Pledge**

The Global Medium Term Notes, the exchangeable bonds and the facilities totaling Euro 1,050 million are subject to negative pledge clauses, which restrict the pledge of security interests in the assets of companies included in the consolidation.

36. Accounts payable

As at 31 December 2007 and 2006, this caption consists of:

	2007	**2006**
Accounts payable-trade	726,507,575	706,367,545
Fixed asset suppliers	310,118,957	347,216,526
Accounts payable to employees	22,693,009	18,382,030
Other	49,562,622	43,123,122
	1,108,882,163	**1,115,089,223**

37. Accrued expenses

As at 31 December 2007 and 2006, this caption consists of:

	2007	**2006**
Supplies and external services	256,280,710	299,237,991
Interest expense (i)	188,695,831	196,902,460
Vacation pay and bonuses	107,293,868	111,835,095
Discounts to clients	53,500,672	39,057,657
Other	35,279,847	33,184,329
	641,050,928	**680,217,532**

(i) As at 31 December 2007 and 2006, this caption included (a) Euro 44.7 million and Euro 58.5 million (Note 42), respectively, related to the fair value of the interest component of the exchange rate and interest rate derivatives contracted by Vivo, and (b) Euro 13.7 million and Euro 11.2 million (Note 42), respectively, related to the fair value of exchange rate and interest rate derivatives contracted by several Group companies.

38. Deferred income

As at 31 December 2007 and 2006, this caption consists of:

	2007	2006
Current deferred income		
Advance billings		
Pre-paid mobile traffic	129,224,776	111,408,166
Penalties imposed to customers relating to violations of contracts	45,031,350	39,942,294
Other advance billings	76,102,570	41,948,176
Other	35,697,771	22,439,675
	286,056,467	**215,738,311**

39. Provisions and adjustments

During the years 2007 and 2006, the movements in this caption were as follows:

	Balance 31 Dec 2006	Changes in the consolidation perimeter	Descontinued operations	Increases	Decreases	Foreign currency translation adjustments	Other	Balance 31 Dec 2007
Adjustments								
For doubtful accounts receivable (Notes 25 and 26)	424,611,862	(326,253)	(63,075,788)	104,873,101	(7,561,496)	7,458,925	(98,201,278)	367,779,073
For inventories (Note 27)	24,632,948		(7,555,757)	761,252	(1,981,787)	1,032,940	(513,224)	16,376,372
For investments (Note 31 and 32)	33,836,782	7 620 942	(3,076,928)	1,302,893	(903,796)	221 617	(2,237,212)	36,764,298
	483,081,592	**7,294,689**	**(73,708,473)**	**106,937,246**	**(10,447,079)**	**8,713,482**	**(100,951,714)**	**420,919,743**
Provisions for risks and costs								
Litigation (Note 46)	52,386,942		(137,000)	40,991,892	(2,210,664)	3,925,349	(25,472,417)	69,484,102
Taxes	43,655,078	(22 689)	(6,423,765)	10,871,672	(13,464,072)	1,436,574	(1,301,846)	34,750,952
Other	111,743,038	(773 190)	(5,843,708)	9,908,852	(379,335)	3,586,804	12,696,059	130,938,520
	207,785,058	**(795,879)**	**(12,404,473)**	**61,772,416**	**(16,054,071)**	**8,948,727**	**(14,078,204)**	**235,173,574**
	690,866,650	**6,498,810**	**(86,112,946)**	**168,709,662**	**(26,501,150)**	**17,662,209**	**(115,029,918)**	**656,093,317**

Changes in the **Foreign currency**

	Balance 31 Dec 2005	consolidation perimeter	Increases	Decreases	translation adjustments	Other	Balance 31 Dec 2006
Adjustments							
For doubtful accounts receivable (Notes 25 and 26)	373,818,493	521 587	283,188,936	(42,065,033)	(6,258,490)	(184,593,631)	424,611,862
For inventories (Note 27)	28,247,571		2,653,654	(5,247,510)	(227,079)	(793,688)	24,632,948
For investments (Note 31 and 32)	65,270,472		6,336,241	(36,098,033)	310,993	(1,982,891)	33,836,782
	467,336,536	**521,587**	**292,178,831**	**(83,410,576)**	**(6,174,576)**	**(187,370,210)**	**483,081,592**
Provision for risks and costs							
Litigation (Note 46)	74,717,074		26,460,483	(2,286,421)	(1,924,893)	(44,579,301)	52,386,942
Taxes	68,293,691		13,960,219	(32,635,330)	(1,391,010)	(4,572,492)	43,655,078
Other	135,511,379		5,374,211	(12,385,262)	(934,093)	(15,823,197)	111,743,038
	278,522,144		**45,794,913**	**(47,307,013)**	**(4,249,996)**	**(64,974,990)**	**207,785,058**
	745,858,680	**521,587**	**337,973,744**	**(130,717,589)**	**(10,424,572)**	**(252,345,200)**	**690,866,650**

The changes in the consolidation perimeter during 2007 are mainly related to the disposals of TV Cabo Macau and Lea Louise (Exhibit I).

Following the approval of the spin-off of PT Multimédia at the last Annual General Meeting of Portugal Telecom held on 27 April 2007, PT Multimedia was classified as a discontinued operation (Note 20), and after the conclusion of the spin-off on November 2007 is no longer part of the Portugal Telecom Group as at 31 December 2007.

As at 31 December 2007 and 2006, the caption Provisions for risks and costs was classified in the balance sheet in accordance with the expected settlement date, as follows:

	2007	2006
Current provision		
Litigation	41,120,207	32,053,458
Taxes	27,326,736	26,512,397
Other	54,893,257	46,585,636
	123,340,200	**105,151,491**
Non-current provision		
Litigation	28,363,895	20,333,484
Taxes	7,424,216	17,142,681
Other	76,045,263	65,157,402
	111,833,374	**102,633,567**
	235,173,574	**207,785,058**

The provision for taxes relates to probable tax contingencies, which were estimated based on internal information and the opinion of external tax advisors.

As at 31 December 2007 and 2006, the caption Provisions for risks and costs - Other , consists of:

	2007	2006
Asset retirement obligation (Note 3.g)	71,211,681	58,867,102
Customer retention programs (i)	48,381,701	42,607,492
Negative financial investments (Note 31) (ii)	3,634,576	4,548,077
Other	7,710,562	5,720,367
	130,938,520	**111,743,038**

(i) This provision was recognised by TMN and Vivo to settle future liabilities relating to customer retention programmes and was computed based on present catalogue costs and estimated usage levels.
(ii) This provision relates to accumulated losses in affiliated companies resulting from the application of the equity method of accounting exceeding the corresponding total invested amount, including loans (Notes 2.a).

