UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2005

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of Registrant as specified in its charter)

The Portuguese Republic

(Jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing one ordinary share, nominal value 1 per share	New York Stock Exchange
Ordinary shares, nominal value 1 each	New York Stock Exchange*

* Not for trading but only in connection with the registration of American Depositary Shares.

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

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

Ordinary shares, nominal value 1 per share	1,128,856,000
Class A shares, nominal value 1 per share	500

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17 ¨ Item 18 x

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

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CERTAIN DEFINED TERMS

Unless the context otherwise requires, the term *Portugal* refers to the Republic of Portugal, including the Madeira Islands and the Azores Islands; the term *Portuguese Government* refers to the government of the Republic of Portugal and, where the context requires, includes the Portuguese state; the term *Parliament* refers to the Assembly of the Republic of Portugal, the legislative body of the Portuguese state; the term *EU* refers to the European Union; the term *EC Commission* refers to the Commission of the European Communities; the terms *United States* and *U.S.* refer to the United States of America; the term *Portugal Telecom* refers to Portugal Telecom, SGPS, S.A.; and unless indicated otherwise, the terms *we*, *our* or *us* refer to Portugal Telecom and its consolidated subsidiaries.

PRESENTATION OF FINANCIAL INFORMATION

Our audited consolidated financial statements have been prepared in accordance with International Financial Reporting Standards, or IFRS, as adopted by the European Commission for use in the European Union. IFRS differs in significant respects from U.S. GAAP. For a discussion of the principal differences between IFRS and U.S. GAAP, as they relate to us, see *U.S. GAAP Reconciliation and Recent Accounting Pronouncements* below and Notes 46, 47 and 48 to our audited consolidated financial statements.

The U.S. Securities and Exchange Commission, or the SEC, has adopted an accommodation permitting eligible foreign issuers for their first year of reporting under IFRS to file two years rather than three years of statements of income, changes in shareholders equity and cash flows prepared in accordance with IFRS. We are required to prepare our financial statements for the year ended December 31, 2005 for the first time in IFRS, and this Annual Report on Form 20-F has been prepared in reliance on the SEC accommodation.

The comparability of our financial statements as of and for the years presented below is affected by certain corporate changes at Vivo, the 50/50 joint venture with Telefónica Móviles S.A., or Telefónica Móviles, through which we provide mobile telecommunications services in Brazil:

TCP Rights Offering: As of the beginning of 2001, the first year for which financial data in U.S. GAAP is presented below, we held 85.1% of the common (voting) shares of Telesp Celular Participações S.A., or TCP, the controlling shareholder of Telesp Celular S.A., or Telesp Celular, a mobile telecommunications operator in the Brazilian state of São Paulo, and 17.7% of its preferred shares for a total economic interest of 41.2%. In September 2002, TCP completed a rights offering in which we subscribed for additional common and preferred shares. After the rights offering, we held 93.7% of the common shares and 49.8% of the preferred shares for a total economic interest of 65.1%. The Portuguese GAAP financial statements used to produce the U.S. GAAP financial data presented below fully consolidate the results of TCP for 2001 and 2002.

Formation of Vivo Joint Venture: On December 27, 2002, we transferred our interests in TCP and Celular CRT Participações S.A., or Celular CRT Participações, another Brazilian mobile provider, to Brasilcel N.V., our 50/50 joint venture with Telefónica Móviles. Telefónica Móviles transferred to Brasilcel its interests in Tele Sudeste Celular Participações S.A., or Tele Sudeste; Tele Leste Celular Participações S.A., or Tele Leste; and Celular CRT Participações. Since April 2003, Brasilcel has used the brand name Vivo . The joint venture is described further in *Item 4 Information on the Company Our Businesses Brazilian Mobile Business* . Our consolidated balance sheet data as of December 31, 2004 and 2005 proportionally consolidate 50% of Vivo s assets and liabilities. Our consolidated statement of income and cash flow data for the years ended December 31, 2004 and 2005 proportionally consolidate 50% of Vivo s income and cash flows.

Vivo s Acquisition of TCO: On April 25, 2003, TCP acquired a controlling interest in Tele Centro Oeste Participações S.A., or TCO, a mobile telecommunications operator in the midwestern and northern regions of Brazil. As a result, TCO s assets and liabilities as of December 31, 2004 and 2005 are

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reflected in our consolidated balance sheets as of those dates through our proportional consolidation of Vivo. TCO s income and cash flows for the years ended December 31, 2004 and 2005 are reflected in our consolidated statement of income and cash flows for the years ended December 31, 2004 and 2005 through our proportional consolidation of Vivo s income and cash flows.

Tender Offers for Additional Shares of the Vivo Operators: On October 8, 2004, TCP completed a tender offer for additional shares of TCO, thereby increasing its economic interest in TCO to 50.6%. On the same date, a subsidiary of Brasilcel completed a tender offer for additional shares of Tele Sudeste, Tele Leste and Celular CRT Participações. As a result of the successful completion of the tender offer, Vivo increased its interest in Tele Sudeste to 90.9%, in Tele Leste to 50.6% and in Celular CRT Participações to 67.0%.

We publish our financial statements in Euro, the single European currency adopted by certain participating member countries of the European Union, including Portugal, as of January 1, 1999. Unless otherwise specified, references to Euros, EUR or are to the Euro. References herein to U.S. dollars, $ or US$ are to United States dollars. References to Escudos or PTE are to Portuguese Escudos. References to Real, Reais are to Brazilian Reais. The Federal Reserve Bank of New York s noon buying rate in the City of New York for Euros was 0.8260 = US$1.00 on April 14, 2006, and the noon buying rate on that date for Reais was R$2.1390 = US$1.00. For convenience and comparability, figures previously stated in Escudos have been converted to figures in Euros based on the fixed Escudo/Euro exchange rate of PTE 200.482 = 1.00. We are not representing that the Euro, US$ or R$ amounts shown herein could have been or could be converted at any particular rate or at all. See *Item 3 Key Information Exchange Rates* for further information regarding the rates of exchange between Euros and U.S. dollars and between Reais and U.S. dollars.

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FORWARD-LOOKING STATEMENTS

This Form 20-F includes, and documents incorporated by reference herein and future public filings and oral and written statements by our management may include, statements that constitute forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995. These statements are based on the beliefs and assumptions of our management and on information available to management at the time such statements were made. Forward-looking statements include, but are not limited to: (a) information concerning possible or assumed future results of our operations, earnings, industry conditions, demand and pricing for our products and other aspects of our business under *Item 4 Information on the Company*, *Item 5 Operating and Financial Review and Prospects* and *Item 11 Quantitative and Qualitative Disclosures About Market Risk* ; and (b) statements that are preceded by, followed by or include the words believes, expects, anticipates, intends, is confident, plans, estimates, may, might, could, would, the negatives of such terms or similar expressions.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Although we make such statements based on assumptions that we believe to be reasonable, there can be no assurance that actual results will not differ materially from our expectations. Many of the factors that will determine these results are beyond our ability to control or predict. We do not intend to review or revise any particular forward-looking statements referenced in this Form 20-F in light of future events or to provide reasons why actual results may differ. Investors are cautioned not to put undue reliance on any forward-looking statements.

Any of the following important factors, and any of those important factors described elsewhere in this or in other of our SEC filings, among other things, could cause our results to differ from any results that might be projected, forecast or estimated by us in any such forward-looking statements:

- the outcome of the tender offer for all our ordinary shares by Sonae, SGPS, S.A. and its affiliates described below;
- material adverse changes in economic conditions in Portugal or Brazil;
- exchange rate fluctuations in the Brazilian Real and the U.S. dollar;
- risks and uncertainties related to national and supranational regulation;
- increased competition resulting from further liberalization of the telecommunications sector in Portugal and Brazil;
- the development and marketing of new products and services and market acceptance of such products and services; and
- the adverse determination of disputes under litigation.

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RECENT DEVELOPMENT

On February 6, 2006, Sonae, SGPS, S.A. and Sonaecom SGPS, S.A., or Sonaecom, announced an unsolicited tender offer for all the outstanding ordinary shares (including ordinary shares represented by American Depositary Shares) and of Portugal Telecom at a price of 9.50 in cash per share. The offer will be made by Sonaecom and Sonaecom, B.V., both subsidiaries of Sonae, SGPS, S.A., a Portuguese conglomerate engaged in the distribution business, shopping center development, media and telecommunications services, information technology services and other businesses. We refer to Sonae, SGPS, S.A., Sonaecom and Sonaecom, B.V. collectively as Sonae . Sonae will also offer 5,000 in cash for each 5,000 in principal amount of outstanding convertible bonds issued by Portugal Telecom pursuant to resolutions of a general meeting of its shareholders on February 5, 2001 and of its board of directors on November 29, 2001.

The commencement of Sonae s tender offer is subject to the following conditions:

- the granting of registration of the tender offer by the Comissão do Mercado de Valores, or the CMVM (the Portuguese securities commission);
- granting of the approvals and administrative authorizations that are required in accordance with Portuguese law or other applicable foreign law, including a non-opposition decision from the Autoridade da Concorrência, the Portuguese competition authority; and
- a declaration from the CMVM confirming an exemption of Sonae s duty to launch a subsequent mandatory tender offer as a result of the acquisition of shares and convertible bonds in the tender offer in accordance with specified provisions of Portuguese law.

If and when the tender offer is commenced, the purchase of shares and convertible bonds in the tender offer is subject to several conditions, including the following:

- acquisition by Sonae of a number of shares such that Sonae and its affiliates hold at least 50.01% of Portugal Telecom s share capital;
- authorization at a general meeting of the shareholders of Portugal Telecom allowing the acquisition by Sonae of a stake above 10% of Portugal Telecom s share capital, in accordance with Article 9 of Portugal Telecom s articles of association, which prohibit a person that competes directly or indirectly with Portugal Telecom or its subsidiaries from holding more than 10% of Portugal Telecom s ordinary shares without approval at a general shareholders meeting.
- amendment of Portugal Telecom s articles to remove any limits to the casting of votes by a shareholder (See *Item 10 Additional Information Memorandum and Articles of Association Voting Rights of the Ordinary Shares and the A Shares*); and
- amendment to the provisions of Portugal Telecom s articles of association relating to its A shares held by the Portuguese government, or waiver of the rights pertaining to those shares, to the extent necessary to allow the implementation of the reorganization plan for Portugal Telecom to be included by Sonae in its final tender offer materials.

Concurrently with its announcement of the tender offer for ordinary shares and convertible bonds of Portugal Telecom, Sonae announced a tender offer for all the outstanding ordinary shares of Portugal Telecom s subsidiary PT MULTIMÉDIA Serviços de Telecomunicações e Multimédia, SGPS, S.A., or PT Multimédia, for 9.03 per share. Sonae will commence the tender offer for shares of PT Multimédia only if Sonae acquires at least 50.01% of the ordinary shares of Portugal Telecom in the separate tender offer for that company.

On February 27, 2006, Sonae submitted preliminary tender offer materials to the CMVM. On March 6, 2006, the boards of directors of Portugal Telecom and PT Multimédia responded to Sonae s preliminary tender offer materials, recommending that shareholders reject the Sonae tender offers.