The increases in provisions and adjustments in 2007 and 2006 were recognised in the income statement as follows:

	2007	2006
Provisions and adjustments	150,849,660	288,106,111
Equity in losses of affiliated companies	5,997,142	7,588,684
Income taxes (Notes 19 and 28)	9,430,412	8 545 381
Discontinued operations - other costs (Note 20)		16,456,669
Costs of products sold (Note 11)	197,841	1,159,694
Curtailment costs, net (Note 9.5)		11,528,257
Other	2,234,607	4,588,948
	168,709,662	**337,973,744**

The decreases in these captions in 2007 and 2006 were recognised in the income statement as follows:

	2007	2006
Provisions and adjustments	22,913,191	69,378,844
Costs of products sold (Note 11)	1,957,157	3,279,638
Equity in earnings of affiliated companies	892,076	36,675,164
Income taxes (Notes 19 and 28)	622,021	
Discontinued operations - other costs (Note 20)		14,078,590
Indirect taxes (Note 14)		4,214,639
Discontinued operations - commercial costs		1,874,213
Other	116,705	1,216,501
	26,501,150	**130,717,589**

In 2007 and 2006, the profit and loss caption Provisions and adjustments consists of:

	2007	2006
Increases in provisions and adjustments for doubtful receivables and other	150,849,660	288,106,111
Decreases in provisions and adjustments for doubtful receivables and other	(22,913,191)	(69,378,844)
Direct write-off of accounts receivable	2,986,716	11,051,654
Collections from accounts receivable which were previously written-off	(3,889,466)	(13,142,566)
	127,033,719	**216,636,355**

The amount in the column Other movements under the caption Adjustments for doubtful accounts receivable relates mainly to the write-off of balances previously fully provided for (Note 25).

In the caption of Provisions for risks and costs Litigation , the reduction in column Other in the year 2006 is mainly related to the unfavorable resolution of a legal action against Vivo related to the privatization of Telebrás in 1998, following which Vivo paid an amount of Euro 26 million.

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40. Other current and non-current liabilities

As at 31 December 2007 and 2006, these captions consist of:

	2007	2006
Other current liabilities		
Accounts payable from QTE transactions (Notes 3.l.ix) and 30)	35,324,314	46,332,009
Dividends payable (i)	5,680,966	8,909,070
Other (ii)	26,303,667	27,254,810
	67,308,947	**82,495,889**
Other non-current liabilities		
Accounts payable from QTE transactions (Notes 3.l.ix) and 30)	470,140,303	627,430,804
Fair value of derivative financial instruments (Note 42)	47,808,141	44,048,655
Other (iii)	3,824,096	11,065,915
	521,772,540	**682,545,374**

(i) This caption is related to unpaid dividends declared by Brasilcel s subsidiaries.

(ii) As at 31 December 2007 and 2006, this caption includes primarily an account payable to the shareholders of the subsidiaries of Brasilcel in connection with a reverse stock split undertaken in 2005. In this transaction, the shares issued by the various companies were grouped in lots, with each lot exchanged for a new share. Because certain shareholders did not possess a sufficient number of shares to receive a new share in exchange, an auction of the shares not attributed/exchanged was undertaken. Each company recognized the value received in this auction as a payable to the former shareholders, which will be reduced to the extent the former shareholders request those amounts.

(iii) This caption includes primarily accrued expenses in connection with certain loans obtained by Vivo where the interest component is payable in more than 12 months.

41. Shareholders Equity

During 2006 and 2007, the movements in this caption were as follows:

	Share capital	Capital issued premium	Treasury shares	Legal reserve	Reserve for treasury shares	Accumulated earnings	Total equity excluding minority interests
Balance as at 31 December 2005	**1,128,856,500**	**91,704,891**	**(102,044,948)**	**179,229,361**	**125,428,500**	**405,216,985**	**1,828,391,289**
Share capital increase through the incorporation of reserves	338,656,950	(91,704,891)		(121,523,559)	(125,428,500)		
Increase of free reserves through a share capital reduction	(1,072,413,675)					1,072,413,675	
Acquisition of treasury shares through equity swaps			(171,984,398)				(171,984,398)
Cash settlement of equity swaps over treasury shares (Note 41.3)			86,416,953				86,416,953
Dividends paid (Notes 22 and 44.i)						(526,402,838)	(526,402,838)
Earnings allocated to the legal reserve				25,001,079		(25,001,079)	
Income recognized directly in equity						172,069,067	172,069,067
Income recognized in the income statement						866,759,657	866,759,657
Balance as at 31 December 2006	**395,099,775**		**(187,612,393)**	**82,706,881**		**1,965,055,467**	**2,255,249,730**
Share capital increase	79,019,955			(79,019,955)			
Share capital reduction	(440,254,035)					440,254,035	
Acquisition of treasury shares, through equity swaps (Note 41.3)			(607,692,439)				(607,692,439)
Acquisition of treasury shares (Note 41.3)			(1,050,271,924)		1,050,271,924	(1,050,271,924)	(1,050,271,924)
Cancellation of treasury shares (Note 41.3)	(3,091,695)		1,050,271,924		(1,047,180,229)		
Cash settlement of equity swaps over treasury shares (Note 41.3)			472,125,919				472,125,919
Dividends paid (Notes 22 and 44.i)						(516,506,816)	(516,506,816)
Spin-off of PT Multimédia (Note 20)						(405,328,608)	(405,328,608)
Equity component of exchangeable bonds (Note 35)						57,145,442	57,145,442
Earnings allocated to the legal reserve				3,086,213		(3,086,213)	
Income recognized directly in equity						391,640,857	391,640,857
Income recognized in the income statement						741,859,736	741,859,736
Balance as at 31 December 2007	**30,774,000**		**(323,178,913)**	**6,773,139**	**3,091,695**	**1,620,761,976**	**1,338,221,897**

41.1. Share capital

As approved at the Annual General Meeting held on 27 April 2007, Portugal Telecom has completed on 22 May 2007 its share capital increase of Euro 79,019,955, through the incorporation of legal reserve, and its share capital reduction of Euro 440,254,035, for the release of excess capital through the creation of free reserves in the same amount.

On 28 September 2007, under the terms of the share buyback program approved at the General Shareholders Meeting held on 27 April 2007, Portugal Telecom acquired 103,056,500 of its own shares, through the physical exercise of equity swaps (Note 41.3). As resolved also in the General Meeting held on 27 April 2007 and for the purposes of the execution of the share buyback program and the corresponding share capital reduction, Portugal Telecom has reduced its share capital by Euro 3,091,695 (Note 41.3) through the cancellation of these 103,056,500 treasury shares.

As a result of the referred operations, Portugal Telecom s fully subscribed and paid share capital as at 31 December 2007, amounted to Euro 30,774,000 and was represented by 1,025,800,000 shares, with a nominal value of three cents each with the following distribution:.

- 1,025,799,500 ordinary shares; and
- 500 Class A shares.

The following matters may not be approved in a General Shareholders Meeting against the majority of the votes corresponding to Class A shares:

- Authorization for the acquisition of ordinary shares representing more than 10% of the share capital by shareholders that directly or indirectly perform competing activities to those of the companies within a dominant relation with Portugal Telecom;
- Amendments to the by-laws and share capital increases, as well as the limitation or suppression of pre-emptive rights and the establishing of standards for share capital increases to be resolved by the Board of Directors;
- Issuing of bonds or other securities, establishing the issue value for these securities to be resolved by the Board of Directors and limitation or suppression of pre-emptive rights in the issuing of bonds convertible into shares, as well as establishing the standards for the issuing of bonds of such nature to be resolved by the Board of Directors;
- The passing of resolutions on the application of the financial year results, in the case of dividend distribution to the shareholders in a percentage superior to 40% of distributable profits;
- Election of the Board of the General Shareholders Meeting;
- Approval of the general goals and fundamental principles of the Company s policies;
- Definition of the general principles of the policy of shareholdings in companies, as well as, in the cases where those principles require prior General Shareholders Meeting authorization, the passing of resolutions on the respective acquisitions and sales;
- Moving the Company s registered offices within the municipality of Lisbon or to a neighbouring municipality.

In addition, the election of one third of the total number of Directors, including the Chairman of the Board of Directors, requires the approval of a majority of the votes of the Class A shares.

41.2. Capital issued premium

This caption resulted from premiums generated in capital increases made by Portugal Telecom. According to Portuguese law, applicable to companies listed in stock exchanges under the supervision of Comissão do Mercado de Valores Mobiliários (CMVM , the Portuguese securities and stock exchange regulator), these amounts can only be used to increase share capital or to absorb accumulated losses (without it being necessary to first use other reserves). This amount cannot be used to pay dividends or to acquire treasury shares. The total capital issued premium was used in the share capital increase effective on 11 May 2006, as approved at the Annual General Meeting of 21 April 2006.

41.3. Treasury shares

As at 31 December 2007 and 2006, this caption includes equity swaps contracted by Portugal Telecom up to those dates that are recognised as an effective acquisition of treasury shares, thus implying the recognition of a corresponding financial liability (Note 35).

During 2006 and 2007, the movements in these captions were as follows:

	Number of shares	Nominal value	Premiums and discounts	Carrying value	Carrying value per share
Balance as at 31 December 2005	**13,240,000**	**13,240,000**	**88,804,948**	**102,044,948**	**7.71**
Equity swaps over treasury shares	18,740,000	6,559,000	165,425,398	171,984,398	
Cash settlement of equity swaps over treasury shares	(11,340,000)	(3,969,000)	(82,447,953)	(86,416,953)	
Change in the nominal value of each share		(8,606,000)	8,606,000		
Balance as at 31 December 2006	**20,640,000**	**7,224,000**	**180,388,393**	**187,612,393**	**9.09**
Equity swaps over treasury shares (i)	63,412,972	1,902,389	605,790,050	607,692,439	
Acquisitions of treasury shares (Note 41.1)	103,056,500	3,091,695	1,047,180,229	1,050,271,924	
Cancellation of trasury shares (Note 41.1)	(103,056,500)	(3,091,695)	(1,047,180,229)	(1,050,271,924)	
Cash settlement of equity swaps over treasury shares (ii)	(48,810,043)	(1,464,301)	(470,661,618)	(472,125,919)	
Change in the nominal value of each share		(6,604,800)	6,604,800		
Balance as at 31 December 2007	**35,242,929**	**1,057,288**	**322,121,625**	**323,178,913**	**9.17**

(i) This caption is net of an amount of Euro 28.5 million related the the reset of equity swaps over 20,640,000 of its own shares, since Portugal Telecom gave up the right to the dividends related to the spin-off of PT Multimédia attributrable to the shares of the equity swaps.

(ii) During 2007, equity swaps over 48,810,043 of its own shares were cash settled, having Portugal Telecom received an amount of Euro 32,188,194 (Note 17) resulting from the difference between the exercise price and the market price of Portugal Telecom s shares as of the dates of the financial settlement.

41.4. Legal reserve

Portuguese law provides that at least 5% of each year s profits must be appropriated to a legal reserve until this reserve equals the minimum requirement of 20% of share capital. This reserve is not available for distribution to shareholders but may be capitalized or used to absorb losses, once all other reserves and retained earnings have been exhausted. A portion of the legal reserve amounting to Euro 121,523,559 and Euro 79,019,955 was used in the share capital increases effective on 11 May 2006 and 22 May 2007, respectively. As at 31 December 2007, the legal reserve is already fully incorporated, corresponding to more than 20% of share capital.

41.5. Reserve for treasury shares

The reserve for treasury shares is related to the recognition of a non-distributable reserve equivalent to the nominal value of the shares cancelled or to the acquisition cost of treasury shares held by the Company. This reserve has the same legal regime as the legal reserve. The total reserve for treasury shares was used in the share capital increase effective on 11 May 2006, as approved at the Annual General Meeting of 21 April 2006. As at 31 December 2007, this reserve was related to shares cancelled on 20 December 2007.

41.6. Accumulated earnings

As at 31 December 2007 and 2006, this caption consisted of:

	2007	2006
Income and expenses recognized directly in equity		
Net actuarial losses (Notes 9.1 and 9.2)	(1,365,360,771)	(1,650,597,836)
Hedge accounting of financial instruments (Note 42.2)	(617,041)	3,984,931
Investments available for sale		22,968,096
Cumulative foreign currency translation adjustments and other (i)	839,593,851	637,337,339
	(526,383,961)	(986,307,470)
Tax effect	362,188,945	430,471,597
	(164,195,016)	(555,835,873)
Reserves and retained earnings	1,043,097,256	1,654,131,683
Net income attributable to equity holders of the parent	741,859,736	866,759,657
	1,620,761,976	**1,965,055,467**

(i) This caption includes mainly the translation adjustments of assets and liabilities denominated in foreign currencies as from 1 January 2004 up to the balance sheet date (Note 3.q)), and is mainly related to Portugal Telecom s investment in Brazil, whose currency translation adjustments amounted to Euro 875 million as at 31 December 2007, mainly related to the investment in Vivo.