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PART I

ITEM 1 IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

We are not required to provide the information called for by Item 1.

ITEM 2 OFFER STATISTICS AND EXPECTED TIMETABLE

We are not required to provide the information called for by Item 2.

ITEM 3 KEY INFORMATION

Selected Consolidated Financial Data

The selected consolidated balance sheet data as of December 31, 2004 and 2005 and selected consolidated statement of income and cash flow data for each of the years ended December 31, 2004 and 2005 have been derived from our audited consolidated financial statements included herein prepared in accordance with IFRS. The SEC has adopted an accommodation permitting eligible foreign issuers for their first year of reporting under IFRS to present two years of selected consolidated financial data in accordance with IFRS rather than five years of such data. We are required to prepare our financial statements for the year ended December 31, 2005 for the first time in IFRS, and this Annual Report on Form 20-F has been prepared in reliance on the SEC accommodation.

IFRS differs in significant respects from U.S. GAAP. For a discussion of the principal differences between IFRS and U.S. GAAP, as they relate to us, see *U.S. GAAP Reconciliation and Recent Accounting Pronouncements* below and Note 46, 47 and 48 to our audited consolidated financial statements.

Under the SEC accommodation for eligible foreign private issuers reporting in IFRS for the first time, such issuers must also present selected consolidated financial data for five years on a basis reconciled to U.S. GAAP. We have provided, in the information below, amounts in accordance with U.S. GAAP of operating revenues, operating income, net income, net income per share, total assets, total liabilities and shareholders equity as of and for the years ended December 31, 2001, 2002, 2003, 2004 and 2005.

The information set forth below is qualified by reference to, and should be read in conjunction with, our audited consolidated financial statements and the notes thereto and also *Item 5 Operating and Financial Review and Prospects* included in this Form 20-F.

Our consolidated balance sheet data as of December 31, 2004 and 2005 proportionally consolidate 50% of Vivo s assets and liabilities. Our consolidated statement of income and cash flow data for the years ended December 31, 2004 and 2005 proportionally consolidate 50% of Vivo s income and cash flows. See *Presentation of Financial Information* .

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	Year Ended December 31, 2004	2005
	(EUR Millions)	
Statement of Income Data:		
Amounts in accordance with IFRS		
Continued Operations		
Operating revenues:		
Services rendered	5,520.5	5,836.9
Sales of merchandise and products	365.8	447.5
Other revenues	81.1	101.1
Total operating revenues	5,967.4	6,385.4
Costs, expenses losses and income:		
Wages and salaries	631.8	667.3
Post retirement benefits	58.8	(21.6)
Direct costs	852.0	881.2
Depreciation and amortization	934.9	1,059.6
Costs of products sold	595.8	652.3
Marketing and publicity	159.8	184.4
Support services	203.8	230.2
Maintenance and repairs	141.7	157.2
Supplies and external services	643.5	760.4
Provisions and adjustments for doubtful receivables and other	168.8	171.5
Indirect taxes	123.2	166.0
Other operating costs	25.2	40.9
Impairment losses(1)	28.0	
Workforce reduction program costs	165.6	314.3
Losses on disposals of fixed assets, net	9.2	1.2
Other costs	83.6	17.6
Income before financial results and taxes	1,141.6	1,102.9
Financial results	232.5	51.3
Income before taxes	909.1	1,051.6
Income taxes	210.0	384.3
Net income from continued operations	699.1	667.2
Discontinued Operations		
Net income from discontinued operations	26.1	21.7
Net income	725.2	689.0
Attributable to:		
Minority interests	102.0	35.0
Equity holders of the parent	623.2	654.0
Income before financial results and taxes per ordinary share, A share and ADS(2)	0.98	0.98
Earnings per share, A share and ADS from continuing operations, net of minority interests:		
Basic (2)	0.51	0.55
Diluted (3)	0.50	0.54
Earnings per ordinary share, A share and ADS:		
Basic (2)	0.53	0.57
Diluted (3)	0.52	0.56

Cash dividends per ordinary share, A share and ADS(4)	0.35	0.475
Share capital	1,166.5	1,128.9

(1) We recorded an impairment loss on the goodwill of the Audiovisuals unit of PT Multimédia in 2004, calculated as the difference between the carrying value and management s estimates of the recoverable

amount based on the discounted cash flows from this business. See Note 30 to our audited consolidated financial statements.

(2) Based on 1,166,485,050 ordinary and A shares issued in the year ended December 31, 2004 and 1,128,856,500 ordinary and A shares issued in the year ended December 31, 2005.

(3) The weighted average number of shares is computed as a weighted average as of the date given and taking into account the number of shares from the exchangeable bonds issued on December 6, 2001, assuming the conversion of the bonds into ordinary shares.

(4) The amount shown for 2005 reflects the amount proposed by the Board of Directors and submitted for consideration at the general meeting of shareholders scheduled for April 21, 2006. Cash dividends per ordinary share, A share and ADS for the years ended December 31, 2001, 2002, 2003, 2004 and 2005 were 0.10, 0.16, 0.22, 0.35 and 0.475 (proposed), respectively. Cash dividends per ordinary share, A share and ADS for the years ended December 2001, 2002, 2003, 2004 and 2005 were US$0.09, US$0.18, US$0.26, US$0.43 and US$0.58 (proposed), respectively.

	Year Ended December 31, (EUR Millions)				
	2001	2002	2003	2004	2005
Statement of Income Data:					
Amounts in accordance with U.S. GAAP					
Operating revenues	6,042.8	6,007.7	4,460.0	4,498.5	4,453.7
Operating income	696.1	383.2	723.1	879.4	759.0
Net income before change in accounting principles	208.1	1,315.3	145.5	509.9	306.0
Cumulative effect of a change in accounting principles SFAS 133	(57.5)				
Cumulative effect of a change in accounting principles SFAS 142		(1,038.9)			
Cumulative effect of a change in accounting principles SFAS 143			(7.4)		
Cumulative effect of a change in accounting principle subscriber acquisition costs				(24.2)	
Net income after change in accounting principles	150.6	276.4	138.2	485.7	306.0
Basic earnings per ordinary share, A share and ADS(1)	0.12	0.22	0.11	0.41	0.27
Diluted earnings per ordinary share, A share and ADS(2)	0.12	0.21	0.11	0.41	0.27

(1) Based on the weighted average number of shares as of the date given and taking into account the number of shares issued pursuant to capital increases and all treasury shares, there were 1,228,392,386 shares for the year ended December 31, 2001, 1,253,880,328 shares for the year ended December 31, 2002, 1,249,778,188 shares for the year ended December 31, 2003, 1,173,266,406 shares for the year ended December 31, 2004 and 1,138,250,826 shares for the year ended December 31, 2005.

(2) The weighted average number of shares is computed as a weighted average as of the date given and taking into account the number of shares from the exchangeable bonds issued on December 6, 2001, assuming conversion of the bonds into ordinary shares. For the years ended December 31, 2001 and 2003, the effects of the exchangeable bonds have been excluded from the calculation of diluted earnings per share since they would be antidilutive.

	As of and for the Year Ended December 31, (EUR Millions)	
	2004	2005
Cash Flow Data:		
Amounts in accordance with IFRS		
Cash flows from operating activities	1,958.9	1,392.3
Cash flows from investing activities	185.5	(1,910.7)
Cash flows from financing activities	(1,958.2)	590.2

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	As of December 31, 2004	As of December 31, 2005
	(EUR Millions)	
Balance Sheet Data:		
Amounts in accordance with IFRS		
Current assets	3,972.9	6,168.0
Investments in group companies	318.3	425.6
Other investments	114.7	96.1
Tangible assets	3,936.3	4,062.0
Intangible assets	3,244.9	3,601.6
Other non-current assets	2,341.6	2,289.8
Total assets	13,928.7	16,643.1
Current liabilities	4,077.2	4,947.5
Medium and long-term debt	3,899.3	5,168.6
Accrued post retirement liability	2,321.6	2,635.9
Other non-current liabilities	1,376.5	1,309.0
Total liabilities	11,674.5	14,061.0
Equity excluding minority interests	1,686.5	1,828.4
Minority interests	567.6	753.7
Total equity	2,254.2	2,582.1
Number of ordinary shares	1,166.5	1,128.9
Share capital(1)	1,166.5	1,128.9

(1) As of the dates indicated, Portugal Telecom did not have any redeemable preferred stock.

	As of December 31, 2001	2002	2003	2004	2005
			(EUR Millions)		
Amounts in accordance with U.S. GAAP					
Total assets	16,747.8	12,554.2	11,764.3	11,864.7	13,649.5
Total liabilities	11,902.5	10,17.9	9,562.1	9,967.0	11,595.9
Total shareholders equity	3,736.5	2,343.7	1,999.0	1,638.5	1,819.4

Exchange Rates

Euro

Effective January 1, 1999, Portugal joined ten other member countries of the European Union in adopting the Euro as the common currency. During the transition period between January 1, 1999 and December 31, 2001, the Escudo remained legal tender in Portugal as a denomination of the Euro, and public and private parties paid for goods and services in Portugal using either the Euro or the Escudo. On January 1, 2002, the Euro entered into cash circulation, and from January 1, 2002 through February 28, 2002, both the Euro and the Escudo were in circulation in Portugal. From March 1, 2002, the Euro became the sole circulating currency in Portugal.

For the years ended December 31, 2002, 2003, 2004 and 2005 the majority of our revenues, assets and expenses were denominated in Euro, although a significant portion of our assets and liabilities are denominated in Brazilian Reais. We have published our audited consolidated financial statements in Euros, and our shares trade in Euros on the Euronext Lisbon Stock Exchange. Our financial results could be affected by exchange rate fluctuations in the Brazilian Real. See *Item 5 Operating and Financial Review and Prospects Exchange Rate Exposure to the Brazilian Real* .

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Our future dividends, when paid in cash, will be denominated in Euros. As a result, exchange rate fluctuations have affected and will affect the U.S. dollar amounts received by holders of ADSs on conversion of such dividends by The Bank of New York as the ADS depositary. The Bank of New York converts dividends it receives in foreign currency into U.S. dollars upon receipt, by sale or such other manner as it has determined, and distributes such U.S. dollars to holders of ADSs, net of The Bank of New York s expenses of conversion, any applicable taxes and other governmental charges. Exchange rate fluctuations may also affect the U.S. dollar price of the ADSs on the New York Stock Exchange.

The following tables show, for the period and dates indicated, certain information regarding the U.S. dollar/Euro exchange rate. The information is based on the noon buying rate in the City of New York for cable transfers in Euro as certified for United States customs purposes by the Federal Reserve Bank of New York. On April 14, 2006, the Euro/U.S. dollar exchange rate was 0.8260 per US$1.00.

Year ended December 31,	Average Rate(1) (EUR per US$1.00)
2001	1.1217
2002	1.0561
2003	0.8786
2004	0.8022
2005	0.8082

(1) The average rate is calculated as the average of the noon buying rates on the last day of each month during the period.

Period	High	Low
	(EUR per US$1.00)	
October 31, 2005	0.8355	0.8272
November 30, 2005	0.8507	0.8472
December 31, 2005	0.8490	0.8412
January 31, 2006	0.8286	0.8203
February 28, 2006	0.8450	0.8379
March 31, 2006	0.8275	0.8213

None of the 25 member countries of the European Union has imposed any exchange controls on the Euro.

Brazilian Real

Although the majority of our revenues, assets and expenses are denominated in Euros, most of the revenues, assets and expenses from our Brazilian investments are denominated in Brazilian Reais. Consequently, exchange rate fluctuations between the Euro and the Brazilian Real affect our revenues.

The Brazilian government may impose temporary restrictions on the conversion of Reais into foreign currencies and on the remittance to foreign investors of proceeds from their investments in Brazil. Brazilian law permits the government to impose these restrictions whenever there is a serious imbalance in Brazil s balance of payments or reason to foresee a serious imbalance.

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The following tables show, for the periods and date indicated, certain information regarding the Real/U.S. dollar exchange rate. On April 14, 2006, the Real/U.S. dollar exchange rate was R$2.1390 per US$1.00. The information is based on the noon buying rate in the City of New York for cable transfers in Brazilian Reais as certified for United States customs purposes by the Federal Reserve Bank of New York.

Year ended December 31,	Average Rate(1) (R$ per US$1.00)
2001	2.3522
2002	2.9309
2003	3.0715
2004	2.9171
2005	2.4341

(1) The average rate is calculated as the average of the noon buying rates on the last day of each month during the period.

Period	High	Low
	(R$ per US$1.00)	
October 31, 2005	2.2886	2.2339
November 30, 2005	2.2516	2.1633
December 31, 2005	2.3735	2.1800
January 31, 2006	2.3460	2.2116
February 28, 2006	2.2217	2.1177
March 31, 2006	2.2238	2.1067

Escudo

As of January 1, 2002, we ceased to use the Escudo. For the years ended December 31, 2001, 2002, 2003, 2004 and 2005 the majority of our revenues, assets and expenses were denominated in Euros. All figures previously stated in Escudos have been converted to figures in Euro based on the fixed Escudo/Euro exchange rate, established on January 1, 1999, of PTE 200.482 per 1.00, or approximately 0.005 per PTE 1.00. See *Euro* .

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Risk Factors

The Portuguese Government Holds All of Our A Shares, Which Afford It Special Approval Rights

All of our 500 A shares are held by the Portuguese government. Under our articles of association, as the holder of all of our A shares, the Portuguese government may veto a number of actions of our shareholders, including the following:

- election of one-third of the directors, including the chairman of the board of directors;
- authorization of a dividend in excess of 40% of our distributable net income in any year;
- capital increases and other amendments to our articles of association;
- issuance of bonds and other securities;
- authorization for a shareholder that is engaged in an activity in competition with us to hold more than 10% of our ordinary shares;
- altering our general objectives, strategy or policies; and
- defining our investment policies, including the authorization of acquisitions and disposals.

Sonae s tender offer for the outstanding ordinary shares of Portugal Telecom is subject to the amendment of these provisions of our articles of association, or waiver of the rights pertaining to our A shares, to the extent necessary to allow the implementation of the reorganization plan for Portugal Telecom contained in Sonae s tender offer materials filed with the CMVM on February 27, 2006.

Competition From Mobile Telephony and From Other Wireline Operators Has Significantly Reduced Our Fixed Telephone Revenues and Is Likely to Continue to Adversely Affect Our Revenues

During 2005, approximately 32.1% of our consolidated revenues were derived from services provided by our wireline business in Portugal. As a result of the trend toward the use of mobile services instead of fixed telephone services, combined with the increase in competition from other wireline operators, we have experienced, and may continue to experience, erosion of market share of both access lines and of outgoing domestic and international traffic. The number of active mobile telephone cards in Portugal has overtaken the number of wireline main lines, and more than 58% of the total Portuguese voice traffic is originated in mobile networks. Some of our wireline customers are using mobile services as an alternative to wireline telephone services. Mobile operators can bypass our international wireline network by interconnecting directly with wireline and mobile networks either in our domestic network or abroad. Competition is also forcing down the prices of our wireline telephone services for long distance and international calls. Lowering our international call prices has caused a significant decline in our revenues from international wireline telephone services.

The decrease in wireline traffic and lower tariffs resulting from competition has significantly affected our overall revenues, and we expect these factors to continue to negatively affect our revenues. See *Item 4 Information on the Company Competition Competition Facing our Wireline Business* .

The Development of Voice over Internet Protocol Services May Reduce Our Voice Telephony Revenues

As existing Voice over Internet Protocol, or VoIP, technology develops and new technologies emerge, competition from VoIP services is likely to intensify. VoIP has a significantly more advantageous cost structure when compared to Public Switched Telephony Networks, or PSTN. Currently, some VoIP-based providers are able to offer cost-free calls between VoIP users, as well as call prices to PSTN and mobile networks at significant discounts to our tariffs. Competition from VoIP-based operators is likely to increase price pressure on voice tariffs and reduce wireline and mobile traffic, which could harm significantly our voice telephony revenues.

In addition, there is significant regulatory uncertainty regarding VoIP services. In November 2005, ANACOM began a period of consultation regarding regulation of these services, but we expect regulations to be proposed and implemented only after this period of consultation has ended. We cannot predict when this regulatory process will be completed, nor can we predict the effect of any new regulations on our business.

Reduced Interconnection Rates Have Negatively Affected Our Revenues for Our Mobile and Wireline Businesses and May Continue to Do So

In February 2005, ANACOM declared all mobile operators to have significant market power in call termination in the mobile networks market. ANACOM has accordingly imposed price controls on interconnection rates for the termination of calls on mobile networks. In 2005, interconnection rates (both fixed-to-mobile and mobile-to-mobile) were reduced by an average of 23.5% compared with 2004 rates. In 2006, we expect these rates to be further reduced by an average of 18.4% compared to the 2005 rates. These reductions have had, and are expected to continue to have, a significant impact on TMN s interconnection revenues and consequently its earnings. See *Item 5 Operating and Financial Review and Prospects Results of Operations* . ANACOM is in the process of determining who has significant market power in the call origination on the mobile networks market. A decision is expected during 2006 and could also negatively impact our revenues and results of operations.

ANACOM s price controls on fixed-to-mobile interconnection also negatively affected our wireline retail revenues because we were required to reflect the reduction in these interconnection charges in our retail prices for calls from our fixed line network. We expect that the reduction in interconnection charges will continue to have a significant impact on our wireline retail revenues.

In addition, the lower interconnection rates have also reduced revenues for our wholesale wireline business because our wholesale wireline unit records revenue from incoming operating calls through our network that terminate on the networks of mobile operators. The prices we charge to international operators (and hence our revenues) depends on the interconnection fees charged by mobile operators for international incoming calls terminating on their networks, and these fees have been decreasing. We expect that the lower interconnection rates in 2006 will continue to have a negative impact on our wholesale wireline revenues.

We also expect ANACOM to issue a decision requiring our wireline business to offer flat rate interconnection, which would negatively affect our wholesale wireline revenues.

Increased Competition in the Portuguese Mobile Markets May Result in Decreased Tariffs and Loss of Market Share

We operate in the highly competitive Portuguese mobile telecommunications market. We believe that our existing mobile competitors, Vodafone and Optimus (owned by Sonae and France Telecom) will continue to market their services aggressively. In mid-2005, Optimus introduced a low-cost brand Rede 4 in response to our new brand Uzo . Vodafone also launched a product called Directo in mid-2005 targeting the same market as Uzo and Rede 4.

In addition, the commercial introduction in Portugal of third generation mobile services has heightened competition and reduced the profitability of providing third generation services. Moreover, ANACOM may open the mobile market to mobile virtual network operators, or MVNOs, which do not have their own network infrastructure and thus would not have the fixed cost burdens facing our current GSM (Global System for Mobile Communications) and UMTS (Universal Mobile Telecommunications System) services. We expect competition from VoIP-based operators also to place increasing price pressure on voice tariffs and lead to reductions in mobile traffic. Competition from companies providing wireless local-area network, or WLAN, services, which can deliver wireless data services more cheaply than UMTS in concentrated areas, may also affect the market and pricing for third generation services. See *Item 4 Information on the Company Competition Competition Facing TMN in Portugal* .

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The European Commission s Review of Roaming Charges May Lead to a Reduction in Domestic Mobile Revenues

We receive approximately 6.5% of our domestic mobile revenues from incoming and outgoing roaming charges. The European Commission has determined that roaming prices in Europe should be reduced and is currently reviewing the market for roaming charges across Europe. Any decision that mandates a reduction in roaming charges would adversely affect the revenues of our domestic mobile business and of our company as a whole.

In addition, within the EU regulatory framework for electronic communications approved in 2002, the Portuguese telecommunications regulator has been analyzing concentrations of market power in various telecommunications markets in Portugal. Among the markets that the regulator has not yet analyzed is the market for roaming charges, and it is expected to do so in 2006. See *Item 4 Information on the Company Regulation Portugal* . Any finding that we have significant market power in the roaming market could lead to price controls or other measures that could adversely affect the revenues and results of our domestic mobile business and of our company as a whole.

PT Multimédia s Success Depends on Its Ability to Offer New Products and Services and to Keep Up with Advances in Technology

PT Multimédia has introduced and continues to introduce new products and services, such as high speed Internet access via cable and TV services, including improving channel offer and introducing services through digital signal transmission. If it is not successful in marketing and selling such products and services, its business, financial position and results of operations may be harmed. In addition, PT Multimédia cannot be sure that there will be adequate demand for its system upgrades or new product and service offerings. Because technology changes very rapidly, it is not possible to ensure that the technology PT Multimédia uses or will use in offering its products and services will not be rendered obsolete by new and superior technology. In addition, many of the new products and services that PT Multimédia intends to offer may also be offered by its competitors. Therefore, these new products and services may fail to generate revenue or attract and retain the level of customers that we currently anticipate.

PT Multimédia is Subject to Competition in Each of Its Business Areas, which is Expected to Intensify

PT Multimédia faces competition in all its business areas. As existing technology develops and new technologies emerge, competition is likely to intensify in all these areas, particularly with regard to products and services related to subscription TV and Internet. PT Multimédia s cable and satellite TV services face competition from broadband local loop access based on broadband wireless access. In 2005, Ar Telecom (formerly Jazztel), a direct competitor of Portugal Telecom s wireline business, launched broadband wireless access service in Lisbon and Oporto and is expected to invest considerably in its network in the coming years. Video over ADSL is also expected to be a competitor of PT Multimédia s television services. Novis, a direct competitor of Portugal Telecom s wireline business, has performed tests of an IP television offer that would compete with PT Multimédia s television services and is expected to launch such services in 2006. When licenses are granted in the future, terrestrial digital television will be a direct competitor of PT Multimédia s subscription TV business. In its audiovisuals business, PT Multimédia also faces competition at the film distribution, film rights marketing and film screening levels. If PT Multimédia is unable to compete successfully, its business, financial position and results of operations could be significantly harmed. See *Item 4 Information on the Company Competition Competition Facing PT Multimédia s Pay TV and Broadband Internet Business* and *Competition Facing PT Multimédia s Audiovisuals Business* .