42. Financial instruments

42.1. Financial risks

Portugal Telecom is primarily exposed to (i) market risks related mainly to changes in foreign currency exchange rates and in interest rates, (ii) credit risks and (iii) liquidity risks. The main objective of Portugal Telecom s financial risk management is to reduce these risks to a lower level. Portugal Telecom enters into derivative financial instruments to manage its risk exposure to changes in interest rates and foreign currency exchange rates.

The contracting of these derivatives is made after careful analysis of associated risks and rewards, taking into consideration information obtained from different institutions. These transactions are subject to authorization from Portugal Telecom s Executive Committee. The positions held by the Company, as well as the relevant financial markets, are periodically monitored. The fair value of these derivatives is determined on a regular basis in order to assess the economic and financial implications of different scenarios.

Foreign currency exchange rate

Foreign currency exchange rate risks are mainly related to our investments in Brazil and other foreign countries, and to our debt denominated in currencies different from the functional currency of the country where the borrowing company operates.

As at 31 December 2007, the net exposure (assets minus liabilities) to Brazil amounted to R$ 7,536 million (Euro 2,903 million at the Euro/Real exchange rate as at 31 December 2007), of which more than approximately 90% is related to our investment in Vivo.

The Group is also exposed to foreign currency exchange-rate risks related to debt denominated in foreign currencies different from the Group companies functional currencies. As at 31 December 2007, these risks were basically related to:

- Debt denominated in US Dollars contracted by Portugal Telecom amounting to US$ 43 million (Euro 29 million at the Euro/US Dollar exchange rate as at 31 December 2007), for which Portugal Telecom has contracted an exchange rate and interest rate derivative;
- Debt denominated in US Dollars contracted by Vivo amounting to US$ 195 million (Euro 133 million), for which Vivo has contracted exchange and interest rate derivatives, which hedged more than 90% of this debt at that date.
- Debt denominated in Japanese Yenes contracted by Vivo amounting to ¥ 33,028 million (Euro 201 million), for which Vivo has contracted exchange rate and interest rate derivatives, which hedged 100% of the debt at that date.
- Debt denominated in Euro contracted by Vivo amounting to Euro 8 million, for which Vivo has contracted exchange rate and interest rate derivatives, which hedged 100% of this debt at that date.
- An exchange rate derivative contracted by Portugal Telecom with a notional of US$ 218 million (put) and Euro 200 million (call). This derivative is classified in the balance sheet as a financial instrument held for trading, since it did not comply with the requirements to account for as a hedge financial instrument (Note 42.2).

As required by IFRS 7, the effects of hypothetical changes of relevant risk variables on income statement and shareholders equity of Portugal Telecom are as follows:

- The impact of the appreciation (devaluation) of the Euro/Real exchange rate by 0.1 from 2.5963 to 2.4963 (2.6963), would be an increase (decrease) in Portugal Telecom s net assets as at 31 December 2007 by approximately Euro 116 million (Euro 108 million);

- The impact of the US Dollar appreciation (devaluation) against the Euro by 0.01 in Portugal Telecom s held for trading exchange rate derivative mentioned above, would be a decrease (increase) in net financial expenses amounting to approximately Euro 1 million (Euro 1 million);

- Most of non-derivative financial assets and liabilities (cash and cash equivalents, trade receivables and payables, and debt) are denominated in the functional currency either directly or indirectly through the use of derivatives. Therefore, changes in exchange rates would have no material effects on the income statement and shareholders equity of the companies where those assets and liabilities are recorded.

Interest rate

Interest rate risks basically impact our financial expenses on the floating interest rate debt. Portugal Telecom is exposed to these risks primarily in the Euro zone and in Brazil (Vivo). With the purpose of reducing the impact of these risks, the Group has entered into interest-rate swaps, swapping floating rate into fixed rate debt.

As at 31 December 2007, 64.0% of the Company s debt was, directly or indirectly through the use of interest rate derivatives, set in fixed rates. The remaining 36.0% is exposed to changes in market interest rates. If all market interest rates had been higher (lower) by 1% during the year ended 31 December 2007, net interest expenses would have been higher (lower) by an amount of approximately 2.9 million (2.9 million).

The Group has also entered into some derivatives, which include an interest rate component, that are classified as held for trading derivatives, although its economic goal is to hedge currency or interest rate risk. If the market interest rates had been higher (lower) by 1% during the year ended 31 December 2007, interest expenses net of interest income in respect of these instruments would have been lower (higher) by an amount of approximately Euro 1.4 million (Euro 1.4 million).

Interest rate risks also results from the exposure to changes in the fair value of Portugal Telecom s long term fixed-rate debt due to changes in market interest rates.

Credit risk

Credit risk is related to the risk that a third party fails on its contractual obligations resulting in a financial loss to the Group. Portugal Telecom is subject to credit risks in its operating and treasury activities.

Credit risks in operations are basically related to outstanding receivables from services rendered to our customers (Notes 25 and 26). These risks are monitored on a business-to-business basis, and Portugal Telecom s management of these risks aims to: (a) limit the credit granted to customers, considering the profile and the aging of receivables of each customer; (b) monitor the evolution of the level of credit granted; (c) perform an impairment analysis of its receivables on a regular basis; and (d) assess the market risk where the customer is located. Accordingly, the criteria used to compute these adjustments is based on these risks.

The Group does not have any significant credit risk exposure to any single customer, since trade receivables consist of a large number of customers, spread across several businesses and geographical areas.

Adjustments for accounts receivable are computed taking into consideration primarily: (a) the risk profile of the customer, weather it s a corporate or a residential customer; (b) the aging of the receivables, which differs from business to business; (c) the financial condition of the customers; and (d) the market risk where the customer is located.

The movement of these adjustments for the year ended 31 December 2007 and 2006 is disclosed in Note 39. As at 31 December 2007, the Group believes that there was no further credit adjustment required in excess of the adjustments for accounts receivable included in Note 39.

As at 31 December 2007, approximately 20% of the Group s accounts receivables not adjusted for were already due with maturities above one hundred and eighty days.

Risks related to treasury activities result mainly from the cash investments made by the Group. In order to dilute these risks, Portugal Telecom s policy is to invest its cash for short time periods, entering in agreements with highly rated financial institutions and diversifying counterparties.

Liquidity risks

These risks may occur if the sources of funding, including operating cash inflows, divestments, credit lines and cash flows obtained from financing operations, do not match with our financing needs, such as operating and financing outflows, investments, shareholder remuneration and debt repayments.