The Broadband Market in Portugal is Highly Competitive and It May Become More Competitive in the Future

At the end of 2005, we had 933 thousand retail broadband subscribers (585 thousand asymmetric digital subscriber lines, or ADSL, and 348 thousand through cable modems), which represented a growth of 35.9% over the number of broadband subscribers at the end of 2004. Some of our competitors have been improving their commercial offer in broadband Internet, with most of them offering triple-play bundled packages (voice telephony, broadband Internet and pay-TV subscription). We believe that with competition in Internet broadband access intensifying, and with the development of existing technologies such as broadband wireless access, UTMS service and video over ADSL, we may face loss of market share in the broadband market, which could result in a loss of subscribers and a loss in revenues.

Burdensome Regulation in an Open Market May Put Us at a Disadvantage to Our Competitors and Could Adversely Affect Our Business

The Portuguese electronic communications sector is now fully open to competition. However, many regulatory restrictions and obligations are still imposed on us. The Portuguese telecommunications regulator, ANACOM, is conducting a market analysis to determine the regulatory obligations that should be imposed on operators with significant market power in the provision of electronic communications pursuant to a new EU regulatory framework for electronic communications networks and services. In all but one of the 15 markets for which ANACOM has completed its analysis, the Portugal Telecom group has been found by ANACOM to have significant market power and consequently is subject to regulatory restrictions and obligations. Not all of these obligations and restrictions have been imposed on other telecommunications operators and service providers. The substantial resources we must commit to fulfill these obligations could adversely affect our ability to compete. See *Item 4 Information on the Company Regulation Portugal*.

Regulatory Investigations and Litigation May Lead to Fines or Other Penalties

We are regularly involved in litigation and regulatory inquiries and investigations involving our operations. ANACOM, the Portuguese telecommunications regulator, the European Commission and the Autoridade da Concorrência, the Portuguese competition authority, can make inquiries and conduct investigations concerning our compliance with applicable laws and regulations. Current inquiries and investigations include several complaints before the Autoridade da Concorrência relating to alleged anti-competitive practices in our wireline and multimedia businesses, including against:

- PT Comunicações for alleged abuse of dominant position in the access to telecommunications ducts;
- PT.com (this complaint was formerly against Telepac, which was merged into PT.com in December 2004) and TV Cabo regarding alleged anti-competitive practices in the broadband Internet market;
- TV Cabo and Sport TV by TV TEL, a cable TV company operating in the Oporto area, for alleged refusal to supply advertising space;
- TMN by Optimus for alleged abuse of dominant position in the call termination market;
- PT Comunicações for alleged anti-competitive practices in the public wireline telephone market and for granting discriminatory discounts on leased lines; and
- PT Conteúdos and TV Cabo for alleged anti-competitive practices in connection with media content and its strategic partnership with SIC.

See *Item 4 Information on the Company Regulation Portugal Regulatory Institutions* and *Item 8 Financial Information Legal Proceedings Regulatory Proceedings* .

If we are found to be in violation of applicable laws and regulations in these or other regulatory inquiries and investigations, or in litigation proceedings, that are currently pending against us or which may be brought against us in the future, we may become subject to penalties, fines, damages or other sanctions. Any adverse outcome could have a material adverse effect on our operating results or cash flows.

A Governmental or Regulatory Decision Could Force Us to Dispose of One of Either Our Fixed Line or Cable Network

In the context of their regulation of concentrations of market power, the European Commission or the Portuguese Autoridade da Concorrência could require us to separate our fixed line network from our cable

network. We have also been studying the possibility of separating our wholesale division from our retail division of our wireline business, including by contributing our fixed line network to an entity that would manage that network for our company. Such a separation might serve as a stage in the separation of our fixed line and cable networks. Any such separation would significantly change the nature of our wireline business and its results of operations.

The Portuguese Government Could Terminate or Fail to Renew Our Wireline Concession and Our Licenses and Authorizations for Data, Mobile and Cable TV Services

We provide a significant number of services under a Concession granted to us by the Portuguese government and under licenses and authorizations granted to us by ANACOM. See *Item 4 Information on the Company Regulation Portugal* . The Concession runs until 2025, with provisions for renewal. The Portuguese government can revoke the Concession after 2010 if it considers the revocation to be in the public interest. It can also terminate our Concession at any time if we fail to comply with our obligations under it. The Portuguese government can also terminate our licenses under certain circumstances. If the Portuguese government took such action, we would not be able to conduct the activities authorized by the Concession or the relevant licenses. This loss would eliminate an important source of our revenues.

The first of our major licenses to expire is the renewable, non-exclusive license held by TMN to provide GSM mobile services throughout Portugal. This license is valid until 2007 and may be renewed thereafter by authorization of the Portuguese telecommunications regulator. However, the Portuguese regulator has the power not to renew our license, and failure to renew this license would eliminate an important source of our revenues.

Our Recent Ratings Downgrade and Any Future Downgrades May Impair Our Ability to Obtain Financing and May Significantly Increase Our Cost of Debt

On March 8, 2006, Moody s and Standard & Poor s downgraded our credit ratings to Baa1 and BBB+ as a result of our announcement that we are conditionally stepping up our shareholder remuneration policy for the period through 2008. We have four loans from the European Investment Bank (EIB) totaling 379 million that contain a provision under which the EIB has the right to require us to provide a guarantee acceptable to the EIB in the event our ratings are downgraded to BBB+/Baa1. In that circumstance, and after notice from the EIB, we would have 60 days to present an acceptable guarantee. If we fail to provide EIB the required guarantee, the EIB has the right to accelerate the repayment of the loans. We began to renegotiate these provisions with the EIB in October 2005. After our ratings downgrade, we completed the negotiation with the EIB and have been notified by the EIB that they will not require us to deliver a guarantee. The EIB has stated that it will accept the BBB+/Baa1 ratings and has asked us to increase the spread on these loans, which will increase our interest expenses. However, we have not yet formalized this agreement with the EIB.

Our ratings downgrade could adversely affect our ability to obtain future financing to fund our operations and capital needs. The downgrade could affect the marketability of any new debt securities we may wish to issue and could affect the pricing terms we are able to obtain in any new bank financing or issuance of debt securities. In addition, Moody s has placed our rating under review for possible downgrade, and Standard & Poor s has placed us on credit watch with negative implications. Any further downgrade of our ratings could have even more significant effects on our ability to obtain financing and therefore on our liquidity.

We Are Exposed to Exchange Rate and Interest Rate Fluctuations

We are exposed to exchange rate fluctuation risks, mainly due to the significant level of our investments in Brazil. These investments are not hedged against exchange rate fluctuations. We are required to make adjustments to our equity on our balance sheet in response to fluctuations in the value of foreign currencies in which we have made investments. For example, as of December 31, 2005, cumulative foreign currency translation adjustments related to investments in Brazil were 715.1 million. A devaluation in the Brazilian Real

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in the future could result in negative adjustments to our balance sheet. See *Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources Equity* and *Exchange Rate Exposure to the Brazilian Real*.

We are also exposed to interest rate fluctuation risks. We have entered into financial instruments to reduce the impact on our earnings of an increase in market interest rates, but these financial instruments may not prevent unexpected and material fluctuations of interest rates from having any material adverse effect on our earnings.

Macroeconomic Factors in Brazil Could Reduce Expected Returns on Our Brazilian Investments and Potentially Lead to Impairment Charges

A material portion of our business, prospects, financial condition and results of operations is dependent on general economic conditions in Brazil. In particular, it depends on economic growth and its impact on demand for telecommunications and other related services. The major factors that could have a material adverse effect on our investments and results of operations in Brazil, include:

Adverse political and economic conditions. The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. The Brazilian government has utilized salary and price controls, currency devaluation and foreign exchange controls as tools in its previous attempts to stabilize the Brazilian economy and control inflation. Changes in the government s exchange control policy, or in general economic conditions in Brazil, could have a material adverse effect on the results of our operations in Brazil. Deterioration in economic and market conditions in other countries (mainly in other Latin American and emerging market countries) may adversely affect the Brazilian economy and our business.

Fluctuations in the Real and increases in interest rates. The Brazilian currency has historically experienced frequent devaluations. The Real devalued against the Euro by 12.8% in 2001 and by 81.4% in 2002. During 2002, the Real underwent significant devaluation due in part to political uncertainty in connection with the elections and the global economic slowdown. In the period leading up to, and after, the general election in 2002, there was substantial uncertainty relating to the policies that the new government would pursue, including the potential implementation of macroeconomic policies that would differ significantly from those of the prior administration. This uncertainty resulted in a loss of confidence in the Brazilian capital markets, and the continued devaluation of the Real until the end of 2002. The Real depreciated against the Euro by 1.3% and 1.4% in 2003 and 2004, respectively, and appreciated by 31.7% against the Euro in 2005. Any substantial negative reaction to the policies of the Brazilian government could have a negative impact, including devaluation. The devaluation of the Real could negatively affect the stability of the Brazilian economy and accordingly could negatively affect the profitability and results of our operations. It would also increase costs associated with financing our operations in Brazil. In addition, a devaluation of the Real relative to the U.S. dollar may increase the costs of imported products and equipment. Our operations in Brazil rely on imported equipment and, as a result of such devaluation, such equipment would be more expensive to purchase.

During 2004 and 2005, the Brazilian Central Bank tightened its monetary policy to contain inflationary pressures resulting from high international prices for oil and other commodities, and increased the SELIC basic interest by 125 basis points to 17.75% at the end of 2004 and to 19.75% in May 2005. Since then, the Brazilian Central Bank has eased its monetary policy, decreasing the SELIC basic interest rate to 18% at the end of 2005. However, an increase in interest rates could negatively affect our profitability and results of operations and would increase the costs associated with financing our operations in Brazil. In addition, an increase would raise our interest costs because most of the interest on Vivo s debt is floating.

Inflation in Brazil. Brazil has historically experienced extremely high rates of inflation. Inflation, as well as governmental measures put in place to combat inflation, have had a material adverse effect on the Brazilian economy. Since the implementation of the Real Plan in 1994, the rate of inflation has been substantially lower than in previous periods. However, inflationary pressures persist, and actions taken in an effort to curb inflation, coupled with public speculation about possible future governmental actions, have contributed to economic

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uncertainty in Brazil and heightened volatility in the Brazilian securities market. The general price index, or the IGP-DI (the Índice Geral de Preços Disponibilidade Interna), an inflation index developed by the Fundação Getúlio Vargas, a private Brazilian economic organization, reflected inflation of 1.2% in 2005 compared to 12.1% in 2004, 7.7% in 2003 and 26.4% in 2002. If Brazil experiences significant inflation, Vivo may be unable to increase service rates to its customers in amounts that are sufficient to cover its increasing operating costs, and its business may be adversely affected, which could in turn have an adverse effect on our results of operations.

We could be required to record impairment charges relating to goodwill for our investment in Vivo. Under IFRS, we are required to test our goodwill for impairment at least annually. If the carrying value of the goodwill exceeds the related recoverable amount, we are required to write down our goodwill. The recoverable amount is the higher of the estimated selling price of the asset less the related selling costs and value in use. See *Item 5 Operating and Financial Review and Prospects Overview Critical Accounting Policies and International Financial Reporting Standards* . We recorded 701.4 million of goodwill on our balance sheet as of December 31, 2005 relating to Vivo. An increase in interest rates or other macroeconomic events (or an adverse event affecting the operations of Vivo) could decrease the estimated future cash flows from our investment in Vivo. An event that causes us to reduce our estimates of the future cash flows of Vivo could require us to record an impairment of this goodwill, and, depending on the size of the impairment, this could have a material adverse effect on our balance sheet and our results of operations.

Our Strategy of Enhancing Our Mobile Operations in Brazil Through Our Joint Venture With Telefónica Móviles May Not Be Successful

The successful implementation of our strategy for our mobile operations in Brazil depends on the development of our mobile services joint venture company with Telefónica Móviles. On December 27, 2002, we and Telefónica Móviles transferred our direct and indirect interests in Brazilian mobile operators to the mobile services joint venture company, Brasilcel, operating under the brand name Vivo, with headquarters in the Netherlands.

As in any joint venture, it is possible that Telefónica Móviles and we will not agree on Vivo s strategy, operations or other matters. Any inability of Telefónica Móviles and us to operate Vivo jointly could have a negative impact on Vivo s operations, which could have a negative impact on our strategy in Brazil and could have a material adverse effect on our results of operations. In addition, we cannot be sure that Vivo will be able to take advantage of its position in the Brazilian market to increase the scope and scale of its operations or that any anticipated benefits of the joint venture will be realized. See *Item 4 Information on the Company Strategic Alliances Alliance with Telefónica* .

Regulation May Have a Material Adverse Effect on Vivo s Results

Our mobile business in Brazil is subject to extensive regulation, including certain regulatory restrictions and obligations relating to licenses, competition, taxes and rates (including interconnection rates) applicable to mobile telephone services. Changes in the regulatory framework in the mobile telecommunications sector may have a negative impact on Vivo s revenues and results of operations. Moreover, Vivo s operating subsidiaries are restricted from increasing some of the rates that they charge for services provided even if a devaluation of the Real or an increase of interest rates by the Brazilian government increases their costs. Such circumstances may limit Vivo s flexibility in responding to market conditions, competition and changes in its cost structure, which could have a material adverse effect on its results of operations and in turn adversely affect our results of operations.

The Conditions Applying to Vivo s Subsidiaries Under the SMP Licensing Regime May Result in Reducing Our Revenues and Results of Operations

In September 2000, ANATEL, the Brazilian telecommunications regulator, introduced a new mobile services licensing regime, referred to as the SMP regime. The SMP regime permits existing mobile service

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providers operating under concessions to migrate to the SMP regime and become SMP license holders. Each of Vivo s subsidiaries has migrated to the SMP regime and now holds a SMP license instead of their previous concessions.

In 2003, SMP operators were required to implement long distance carrier selection codes to allow customers to choose their carrier for domestic long distance services (for both VC2 and VC3 calls) and international cellular calls. VC2 calls are calls made to parties outside a caller s area code but inside the same state, and VC3 calls are calls made to parties outside the caller s state. As a result, Vivo s subsidiaries no longer receive revenues from long distance services but instead receive revenues from interconnection fees paid by wireline long distance operators for wireline long distance traffic originating and terminating on their networks. The interconnection fees do not fully compensate, however, for the loss of long distance revenues that Vivo s subsidiaries formerly received from VC2 and VC3 calls, and this has had a negative impact on the overall revenues of Vivo s subsidiaries. If Vivo were able to offer wireline long distance services in addition to mobile services, it might be able to mitigate the impact of carrier selection codes on its revenues. However, because ANATEL considers Vivo s subsidiaries to be affiliated with Telefónica, which provides wireline long distance services in the state of São Paulo and was awarded a license to provide such services nationwide, ANATEL will not award a wireline long distance license to any of Vivo s subsidiaries.

In addition, under the SMP regime, an SMP mobile operator pays for the use of another SMP mobile operator s network in the same authorization area only if the traffic carried from the first operator to the second exceeds 55% of the total traffic exchanged between them (known as a partial Bill & Keep regime). In that case, only those calls that have surpassed the 55% level will be subject to payment for network usage. ANATEL has proposed to replace this partial Bill & Keep regime with a model based on the costs of mobile operators. However, we cannot predict whether the current regime will remain in place or whether any future regulatory change could have an adverse effect on our operations. While ANATEL analyzes regulatory alternatives, it has maintained the partial Bill & Keep regime, extending these rules through Resolution No. 408, promulgated in 2005.

In 2005, the partial Bill & Keep regime contributed to a decrease in Vivo s revenues from interconnection fees charged to other companies. If ANATEL were to implement a full Bill & Keep regime and if the traffic Vivo s subsidiaries terminate for other SMP mobile operators were to exceed the traffic other SMP mobile operators terminate for Vivo s subsidiaries, Vivo s, and consequently our, revenues and results of operations may be adversely affected. We cannot predict whether the current regulatory regime will remain in place or whether any future regulatory change could have an adverse effect on our results of operations. See *Item 4 Information on the Company Regulation Brazil SMP Regulation* .

Interconnection Fees and Regulated Adjustments to Those Fees May Not Result in Sufficiently Remunerative Revenues for Terminating Calls on the Mobile Networks of Vivo s Subsidiaries and May Negatively Affect our Revenues and Results of Operations

Under the new SMP regime, interconnection fees for the termination of calls on mobile networks are determined through free negotiation between Vivo s subsidiaries and other telecommunications operators. If the parties do not reach an agreement, the matter is determined through arbitration, which is conducted by ANATEL. Interconnection agreements must be approved by ANATEL and may be rejected if they are contrary to the principles of free competition and applicable regulations relating to traffic capacity, use of the interconnection infrastructure by requesting parties and other matters.

In 2005, ANATEL approved provisional agreements among the local fixed line and mobile operators to determine the interconnection fees for local calls (known as VC1 calls). These agreements provide for a 4.5% annual adjustment of interconnection fees for these calls. In March 2006, ANATEL approved a provisional agreement for interconnection fees for VC2 and VC3 long distance calls that also provides for a 4.5% annual adjustment to interconnection fees. The annual adjustments under these agreements may not be sufficient to cover Vivo s costs and preserve its margins from interconnections with Vivo s network. In particular, because a significant number of mobile subscribers use prepaid mobile services and generally receive more calls than they make, Vivo s subsidiaries derive an important part of their revenues from the interconnection fees paid to them by the wireline operators for traffic originating on wireline networks and terminating on the subsidiaries mobile networks.

In addition, ANATEL may further modify the regulatory regime governing interconnection fees. ANATEL has proposed to replace the partial Bill & Keep regime with a model based on the costs of mobile operators. ANATEL has proposed to implement this new model in mid-2007. We cannot predict whether this proposed model will be implemented and whether it will have an adverse effect on our operations. If this model were to result in lower annual adjustments to interconnection fees than under the provisional agreements reached in 2005 described above, our revenues and results of operations could be adversely affected.

ANATEL has also published specific proposals for regulations regarding interconnection charges that could adversely affect Vivo s revenues and results of operations. These proposals include (1) a proposal that two SMP operators controlled by the same economic group receive only one interconnection charge for calls originated and terminated on their networks rather than the current two charges, (2) a proposal for new negotiation rules for interconnection charges under which ANATEL would have a role in determining the charges rather than the current free negotiation of the charges and (3) a proposal for interconnection charge unification among SMP providers of the same economic group having significant market power according to criteria still to be defined. If new regulations along these lines take effect, they could have an adverse effect on Vivo s results of operations because (1) interconnection charges could drop significantly, thereby reducing Vivo s revenues, (2) ANATEL may allow favorable prices for economic groups without significant market power and (3) the prices Vivo charges in some regions in which it operates are higher than those in some other regions, and consolidation of those prices, competitive pressures and other factors could reduce Vivo s average prices and its revenues.

See *Item 4 Information on the Company Regulation Brazil SMP Regulation* .

Vivo Faces Substantial Competition in Each of its Markets that may Reduce its Market Share and Harm our Financial Performance

Competition may continue to intensify for Vivo as a result of the strategies of existing competitors, the possible entrance of new competitors and the rapid development of new technologies, products and services. Vivo s ability to compete successfully will depend on its marketing techniques and on its ability to anticipate and respond to various competitive factors affecting the industry, including new services that may be introduced, changes in consumer preferences, demographic trends, economic conditions and discount pricing strategies by its competitors. If Vivo does not keep pace with technological advances, or if it fails to respond timely to changes in competitive factors in its industry, it could continue to lose market share, and Vivo and we could suffer a decline in our revenue. Competition from other SMP communications service providers in the regions in which Vivo operates has also affected, and may continue to affect, its financial results by causing, among other things, a decrease in its customer growth rate, decreases in prices and increases in selling expenses.

These factors have already contributed to a negative effect on Vivo s market share and results of operations and could have a material adverse effect on our results of operations in the future. As a result of competitive pressures, for example, Vivo s market share decreased from 50.9% as of December 31, 2004 to 44.4% as of December 31, 2005, and Vivo s market share of net additions to its customer base decreased from 38.1% for the year ended December 31, 2004 to 21.8% for the year ended December 31, 2005, based on information received from ANATEL. In addition, Vivo s net additions of customers decreased 44.6% from the year ended December 31, 2004 to the year ended December 31, 2005. Similarly, the market share of TCO, Tele Leste, Tele Sudeste and Celular CRT Participações in their authorized areas declined in the same period, and the market share of net additions to the customer base of these companies declined significantly. Net additions of customers of each of these companies also declined significantly from the year ended December 31, 2004 to the year ended December 31, 2005. In addition, Vivo s selling expenses for the year ended December 31, 2005 grew at a significantly higher rate than its net operating revenue compared to the year ended December 31, 2004, and similar trends existed at each of TCO, Tele Leste, Tele Sudeste and Celular CRT Participações.

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Recently, there has been consolidation in the Brazilian telecommunications market, and we believe this trend may continue. Consolidation may result in increased competitive pressures within Vivo s market. Vivo may be unable to respond adequately to pricing pressures resulting from consolidation, which would adversely affect its business, financial condition and results of operations and could adversely affect our results of operations.

Vivo s Results of Operations Have Been Negatively Affected by a Decrease in Its Customer Growth and Could Also Be Affected if Its Rate of Customer Turnover Increases

Vivo s rate of acquisition of new customers has declined significantly, primarily due to competition and increased market penetration. For example, Vivo s net additions of customers decreased 44.6% from the year ended December 31, 2004 to the year ended December 31, 2005 due to a decrease in the rate of addition of new prepaid customers to 2,704,000 new prepaid customers in the year ended December 31, 2005, compared to 5,540,000 new prepaid customers in the comparable period of the prior year. This decrease in the rate of new additions of customers has negatively affected Vivo s results of operations and could continue to do so in the future. In addition, if Vivo s rate of customer turnover were to increase significantly, its results of operations and or competitive position could be adversely affected. Several factors in addition to competitive pressures could influence Vivo s rate of acquisition of new customers and rate of customer turnover, including limited network coverage, lack of sufficient reliability of our services and economic conditions in Brazil.