In order to mitigate liquidity risks, the Group seeks to maintain a liquidity position and an average maturity of debt that allows it to repay its short-term debt and, at the same time, pay all its contractual obligations, as mentioned below. As at 31 December 2007, the amount of available cash plus the undrawn amount of Portugal Telecom s commited commercial paper lines (cash immediately available upon a 2-day notice) and Portugal Telecom s standby facilities totaled Euro 3,286 million. Excluding foreign businesses, this amount was Euro 2,672 million. As at 31 December 2007, Vivo had also available standby facilities in the amount of R$ 1,160 million, of which no amount had been drawn at that date. The average maturity of Portugal Telecom s net debt as at 31 December 2007 is 6.7 years.

The capital structure of Portugal Telecom its managed in order to ensure that its businesses will be able to continue as a going concern and the maximizing of the return to stakeholders. The capital structure of the Group includes debt (Note 35), cash and cash equivalents, short-term investments (Note 24) and equity attributable to equity holders of the parent, comprising issued capital, treasury shares, reserves and accumulated earnings (Note 41). The Group reviews periodically its capital structure considering the risks associated with each of the above mentioned classes of the capital structure.

As at 31 December 2007, the gearing ratio, determined as the proportion of net debt (debt minus cash and cash equivalents and short-term investments) to net debt plus equity increased to 67.8%, from 54.7% as at 31 December 2006. The equity plus long-term debt to total assets ratio increased from 53.4% to 53.7% as at 31 December 2007.

The main contractual obligations are those related to indebtness (Note 35) and related interest, post retirement benefits payments, operating leases (Note 13) and unconditional purchase obligations. The following table presents Portugal Telecom s expected contractual obligations and commercial commitments as at 31 December 2007:

	Total	2008	2009	2010	2011	2012	More than five years
Indebtedness	**6,216.8**	1,256.1	1,122.5	226.3	159.8	1,282.2	2,169.9
Interest on indebtedness (i)	**2,008.0**	318.0	243.3	189.6	180.9	178.7	897.4
Post retirement benefits payments (ii)	**1,327.0**	203.8	193.6	179.9	139.4	115.2	495.1
Operating lease obligations	**454.3**	115.9	64.2	56.2	46.5	44.0	127.5
Unconditional financial commitments (iii)	**478.8**	216.9	23.8	23.8	55.5	31.8	127.1
Total contractual obligations	**10,484.9**	**2,110.7**	**1,647.4**	**675.7**	**582.2**	**1,651.9**	**3,817.0**

(i) Portugal Telecom s expected obligations related to interest on indebtedness are based on the Company s assumptions regarding interest rates on our floating rate debt, and therefore actual interest obligations could vary significantly from these amounts depending on market interest rates.

(ii) These amounts correspond to the undiscounted payments to be made by Portugal Telecom related to salaries due to pre-retired and suspended employees and to expected contributions to the funds. The total amount differs from the net accrued post retirement liability recognized in the consolidated balance sheet primarily because this amount is related to the discounted unfunded obligations.

(iii) As described in Note 43, unconditional purchase obligations arise generally related to (a) contractual agreements with our fixed asset suppliers (including all amounts related to the acquisition of network assets, telecommunications equipment and terminal equipments), (b) the remaining commitments related to the TMN s UMTS license and (c) the contractual agreement for the acquisition of a 3G license at Vivo.

42.2. Derivative financial instruments

Equity derivatives

In order to increase its exposure to PT Multimedia, Portugal Telecom contracted in previous years with a financial institution equity swaps over 30,575,090 shares of PT Multimedia, representing 9.9% of PTM s share capital, which were recorded on the balance sheet at fair value through profit and loss.

During the first half of 2007, a gain amounting to Euro 77,428,725 (Note 7.d) was booked in connection with the change in fair value of these equity swaps up to May 2007, when these equity swaps were cash settled, and as a result Portugal Telecom has received an amount of Euro 94,477,028 (Note 44.f).

Hedging financial instruments

Portugal Telecom analyses its financial instruments regularly in order to identify those that comply with the criteria established by IAS 39 to be classified as hedging instruments. As at 31 December 2007 and 2006, the following financial instruments were classified as cash flow and fair value hedges (amounts in millions of euros, including 100% of Vivo s financial instruments):

31 Dec 2007 Euro million

Company	Notional amount	Transaction	Average maturity (years)	Economic goal
Cash flow hedge				
Portugal Telecom	72.3	EUR Interest rate swaps	4.1	Eliminate the risk of interest rate fluctuations in loans
Fair value hedge				
Portugal Telecom	28.9	Currency swaps EUR/USD	4.0	Eliminate the risk of exchange rate fluctuations in loans
Vivo	15.2	Currency swaps EUR/BRL	0.1	Eliminate the risk of exchange rate fluctuations in loans
Vivo	247.5	Currency swaps USD/BRL	2.2	Eliminate the risk of exchange rate fluctuations in loans
Vivo	400.6	Currency swaps JPY/BRL	0.7	Eliminate the risk of exchange rate fluctuations in loans

31 Dec 2006 Euro million

Company	Notional amount	Transaction	Average maturity (years)	Economic goal
Cash flow hedge				
Portugal Telecom	399.0	EUR Interest rate swaps	6.8	Eliminate the risk of interest rate fluctuations in loans
Fair value hedge				
Portugal Telecom	40.3	Cross currency swaps EUR/USD	5.0	Eliminate the risk of exchange rate fluctuations in loans
Vivo	565.8	Cross currency swaps BRL/USD	0.8	Eliminate the risk of exchange rate fluctuations in loans
Vivo	320.4	Cross currency swaps BRL/JPY	1.3	Eliminate the risk of exchange rate fluctuations in loans

Financial instruments held for trading

As at 31 December 2007 and 2006, Portugal Telecom had contracted the following financial instruments which, according with IAS 39, are classified as held for trading derivatives (amounts in million of euros, including 100% of Vivo s financial instruments):

31 Dec 2007 Euro million

Company	Notional amount	Transaction	Average maturity (years)	Economic goal
Portugal Telecom	27.4	EUR interest rate swaps	4.7	Previous cash flow hedges
Portugal Telecom	200.0	EUR Call / USD Put	1.3	Restructure of previous derivative financial instruments
Cabo Verde Telecom	1.2	Currency swap EUR/USD	1.9	Eliminate the risk of exchange rate and interest rate fluctuations in loans
Vivo	3.3	Currency swaps USD/BRL	1.3	Eliminate the risk of exchange rate fluctuations in loans
Vivo	42.4	BRL Interest rate swaps	2.1	Hedge changes in fair value of loans due to changes in benchmark interest rate
Vivo	422.8	BRL Interest rate swaps	0.1	Eliminate the risk of interest rate fluctuations in loans
Vivo	35.6	USD Interest rate swaps	0.5	Eliminate the risk of interest rate fluctuations in loans
Mobitel	17.2	Currency swaps USD/BRL	2.4	Eliminate the risk of exchange rate fluctuations in loans