Improper Use of Vivo s Network Can Adversely Affect its Costs and Results of Operations

Vivo incurs costs associated with the unauthorized use of its wireless networks (particularly its analog cellular network), including administrative and capital costs associated with detecting, monitoring and reducing the incidence of fraud. Fraud also affects interconnection costs, capacity costs and payments to other carriers for non-billable fraudulent roaming. Improper use of Vivo s network can also increase Vivo s costs if it has to increase its provision for doubtful accounts to reflect amounts it does not believe it can collect for improperly made calls. In 2005, for example, TCP, TCO, Tele Leste, Tele Sudeste and Celular CRT Participações increased their provisions for doubtful accounts because of previously undetected improper use of their networks. Any unexpected increase in the improper use of Vivo s network in the future could materially adversely affect its costs and results of operations and could adversely affect our results of operations.

We Are Currently Reviewing Our Internal Controls for the First Time Pursuant to the Sarbanes-Oxley Act of 2002, and if We Identify any Material Weaknesses or Significant Deficiencies in our Internal Controls, Investors May Lose Confidence in Our Reported Financial Information

We are in the process of assessing the effectiveness of our internal control over financial reporting in connection with the rules adopted by the SEC under Section 404 of the Sarbanes-Oxley Act of 2002. Compliance with Section 404 of the Sarbanes-Oxley Act of 2002 will be required in connection with the filing of our Annual Report on Form 20-F for the fiscal year ending December 31, 2006. We began a comprehensive review of our internal controls in 2005 and have identified areas of focus for strengthening our internal controls. A number of processes and systems are currently being changed in order to bring our internal controls into compliance with best practices in the industry. We expect to complete this process in 2006, but we cannot provide assurance that we will be able to do so. In addition, there can be no assurance that our auditors will issue an unqualified opinion on management s assessment of the effectiveness of our internal control over financial reporting. See *Item 15 Controls and Procedures* .

As part of our review, we may identify material weaknesses in our internal controls as defined in standards established by the Public Company Accounting Oversight Board (PCAOB). A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The PCAOB defines significant deficiency as a deficiency that results in more than a remote likelihood that a misstatement of the financial statements that is more than inconsequential will not be prevented or detected.

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In addition, our Brazilian mobile business at Vivo is engaged in a similar process of evaluating its internal controls and changing a number of processes and systems in anticipation of the Section 404 certification process for its own Annual Report on Form 20-F for the fiscal year ending December 31, 2006. If Vivo were to identify any material weakness in its internal controls as part of its review of internal control over financial reporting, such a material weakness could result in a material weakness in our own internal controls due to the importance of Vivo to our business.

Any failure to complete an assessment of our internal control over financial reporting, to remediate any material weaknesses that we may identify or to implement new or improved controls, or difficulties encountered in their implementation, could cause us to fail to meet our reporting obligations or result in material misstatements in our financial statements. Inadequate internal controls could also cause investors to lose confidence in our reported financial information.

The Benefits of Our Strategy and Our Financial Targets May Not Be Realized

On March 6, 2006, we rearticulated our strategy, announced the potential restructuring of our international investments and announced new financial targets. The principal elements of this strategy are described in *Item 4 Information on the Company Overview*. The financial targets we announced included a goal of 3% to 5% growth in our adjusted EBITDA and specific targets for operating cash flow over the next three years and annual cost savings to be achieved by 2008. We define adjusted EBITDA to mean earnings before interest, taxes, depreciation and amortization, impairment losses, workforce reduction program costs, losses and gains on disposals of fixed assets, and other costs. Although management believes that these targets are achievable, they are subject to significant assumptions and uncertainties that could cause them not to be achieved. For example, these targets assume that we will obtain regulatory relief that we have requested, but have not yet been granted, to allow us to bundle traffic revenues with fixed charges in our wireline business by including a specified number of minutes in the monthly line rental charge. They also assume cost savings initiatives and plans for the optimization of capital expenditures and working capital, and they assume that we will be able to achieve further cost reductions by further streamlining our operations. In addition, the contribution of our Brazilian mobile business to our financial targets assumes that the Real/Euro exchange rate will remain stable at R$2.55 = 1.00. The Brazilian Real has been subject to significant fluctuations in relation to the Euro in past years, including in 2005. See *Macroeconomic Factors in Brazil Could Reduce Expected Returns on Our Brazilian Investments Fluctuations in the Real and increases in interest rates*.

Our target of providing shareholder remuneration of over 3 billion between 2006 and 2008 also depends on our ability to generate profits and cash flows and on shareholder approval of these initiatives.

Any of the factors described above could cause us to be unable to achieve the financial targets and other goals articulated as part of our strategy and could cause shareholders not to receive the benefits of that strategy.

An ADS Holder May Face Disadvantages Compared to an Ordinary Shareholder When Attempting to Exercise Voting Rights

Holders of our ADSs may instruct the depositary to vote the ordinary shares underlying the ADSs. For the depositary to follow the voting instructions, it must receive them on or before the date specified in our voting materials. The depositary must try, as far as practical, subject to Portuguese law and our articles of association, to vote the ordinary shares as instructed. In most cases, if the ADS holder does not give instructions to the depositary, it may vote the ordinary shares in favor of proposals supported by Portugal Telecom s board of directors, or, when practicable and permitted, give a discretionary proxy to a person designated by us. We cannot be certain that ADS holders will receive voting materials in time to ensure that they can instruct the depositary to vote the underlying ordinary shares. Also, the depositary is not responsible for failing to carry out voting instructions or for the manner of carrying out voting instructions. This means that ADS holders may not be able to exercise their right to vote and there may be nothing they can do if their ordinary shares or other deposited securities are not voted as requested.

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ITEM 4A UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 4 INFORMATION ON THE COMPANY

Overview

Portugal Telecom s legal and commercial name is Portugal Telecom, SGPS, S.A. Portugal Telecom is a limited liability holding company, organized as a *Sociedade Gestora de Participações Sociais* under the laws of the Republic of Portugal. The company was originally incorporated as Portugal Telecom, S.A., a *sociedade anónima* in June 1994. Our principal offices are located at Avenida Fontes Pereira de Melo, 40, 1069-300 Lisboa, Portugal. Our telephone number is +351 21 500 1701, and our facsimile number is +351 21 500 0800. Portugal Telecom s agent for service of process in the United States is CT Corporation System at 111 Eighth Avenue, New York, New York 10011. Our home page is located at www.telecom.pt. The information on our website is not part of this report. The website address is included as an indicative textual reference only.

We provide telecommunications and multimedia services in Portugal and Brazil. Our services include:

- wireline services, which include fixed line telephone services for retail and wholesale customers, leased lines, unbundled local loop access and wholesale line rental, interconnection, Internet access (dial-up and broadband), data and business solutions, portal and e-commerce services;
- mobile telecommunications services, such as voice, data and Internet-related services;
- multimedia services, which consist of cable and satellite television services, broadband Internet and film distribution and screening;
- sales of telecommunications equipment; and
- Portuguese-language television programming activities and provision of content.

In Portugal, we are the leading provider of all of these services. The provision of wireline services in Portugal continues to account for a larger proportion of our revenues (32% during 2005) as compared to revenues derived from any other line of business in our group. In Brazil, we have a leading position in the mobile market. To strengthen our position in the Brazilian mobile telecommunications market, we entered into a strategic alliance with Telefónica Móviles, the Spanish mobile telecommunications company, pursuant to which we created, on December 27, 2002, a mobile telecommunications services company in Brazil, Brasilcel, which was rebranded Vivo on April 8, 2003. See *Our Businesses Brazilian Mobile Business* , below.

We are focusing our efforts on market segments and businesses that have the potential for high growth, and we are positioning our company as the leading integrated supplier of a full range of telecommunications services in Portugal. We derive an increasing share of our revenues from mobile services in Portugal and Brazil, and from new services in fast-growing businesses in Portugal, such as multimedia and Internet services.

The telecommunications market is increasingly characterized by new technological developments resulting in new opportunities and risks for telecommunications operators, the growth in demand for Internet-related services and the increasing use of information technology in telecommunications services. The key elements of our strategy include:

enhancing the performance of our operations in the evolving domestic competitive landscape, including initiatives such as aggressively rolling out triple-play VoIP offers and offering differentiated broadband services;

segregating wireline access, which potentially represents a first step towards monetization and regulatory relief;

seeking to promote a model of shared utilization of mobile networks, which would facilitate the further penetration of third generation services and rapid deployment of mobile TV capabilities;

continuing our existing partnerships and seeking to manage our international assets in a proactive manner in selected markets where we have a clear competitive advantage;

continuing our focus on the operational enhancement of Vivo; and

seeking to concentrate and crystallize the value of selected assets in Africa.

Our specific strategies in our domestic market include the following:

Wireline

continue to develop and market voice services at flat rates;

continue to improve the attractiveness of our broadband services by offering exclusive content and value-added services rather than focusing only on price and speed;

launch triple-play services through the roll-out of IP television; and

in our data and corporate unit, increase our emphasis on value-added, integrated information technology and solutions to business.

Domestic Mobile

continue to develop and bring to market innovative data and video services for third generation mobile phones;

launch a Mobile TV service together with PT Multimédia; and

consolidate leadership in the mobile market.

Multimedia Business

introduce triple-play services, as described above;

seek further penetration by focusing on under-served regions of Portugal;

seek to stimulate demand for pay TV services by promoting development of high-quality Portuguese language content; and

- continue to focus on improvements in quality of service.

Group-Wide Initiatives

- seek further company-wide operating efficiencies by centralizing common functions; and

- continue to use workforce reductions to decrease our labor costs and increase our productivity over time.

In addition, we continue to seek avenues for growing our business in a manner consistent with the promotion of competition in the Portuguese telecommunications market. We have begun to explore the further separation of our two fixed networks, the copper network operated by our wireline business and the cable network operated by our multimedia business, conditioned upon obtaining regulatory relief.

For information regarding our current and historic principal capital expenditures and divestitures, see *Item 5 Operating and Financial Review and Prospects Capital Investment and Research and Development*.

For information regarding the public takeover offer by Sonae, see *Recent Development*.

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Our Businesses

Business Units

Our market is characterized by increasing competition and rapid technological change. Portugal Telecom s business unit subsidiaries are held by Portugal Telecom in its role as holding company. The diagram below presents our different businesses as of December 31, 2005.

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(1) Providing wireline services in Portugal, including our fixed telephone service, Internet access services, wholesale services and data and business solutions services.

(2) Providing multimedia services in Portugal, including cable operations through TV Cabo and audiovisuals services through Lusomundo Audiovisuais and Lusomundo Cinemas. In our discussion of this business segment below, we have provided a diagram of the different businesses operating under PT Multimédia Serviços de Telecomunicações e Multimédia, SGPS, S.A., or PT Multimédia.

(3) In our discussion of this business segment below, we have provided a diagram of the organizational structure of Vivo.

(4) Various international investments, including global telecommunications operators in Cabo Verde Islands, São Tomé e Principe Islands and Macao, mobile operators in Morocco and Angola, and other investments in various countries.

(5) Various instrumental companies providing services to Portugal Telecom group companies, including PT Sistemas de Informação (information systems), PT Inovação (research and development), PT PRO (shared services), PT Compras (central purchasing) and PT Contact (call centers).

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The following table sets forth the operating revenues of each of our major business lines, on a standalone basis, for the years ended December 31, 2004 and 2005:

	2004	2005	% Increase (Decrease) of Item
	(EUR millions)		
Wireline Business:			
Retail	1,379.4	1,318.8	(4.4)%
Wholesale	476.4	457.7	(3.9)%
Data and Corporate	242.0	244.9	1.2%
Directories	129.7	120.4	(7.2)%
Sales	36.1	34.2	(5.4)%
Other	41.5	37.7	(9.2)%
Total	2,305.2	2,213.6	(4.0)%
Domestic Mobile Business:			
Services	1,446.3	1,403.6	(3.0)%
Sales	153.3	146.3	(4.5)%
Other	6.7	7.1	5.4%
Total	1,606.3	1,557.1	(3.1)%
Multimedia Business			
Pay TV and Cable Internet	513.2	551.7	7.5%
Audiovisuals	84.9	75.8	(10.8)%
Other	0.7	1.0	58.9%
Total	598.8	628.5	5.0%
Brazilian Mobile Business:			
Services	1,425.3	1,737.8	21.9%
Sales	136.6	233.8	71.2%
Other	37.3	65.3	75.1%
Total	1,599.1	2,036.9	27.4%
Other Businesses	163.2	215.2	31.9%
Eliminations in consolidation	(305.1)	(265.8)	(12.9)%
Total consolidated operating revenues	5,967.4	6,385.4	7.0%

Wireline Business

Our wireline business consists of four operating companies, PT Comunicações, PT Prime, PT.com and PT Corporate, which provide the following services on our wireline network:

- retail, including fixed line telephone services and Internet access services to residential and small office home office customers;

- wholesale, including leased lines, interconnection services, unbundled access to our local loops, and transmission of television and radio signals;

- data and corporate, including data communications, leased lines to major clients, network managing and outsourcing; and

- other wireline services, including our directories business and sales of telecommunications equipment.

PT Comunicações holds and operates our fixed line network, providing fixed line telephone services, wholesale services, directories and sales of telecommunications equipment. PT Comunicações provides fixed line telephone services pursuant to a Concession granted to us by the Portuguese government and transferred to PT Comunicações pursuant to Decree Law 219/2000. On December 11, 2002, PT Comunicações entered into a definitive agreement to acquire full ownership of the basic telecommunications network from the Portuguese government. Since then, PT Comunicações has owned the basic telecommunications network.

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PT Prime offers corporate customers in Portugal data and corporate services through a one-stop-shop for a variety of flexible, efficient and innovative solutions using information technology, telecommunications, Internet and outsourcing. Before October 2003, we held 87.5% of the share capital of PT Prime. In October 2003, we acquired the remaining share capital of PT Prime from SIBS Sociedade Interbancária de Serviços (Interbank Services Company), a Portuguese entity operating the ATM network and the inter-bank payment system in Portugal, for 39 million.

PT.com is the leading Internet company in Portugal, operating as an Internet Service Provider, or ISP, using our fixed line network and the brands SAPO and Telepac, as well as in portal and related activities through sapo.pt, Portugal s leading Internet portal. PT.com was formed as PT Multimédia.com, or PTM.com, in March 2000 by PT Multimédia to aggregate all of its Internet activities focused on the residential and small and medium-sized enterprise markets. In October 2002, we entered into an agreement with PT Multimédia to acquire its 100% interest in PTM.com. The sale of PT Multimédia s Internet business to us was intended to encourage the continued growth of our broadband businesses and increase the loyalty of fixed line subscribers, while providing a single platform for investment and development of on-line services and content for the Portugal Telecom group. The results from our services provided through PTM.com, renamed PT.com in November 2004, have been included in our wireline business segment since 2003.

PT Corporate, launched in July 2003, serves the 49 largest economic groups and government-related entities in Portugal, and acts as a single interface for every company within the PT Group, with the authority to represent, negotiate and sign in the name of each PT Group company. PT Corporate offers these large corporate customers solutions for fixed and mobile telecommunications, internet, technologies and information systems and outsourcing. Due to the size and specific business requirements of its clients, PT Corporate was created to contribute to its clients business success by assuring the integrated and optimized development of their systems and information processes.

Fixed Line Network. We maintained approximately 4.5 million telephone and ADSL access lines in service at December 31, 2005, excluding external supplementary lines, direct extensions and active multiple numbers. We break our fixed line network down into traditional main lines (PSTN), ISDN lines and asymmetric digital subscriber lines (ADSL) lines. Because of their large capacity, we count ISDN lines, which transmit voice and data at higher rates than analog lines, as equivalent to either two or up to 30 (depending on whether they are basic or primary ISDN lines) traditional main lines. We offer high-speed Internet access through ADSL lines. As of December 31, 2005, we had 637 thousand ADSL lines, of which 585 thousand were attributable to our ADSL retail business (which is operated by PT.com), and 3,769 thousand PTSN/ISDN lines, of which 78% were residential/small office home office clients, 16% business and the remainder mainly payphones, wholesale lines and other.

The following table shows the number of our main lines by category.

	As of December 31,				
	2001	**2002**	**2003**	**2004**	**2005**
Fixed line main lines in service (thousands)					
Traditional main lines	3,501	3,317	3,224	3,165	3,011
ISDN main line equivalents	800	826	813	783	758
ADSL	3	53	188	420	637
Unbundled local loop (ULL)				9	72
Total	4,304	4,196	4,225	4,377	4,478
PSTN/ISDN fixed line main lines per 100 inhabitants	42.3	41.9	41.2	40.6	40.5
Public pay phones (thousands)	45.5	43.8	41.4	47.3	57.8

Over past years, we have made significant investments to meet subscriber demand for lines and to modernize our fixed line network. As a result, the number of PSTN/ISDN lines per 100 inhabitants has almost doubled from 20.9 fixed line main lines at the end of 1989 to approximately 40.5 fixed line main lines at the end of 2005.

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We have offered ISDN services commercially since 1994. We offer a basic-rate service, which provides two communications channels, and a primary-rate service, which provides up to 30 communications channels. At the end of December 2005, we had 260,673 accesses to our basic-rate ISDN service and 7,899 accesses to its primary-rate ISDN service. By the end of 2005, ISDN lines represented 20.1% of our total equivalent fixed line main lines, as compared with 19.8% one year before. The conversion of traditional main lines to ISDN lines results in increased quality of service, and our ISDN subscribers tend to produce higher levels of usage per line than traditional main line subscribers.

In September 1999, the number of active mobile cards (the mobile equivalent of main lines) overtook the number of fixed line main lines in Portugal, and traffic that once was transmitted in whole or in part on our fixed line network is being carried on our mobile network or on the network of other mobile operators. We are addressing this trend by encouraging increased use of our fixed line network for other data services.

All of our local switches in Portugal have been digital since 1999. Digital technology is used on all long distance and trunk connections. This level of digitalization of our fixed line network permits us to market and provide network-based value-added services, such as call waiting, call forwarding and voice mail, resulting in increased line usage. By the end of December 2005, PT Comunicações was providing approximately 1,142 thousand voicemail boxes.

We launched ADSL service in Lisbon and Oporto in 2002 and now cover virtually all of Portugal. We offer ADSL lines both to retail customers, such as residential customers and small and medium-sized businesses, and to wholesale customers. During 2004, we focused on customer retention and loyalty in order to turn around the wireline business. The aggressive rollout of ADSL was central to this strategy. Throughout 2004, new broadband products and offers were launched, including the launch of one of the first broadband prepaid offers in Europe and the revamping of the ADSL product brand, Sapo ADSL. In 2005, we continued to improve the quality of services and customer care and to innovate, launching electronic billing with legal validity, VoIP and video services on SAPO Messenger, the group s instant messenger service. We continued to deploy ADSL as one of our principal strategies, increasing geographic coverage to almost all of Portugal and increasing transmission speeds. We also introduced new pricing plans targeted to specific customer needs. The following chart shows the evolution of our ADSL retail and wholesale customer base for the periods indicated.

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We had 0.2 billing complaints per 1,000 bills and 10.4 reported faults per 100 main lines in the year ended December 31, 2005. The percentage of faults repaired in less than 12 working hours was 79.4% in 2005, compared with 77.7% in 2004. We offer residential customers detailed billing on request without extra charge.

Traffic. Total traffic originated on the network has been decreasing since 2002, primarily because consumers have increasingly used mobile service instead of fixed line service and because of the migration of dial-up Internet users to ADSL. The chart below sets forth the rate of growth or decrease of traffic originated on our fixed line network in terms of the percentage change in minutes.

The following table shows the breakdown of fixed line traffic originated on our fixed line network among mobile, Internet and data and other domestic and international traffic for the periods indicated.

Total Growth of Originated Traffic

	Year ended December 31,									
	2001		2002		2003		2004		2005	
	Millions of minutes	%	Millions of minutes	%	Millions of minutes	%	Millions of minutes	%	Millions of minutes	%
Domestic	7,431	43.0	6,480	39.6	5,841	40.1	5,236	42.8	4,669	44.7
International	411	2.4	402	2.5	382	2.6	372	3.0	411	3.9
Fixed-to-mobile	1,215	7.0	1,119	6.8	1,023	7.0	918	7.4	844	8.1
Internet	6,920	40.0	6,581	40.3	5,023	34.5	3,151	25.3	1,818	17.4
Other	1,319	7.6	1,758	10.8	2,294	15.8	2,673	21.5	2,704	25.9
Total	17,296	100.0	16,340	100.0	14,563	100.0	12,440	100.0	10,446	100.0

During 2005, Internet-related traffic accounted for approximately 17.4% of the total traffic originated on the fixed line network, compared with 25% during 2004.

We offer other ISPs access to our network under one of two regulated access regimes that may be chosen by the ISP: (1) the Reference Offer for Internet Access, which allows ISPs either to pay us a call origination charge and a fee for invoicing customers on their behalf or to pay a wholesale flat rate and bill their customers directly

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or (2) the Reference Interconnection Offer, which offers two different billing structures based on call origination, with variations based on the manner in which the ISPs infrastructures are connected to our network and billing arrangements. For additional information, see *Regulation Portugal Interconnection Internet Access* .

We are required to provide carrier selection to our customers for all kinds of traffic. See *Regulation Portugal Number Portability and Carrier Selection* . Carrier selection has been an additional factor that has contributed to the reduction in traffic on our network. In addition, in January 2006, ANACOM published regulations permitting carrier pre-selection of non-geographic services, such as toll-free numbers.

Except for customer pre-selection and Internet traffic, we account for traffic originating on our network in our fixed line telephone services unit, and we allocate the revenue billed to customers to that unit. Traffic originating on other networks but terminating on our network, and the related revenue, is allocated to our wholesale unit.

Marketing. We have increased our marketing efforts aimed at customer loyalty and promoting increased use of our wireline telephone services.