31 Dec 2007 Euro million

Company	**Notional amount**	**Transaction**	**Average maturity (years)**	**Economic goal**
Portugal Telecom	251.6	EUR Interest rate swaps	5.5	Instruments resulting from previous hedgings
Portugal Telecom	200.0	EUR Call / USD Put	2.3	Restructure of previous derivative financial instruments
Portugal Telecom	275.8	Equity swaps on PT Multimedia shares	1.6	Increase exposure to PT Multimedia
Cabo Verde Telecom	2.1	Cross currency swap EUR/USD	2.9	Eliminate the risk of exchange rate and interest rate fluctuations in loans
Vivo	12.5	Cross currency swaps BRL/USD	1.0	Eliminate the risk of exchange rate fluctuations in loans
Vivo	1.9	Cross currency swaps BRL/EUR	0.4	Eliminate the risk of exchange rate fluctuations in loans
Vivo	875.8	BRL Interest rate swaps	0.5	Hedge changes in fair value of loans due to changes in benchmark interest rate
Vivo	176.5	USD Interest rate swaps	0.8	Hedge changes in fair value of loans due to changes in benchmark interest rate
Mobitel	16.6	Cross currency swaps BRL/USD	3.3	Eliminate the risk of exchange rate fluctuations in loans

Fair value of financial instruments

The movement in the fair value of derivatives during 2007 and 2006 was as follows (amounts in millions of euros):

	Balance 31 Dec 2006	Fair value adjustment Income	Fair value adjustment Reserves	Additions and settlements	Foreign currency translation adjustments and other	Balance 31 Dec 2007
Fair value hedges						
Exchange rate and interest rate (i)	(94.1)	(97.4)		103.2	(5.7)	(94.0)
Derivatives held for trading						
Exchange rate (ii)	(35.0)	(11.5)				(46.5)
Exchange rate and interest rate	(11.2)	(1.7)		2.2	(3.0)	(13.7)
Interest rate	(7.4)	(0.2)		8.2	0.1	0.8
Equity swaps over PT Multimedia shares (Notes 7.d and 44.f)	17.0	77.4		(94.5)		
Cash flow hedges						
Interest rate (Note 40.6)	4.0	8.3	(4.6)	(8.3)		(0.6)
	(126.7)	**(25.1)**	**(4.6)**	**10.9**	**(8.6)**	**(154.1)**

(i) This caption includes a liability of Euro 11 million recorded at Portugal Telecom, which has an average maturity of 4.0 years and a liability of Euro 83 million recorded at Vivo with an average maturity of 1.5 years.

(ii) This liability has a maturity of 1.3 years.

	Balance 31 Dec 2005	Fair value adjustment Income	Fair value adjustment Reserves	Additions and settlements	Foreign currency translation adjustments and other	Balance 31 Dec 2006
Fair value hedges						
Interest rate and exchange rate	(122.3)	(125.1)		151.3	2.0	(94.1)
Derivatives held for trading						
Exchange rate	(26.6)	(8.4)				(35.0)
Exchange rate and interest rate	36.3	(9.5)		(38.3)	0.3	(11.2)
Interest rate	(5.3)	(3.7)		1.7	(0.0)	(7.4)
Equity swaps over PT Multimedia shares (Note 44.f)	42.0	1.8		(26.8)		17.0
Cash flow hedges						
Interest rate	(21.6)	7.0	25.6	(7.0)		4.0
	(97.6)	**(137.9)**	**25.6**	**81.0**	**2.2**	**(126.7)**

In 2007 and 2006, the fair value adjustments related to derivatives were recorded in the following income statement captions (amounts in millions of euros):

	2007				2006			
	Net interest expense	Net foreign currency exchange losses/ (gains)	Net losses/ (gains) on financial assets (Note 17)	Total	Net interest expense	Net foreign currency exchange losses/ (gains)	Net losses/ (gains) on financial assets (Note 17)	Total
Fair value hedges								
Interest rate and exchange rate	42.8	54.6		**97.4**	69.0	56.1		**125.1**
Derivatives held for trading								
Exchange rate			11.5	**11.5**			8.4	**8.4**
Exchange rate and interest rate		3.8	(2.1)	**1.7**		5.4	4.1	**9.5**
Interest rate			0.2	**0.2**			3.7	**3.7**
Equity swaps over PT Multimedia shares			(77.4)	**(77.4)**			(1.8)	**(1.8)**
Cash flow hedges								
Interest rate	(8.3)			**(8.3)**	(7.0)			**(7.0)**
	34.6	**58.4**	**(67.8)**	**25.1**	**62.0**	**61.4**	**14.4**	**137.9**

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As at 31 December 2007, the derivatives contracted by the Company recognized at fair value were recorded in the following balance sheet captions (amounts in millions of euros):

	Assets		Liabilities		
	Short term investments	Debt	Accrued expenses (Note 37)	Other liabilities (Note 40)	Total
Fair value hedges					
Exchange rate and interest rate		(49.3)	(44.7)		**(94.0)**
Derivatives held for trading					
Exchange rate				(46.5)	**(46.5)**
Exchange rate and interest rate			(13.7)		**(13.7)**
Interest rate	1.5			(0.7)	**0.8**
Cash flow hedges					
Interest rate				(0.6)	**(0.6)**
	1.5	**(49.3)**	**(58.4)**	**(47.8)**	**(154.1)**

As at 31 December 2006, the derivatives contracted by the Company recognized at fair value were recorded in the following balance sheet captions (amounts in millions of euros):

	Assets			Liabilities		
	Short term investments	Other assets (Note 30)	Debt	Accrued expenses (Note 37)	Other liabilities (Note 40)	Total
Fair value hedges						
Exchange rate and interest rate			(35.6)	(58.5)		**(94.1)**
Derivatives held for trading						
Exchange rate					(35.0)	**(35.0)**
Exchange rate and interest rate				(11.2)		**(11.2)**
Interest rate	1.7				(9.0)	**(7.4)**
Equity swaps over PT Multimedia shares		17.0				**17.0**
Cash flow hedges						
Interest rate		4.0				**4.0**
	1.7	**21.0**	**(35.6)**	**(69.7)**	**(44.0)**	**(126.7)**

42.3. Other disclosures on financial instruments

The carrying amounts of each of the following categories, as defined in IAS 39, were recognized as follows (amouts in millions of euros):

Caption	2007	2006
Financial assets carried at amortised cost		
Cash and cash equivalents	664.6	548.5
Short-term investments (Note 24)	1,170.3	1,535.2
Accounts receivable - trade (Note 25)	1,308.7	1,182.8
Accounts receivable - other (i)	101.7	201.9
Other current and non-current assets - QTE transactions (Note 30)	505.5	673.8
Investments in group companies - loans (Note 31)	95.2	102.0
	3,846.0	4,244.2
Financial assets carried at fair value through profit and loss		
Other non-current assets - held for trading derivatives (Note 42.2)		17.0
Derivatives designated and effective as hedging instruments carried at fair value		
Other non-current assets/(liabilities) - interest rate derivatives - cash flow hedges (Note 42.2)	(0.6)	4.0
Bank loans - exchange and interest rate derivatives - fair value hedges (Note 42.2) (ii)	(49.3)	(35.6)
Accrued expenses - exchange and interest rate derivatives - fair value hedges (Note 42.2) (iii)	(44.7)	(58.5)
	(94.6)	(90.1)
Available-for-sale investments carried at fair value		
Other investments (Note 32)		99.7
Financial liabilities carried at amortised cost		
Debt - exchangeable bonds (Note 35)	(689.4)	
Debt - bonds (Note 35)	(3,158.0)	(3,133.6)
Debt - bank loans (ii)	(1,322.9)	(1,474.6)
Debt - other loans (Note 35)	(324.0)	(750.1)
Debt - UMTS license (Note 35)	(200.6)	
Debt - equity swaps on treasury shares (Note 35)	(323.2)	(187.6)
Accounts payable (Note 36)	(1,108.9)	(1,115.1)
Accrued expenses	(582.7)	(610.5)
Other current liabilities	(32.0)	(36.2)
	(7,741.5)	(7,307.8)
Derivatives held for trading		
Accrued expenses - Exchange rate and interest rate derivatives(Note 42.2)	(13.7)	(11.2)
Other non-current liabilities - Exchange rate derivatives (Note 42.2)	(46.5)	(35.0)
Other non-current liabilities - Interest rate derivatives (Note 42.2)	(0.7)	(9.0)
	(60.9)	(55.3)
Financial liabilities recorded according to IAS 17		
Debt - finance leases (Note 35)	(149.5)	(258.6)
Other current and non-current liabilities - QTE transactions (Note 40)	(505.5)	(673.8)
	(654.9)	(932.4)

(i) The balance sheet caption Accounts receivable other includes certain assets, such as trial deposits, which do not meet the requirements to be classified as a financial asset, and therefore were excluded from this caption.

(ii) Total bank loans include its notional amounts which were carried at amortised cost and the fair value of certain exchange and interest rate derivatives.

Except for debt, whose fair value is disclosed in Note 35, and for derivatives, which are recorded at fair value, as mentioned in Note 42.2, the fair value of the remaining financial assets and liabilities is similar to their carrying amounts. The fair value of derivatives and debt of domestic businesses is based on external valuations, while the fair value of derivatives and debt of Vivo is based on internal valuations computed based on discounted cash flows method.

43. Guarantees and financial commitments

As at 31 December 2007, the Company has presented guarantees and comfort letters to third parties, as follows:

Bank guarantees and other guarantees given to Tax Authorities	**47,706,622**
Bank guarantees given to Portuguese courts for outstanding litigation	**1,671,428**
Bank guarantees given to other entities	
On behalf of TMN	35,566,299
On behalf of PT Comunicações	9,276,796
Other bank guarantees	8,873,652
	53,716,747
Comfort letters given to other entities	**2,770,859**

Bank guarantees given on behalf of TMN include a guarantee presented in connection with cross-border lease transactions contracted by TMN (Note 34) and guarantees presented to ANACOM related to TMN s obligations under the UMTS licenses acquired in December 2000. Bank guarantees given on behalf of PT Comunicações were presented to Municipal Authorities and are mainly related to the repayment of taxes and other fees in connection with Portugal Telecom s use of public rights-of-way.

As at 31 December 2007, the Company had also assumed the following financial commitments, in addition to those recorded in the financial statements:

(a) In June 2006, Médi Télécom entered into a medium and long-term contract with a consortium of Moroccan banks, for a total amount of Euro 544 million. The funds raised were used to repay all the medium and long term debt, denominated in foreign currencies, previously issued under loan contracts entered into with a consortium led by International Finance Corporation and the banks ABN Amro and Sociéte Générale.

As was the case under the loans repaid, under the provisions of the new loan agreements, Médi Télécom is required to attain certain financial performance levels. In accordance with the financing transaction, the major shareholders of Médi Télécom, Portugal Telecom, through PT Móveis (32.18%), Telefónica Móviles España (32.18%) and Banque Marocaine du Commerce Extérieur (17.59%), signed a Shareholders Support Deed, under which they are committed to make future capital contributions to Médi Télécom (in the form of capital or shareholders loans), if this is necessary to cover possible shortfalls in the agreed financial targets. On October 2006, the other shareholders of Médi Télécom also signed the Shareholders Support Deed.

Under this agreement, these parties committed to make contributions (capital subscription or loans), proportional to their stakes in the company, up to a total of Euro 168 million, of which Euro 50 million are related to the repayment of debt, and ends as soon as Médi Télécom reaches a Net Debt/EBITDA ratio of less than 2.0. As at 31 December 2007, following the renegociation of the Shareholders Support Deed during 2006, the maximum liability to Portugal Telecom amounts to Euro 54 million, which is proportional to its stake in Médi Télécom.

(b) Portugal Telecom signed a Shareholders Agreement with the other shareholders of Sportinveste Multimédia, in which Portugal Telecom committed to give additional paid-in capital contributions up to a maximum of Euro 40,000,000. As at 31 December 2007, Portugal Telecom had already granted additional paid in capital contributions to Sportinveste Multimédia amounting to Euro 30,023,168 (Note 31).

(c) Under the purchase agreement for the UMTS license, TMN has committed to make contributions of Euro 95 million for the development of the information society in Portugal during the period through the maturity of the license (2015).

(d) As at 31 December 2007, the Group had assumed purchase commitments to suppliers amounting to Euro 172 million, essentially related to equipment.

(e) Vivo was the winning bidder for the acquisition of a 3G license, after price bids were opened at the head-office of Anatel, in the Band J lots, with 10+10MHz width, with exception of lots VII and X. Vivo offer, for all Band J lots acquired, was approximately R$ 1, 1 billion for a period of 15 years with possibility of one externsion up to 15 additional years. At least 10% of it should be paid at the time of the execution of the Terms of Authorization. The balance that is left unpaid 90% may be paid in six equal and annual installments, with a grace period of three years. The Official Result of the Auction will be disclosed by Anatel in 2008 and contracts will only be executed within up to ten days after the referred publication.

As at 31 December 2007, the guarantees given by third parties on behalf of the Company, in connection with bank loans (Note 35), were as follows:

- Guarantees in favor of European Investment Bank	120,361,001
- Guarantee from the Portuguese State to Kreditanstalt Für Wiederaufbau	4,752,458

As at 31 December 2007, Portugal Telecom had bank deposits amounting to Euro 24 million the use of which was restricted due to the cross-border lease transactions entered into by the Group (Note 34). As at the same date, Vivo had tangible assets and financial applications given as guarantees for legal proceedings that amounted to Euro 21 million and Euro 47 million, respectively.

44. Statement of cash flows

(a) The increase in payments related to income taxes is primarily explained due to full utilization of tax losses carriedforward from Portugal Telecom s tax consolidation group at the end of 2006, following which Portugal Telecom has paid income taxes in 2007 amounting to approximately Euro 170 million.

(b) The caption Payments relating to indirect taxes and other includes primarily payments related to the expenses recorded in the income statement caption Indirect taxes (Note 14), and also payments and collections of Value-Added Tax in Portugal.

(c) These captions include basically cash payments from new short term financial applications entered into and cash receipts from the short term applications matured. Net cash receipts amounting to Euro 364,940,527 and Euro 1,764,028,679 in 2007 and 2006, respectively, are mainly related with the movements occurred in loans obtained (Note 44.h). The decrease in net cash receipts resulting from short-term financial applications, is basically related to the reduction in net cash payments from loans repaid.

(d) During the years ended 31 December 2007 and 2006, cash receipts resulting from financial investments were as follows:

	2007	2006
Africatel (Note 17)	116,999,817	
BES (Note 32)	110,318,600	
Telefónica (Note 32)	5,107,941	
TV Cabo Macau	3,108,957	
Directel Macau	1,209,122	
Iris Capital Fund		2,328,287
Other	2,902,469	107,048
	239,646,906	**2,435,335**

(e) During the years ended 31 December 2007 and 2006, cash receipts resulting from dividends were as follows:

	2007	2006
Unitel (i)	72,949,311	15,024,110
CTM	16,222,842	15,038,429
Banco Espírito Santo	2,632,000	1,344,000
Páginas Amarelas	2,434,000	2,283,714
Other	561,767	577,564
	94,799,920	**34,267,817**

(i) In 2007, this caption includes the dividends received from Unitel related to its earnings of 2006 and 2005 amounting to Euro 46 million and Euro 27 million (Note 26), respectively. In 2006, this caption includes the dividends received from Unitel related to its earnings of 2004.

(f) In 2007, the caption Cash receipts resulting from other investing activities includes mainly Euro 94,477,028 related to the cash settlement of equity swaps over shares of PT Multimedia (Note 42) and Euro 32,188,194 related to the cash settlement of equity swaps over Portugal Telecom s treasury shares (Note17). In 2006, this caption includes primarily Euro 26,772,985 related to equity swaps over shares of PT Multimedia (Note 42), and an amount of Euro 23,513,275 related to the financial settlement of equity swaps over Portugal Telecom s treasury shares (Note 17).

(g) During the years ended 31 December 2007 and 2006, payments resulting from financial investments were as follows:

	2007	2006
Siresp	1,466,516	
MTC (i)		57,489,375
BES (ii)		19,320,000
Web-Lab (iii)		6,418,036
Mobitel (iv)		3,574,460
Other	1,876,021	6,372,334
	3,342,537	**93,174,205**

(i) This caption includes Euro 108,648,089 paid from the acquisition of a 34% stake in the share capital of MTC, net of an amount of Euro 51,158,714 related to cash and cash equivalents of MTC as at 1 September 2006, the date on which this company was included for the first time in the consolidation perimeter.

(ii) This caption is related to Portugal Telecom s share in the capital increase of Banco Espírito Santo occurred in 2006.

(iii) This caption corresponds to the acquisition by Portugal Telecom of the remaining 10% stake in the share capital of Web-Lab from the former shareholders of this company.

(iv) During 2006, PT Brasil acquired the remaining 4.26% stake in Mobitel. As a result, PT Brasil now owns 100% of Mobitel.

(h) These captions are basically related to commercial paper and other bank loans which are regularly renewed.

In 2007, cash receipts from loans obtained net of cash payments from loans repaid amounted to Euro 223,459,521.

In 2006, cash payments from loans repaid net of cash receipts from loans obtained amounted to Euro 1,733,486,143, and included primarily: (i) Euro 899,500,000 related to the repayment of the notes issued by PT Finance on 21 February 2001; (ii) Euro 460,000,000 related to the partial repayment of the Multicurrency Credit Facility entered into in 2003; and (iii) Euro 390,335,000 related to the repayment of convertible bonds issued by PT Finance in December 2001.

(i) During the years ended 31 December 2007 and 2006, the Group payments regarding dividends were as follows:

	2007	2006
Portugal Telecom (Notes 22 and 41)	516,506,816	526,402,838
MTC	12,275,947	13,095,694
Africatel	11,225,634	
Cabo Verde Telecom	7,519,738	6,011,557
Other	5,198,833	6,698,263
	552,726,968	**552,208,352**

(j) During the years ended 31 December 2007 and 2006, the caption Other payments resulting from financing activities includes respectively Euro 43 million and Euro 68 million related to payments made by Vivo in connection with exchange rate derivatives.

45. Related parties

a) Associated companies and jointly controlled entities

Balances as at 31 December 2007 and 2006 and transactions occurred during 2007 and 2006 between Portugal Telecom and associated companies and jointly controlled entities (related to the 50% share not owned by the Portugal Telecom in Vivo) are as follows:

	Loans granted (Note 31)		Accounts receivable		Accounts payable	
Company	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**
Médi Télécom	72,112,464	68,106,243	6,850,319	11,182,595	1,604,300	2,187,396
Sportinveste Multimédia	35,318,668	35,318,668	320,422	68,094		
Inesc (i)	3,292,066	3,292,066	490,756	502,718	13,738	
Siresp	2,302,230	980,951	3,752,822	1,756,418		21,000
Multitel	918,459	73,212	3,514,930	3,312,295	180,935	356,141
Unitel (ii)	339,651	379,651	7,559,522	38,419,763	2,708,033	67,147
Sport TV		12,500,000		3,262,598		8,786,037
Vivo			23,466,477	11,883,846	92,701	100,295
Páginas Amarelas			10,974,342	9,286,412	43,817,942	50,104,723
Caixanet			3,233,842	3,949,043		