Promotional Efforts and Market Analysis. We aggressively promoted the sale of products and services targeted to specific customers in 2005 through, among other things:

- a 52% increase in 2005 of ADSL accesses to 637 thousand, with the rate of service coverage of our network reaching 99.4% in 2005, compared to 95.1% in 2004. Aiming at improvement in the quality of service, we launched two new access levels 4 Mbps and 8Mbps, and decreased the price of ADSL service;
- an increase in the pricing plans we offer with the launch of new flat-rate pricing plans for unlimited consumption for various time slots during the day, namely PT Noites , PT Manhãs , PT Tardes , PT Fim-de-Semana , PT Dias Úteis and PT Total . The total number of accounts subject to pricing plans reached 1.8 million at the end of 2005;
- the successful launch of an instant messenger service called Sapo Messenger in the first half of 2005, followed by the launch of a softphone VoIP and Video service. Sapo Messenger had over 370 thousand users at the end of 2005.
- the successful launch of several campaigns with strong acceptance from customers, namely Especial Dia dos Namorados (Valentine s Day Special), the summer campaign Você paga mas não paga (You pay but don t pay) and Campanha Novo Tarifário 1 cêntimo (New 1 cent Tariff Campaign);
- the development and launch of a new range of security solutions, namely Homeguard , Homealarm , Homesafe and Powermax ;
- the launch of a new voice message reception service for customers with special needs; and
- the launch of a new client portal, PT Casa , allowing fixed line customers to manage their telecommunications services online.

We use market research programs to evaluate customer satisfaction and service quality and to help develop new products. We focus our marketing on different segments of the residential and business market. We have an advanced billing and customer information system and a marketing information database that combines usage and other data.

Customer Care. To provide support and marketing services to our residential and business customers, we have developed a network of regional organizations and retail service centers. In addition, we have separate call centers dedicated to increasing services to our residential and business customers. The call centers are interconnected and cover the whole country. This system allows our customer service representatives to access the history of customers telephone use and commercial dealings with us.

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In 2005, we began to build a new data center in Lisbon to increase our capacity and improve the security of our services. We also improved the infrastructure of our internal IT systems to facilitate the sharing of resources and centralized management.

Increased Selling Efforts. We have developed a distribution network through our retail service centers and agents such as supermarkets and other retail outlets. Our customer support system allows us to develop and implement strategies to sell new and expanded services to our customers. We often use telemarketing to both the residential and small and medium-sized enterprise market segments to develop closer relationships with our customers.

In 2005, we continued to pursue our strategy of market segmentation, namely our residential and business market segments, and established partnerships between subsidiaries of Portugal Telecom to offer integrated telecommunications solutions to corporate customers, including simpler voice services and integrated website solutions. We also executed agreements with corporate associations to benefit small businesses.

Retail

Fixed Line Telephone Services. We provide public fixed line telephone services in Portugal to retail customers, primarily through our subsidiary PT Comunicações. This business area provided 1,318.8 million and 1,379.4 million to our wireline operating revenues during 2005 and 2004, respectively. We distinguish between two principal sources of revenue in the provision of fixed telephone services:

- *Fixed charges*, including network access charges based on a monthly line rental and an initial installation fee, as well as a monthly fee from pricing packages.

- *Traffic*, including charges for the use of our fixed line network based on rates dependent on the amount and type of usage.

We divide traffic into domestic and international traffic. Domestic traffic consists of domestic telephone services provided directly to subscribers that originate or terminate calls on our fixed line network. International traffic consists of international telephone services provided directly to users that originate calls on our fixed line network.

Since 2000, public switched fixed line telephone services in Portugal have been fully open to competition. As a result of this competition, as well as the trend toward use of mobile services instead of fixed line services, we have experienced, and expect to continue to experience, erosion of market share of both access lines and of outgoing domestic and international traffic. See *Competition Competition Facing Our Wireline Business* .

Fixed Charges. Our fixed charges to domestic fixed line telephone subscribers include a one-time installation charge and a monthly line rental fee. These fixed charges provided 679.8 million and 668.5 million to our wireline operating revenues during 2005 and 2004, respectively.

In July 2005, we created two different tariffs one for the residential market and another for the business market. The installation charge remained the same for both markets, 71.83. The standard line rental fee was 12.66 for the residential market and 12.98 for the business market. The fee for basic ISDN lines was 26.46 per month for both markets. The chart below illustrates changes in our prices and fees from 2001 through 2005. All prices are in Euros and exclude VAT.

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Fixed Fees for Fixed Line Telephone Services(1)

	As at December 31,					
	2001	2002	2003	2004	2005	
Installation fee	74.41	71.83	71.83	71.83	71.83	
Line rental per month	12.27	11.85	12.3	12.66	12.66	(residential)
					12.98	(business)

(1) Amounts rounded to nearest hundredth.

Traffic. Traffic contributed 473.6 million and 588.4 million to our wireline operating revenues during 2005 and 2004, respectively. Measured in minutes, total fixed line retail traffic originating on our fixed line network decreased by 16.0% during 2005 compared with 2004. The decrease was primarily due to the continuing effects of the trend toward use of mobile services instead of fixed line services and the migration of Internet users to ADSL.

Domestic. Domestic traffic contributed 408.1 million and 514.7 million to our wireline business s operating revenues in 2005 and 2004, respectively.

Prices. Since July 2005, we have had two domestic tariffs: local (former local + regional) and national. Between the end of 2000 and the end of 2005, weighted average prices for domestic fixed line telephone services decreased by 1.7% per year in nominal terms. Compared with 2004, domestic prices decreased a further 1.97% over the course of 2005 in nominal, annualized terms. See *Regulation Portugal Pricing of Wireline Services* .

The chart below illustrates changes in our prices from 2001 through 2005. The call prices from 2001 through 2005 are for a three-minute call at peak rates in 2005 constant prices. All prices are in Euros and exclude VAT.

Principal Prices for Domestic Fixed Line Telephone Services(1)

	As at December 31,					
	2001	2002	2003	2004	2005	
Local call prices	0.12	0.12	0.12	0.13	0.12	(residential)
					0.13	(business)
Regional call prices	0.24	0.23	0.21	0.16	0.12	(residential)
					0.13	(business)
National call prices	0.35	0.33	0.29	0.20	0.19	(residential)
					0.19	(business)

(1) Amounts rounded to nearest hundredth.

Our pricing structure has come more into line with pricing structures in the rest of the EU over the last ten years. The following table compares our estimates of average domestic services prices per minute, excluding VAT, for a three-minute call at peak rates in the EU with average prices in Portugal in effect at December 31, 2005.

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Principal Prices for Domestic Fixed Line Telephone Services: EU and Portugal

	As of December 31, 2005		
	EU Average(1)	**EU Average(2)**	**Portugal**
Local call prices:			
Residential	3.52	3.68	4.07
Business	3.49	3.69	4.21
National call prices:			
Residential	6.52	6.12	6.47
Business	6.32	6.08	6.33

(1) The average including all 25 member states of the EU.

(2) The average including only the previous 15 member states of the EU.

To increase its price competitiveness, we are promoting innovative differentiated pricing plans for market segments, including various plans specially designed for business customers and residential customers. We also offer a prepaid card and pricing plans suited for Internet users, as well as plans aimed at the development of education and the information society.

International. We estimate that operating revenues from international fixed line telephone services were 65.5 million in 2005 compared to 76.3 million in 2004. Revenues from international fixed line telephone services come primarily from charges to our individual and business subscribers in Portugal for outgoing calls. We must pay a portion of these charges to other international operators whose facilities carry the calls. Although revenues from international fixed line telephone services have generally decreased in recent years as a result of decreases in international traffic and prices for outgoing international calls, traffic increased in 2005 as a result of growth in traffic from prepaid international calling cards.

Accounting Rates. Historically, the amount of incoming traffic has been significantly greater than the amount of outgoing traffic. As a result of this imbalance, we receive higher payments from other international telecommunications operators than we pay out to these operators. We periodically renegotiate the amount of the payments with these operators.

In recent years, the billing rates among operators have been declining steadily, both for incoming and outgoing traffic. We estimate that, on an aggregate basis in Euros, termination rates for international traffic at the end of 2005 decreased by a weighted average of approximately 18.1% for incoming traffic and 21.0% for outgoing traffic compared to the end of 2004.

With the opening of the Portuguese market to competition in 2000, international telecommunications operators are now able to provide services directly in Portugal. They can lease lines from us or obtain international lines from other operators and then interconnect with our fixed line network. The revenues we receive from these services are interconnection fees and thus fall into the wholesale business category of our wireline business. As a result, while our share of the international market has declined, increases in our wholesale business have, to some extent, offset this decline.

Prices. We set traffic charges for international fixed line telephone services by groups of countries. Within each group, we charge different prices according to the time of day and the day of the week that the customer makes the call. Between the end of 2001 and the end of 2005, we experienced aggregate reductions in real terms of 3.7% in international traffic prices.

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The table below shows changes in prices for our international fixed line telephone services to selected destinations since 2001. The prices for 2001 through 2005 are peak rate prices per minute on the basis of a three-minute call, set at 2005 constant prices. They are in Euros and exclude VAT.

Selected Prices for the International Services(1)

	As of December 31,				
	2001	**2002**	**2003**	**2004**	**2005**
EU(2)	0.28	0.27	0.27	0.27	0.27
Other European countries(3)	0.63	0.61	0.61	0.61	0.61
United States	0.29	0.28	0.28	0.28	0.28
Canada	0.29	0.28	0.28	0.28	0.28
Brazil	0.59	0.57	0.57	0.57	0.57

(1) Euro amounts rounded to nearest hundredth.
(2) Including Switzerland.
(3) Excluding Norway and Iceland.

ADSL Services and ISPs. We are the leader in providing Internet access in Portugal. As at December 31, 2005, we had approximately 585 thousand ADSL retail customers, which represented an overall increase of 53.4% over the previous year. We also offer dial-up paid and free Internet access services. In 2005, revenues from ADSL services grew 50.8% to 150.6 million, more than offsetting a 34.6% decline in dial-up revenues to 14.8 million as increasing numbers of people switched to broadband service.

Application Service Provider (ASP). We also provide ASP services in Portugal, which include remote applications services, web hosting and web design services to small and medium-sized enterprises. We had approximately 2,734 customers for our ASP business at December 31, 2005.

Wholesale

Our wireline business wholesale services, which are provided primarily through PT Comunicações, consist of:

- domestic and international interconnection telephone services that we provide to other telecommunications service providers in Portugal, including other companies in our group;
- provision of carrier pre-selection and number portability;
- leasing of national and international lines to other telecommunications service providers and Portuguese cable television operators, including other companies in our group;
- provision of ADSL on a wholesale basis to other ISPs, including other companies within the Portugal Telecom group;
- transmission of television and radio signals for major broadcast television companies in Portugal;
- narrowband Internet access origination services, which we provide to ISPs, including other companies within the Portugal Telecom group;

other services provided to telecommunications service providers and operators, such as local loop unbundling and IP international connectivity;

provision of co-location services and duct sharing to other cable television companies; and

provision of wholesale line rental.

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Wholesale services provided 457.7 million and 476.4 million to our wireline operating revenues in 2005 and 2004, respectively.

Traffic. Interconnection and narrowband Internet access traffic comprises about 50.3% of our wholesale business in terms of revenues. The service providers who purchase interconnection services include fixed and mobile network operators, telephony and data communications service providers, ISPs, value-added service providers and service providers whose international calls are terminated on or carried by our network. Providing interconnection services means allowing third parties to connect their networks to our network, and vice versa. We have interconnection rates for call termination, call origination, transits and international interconnection. In 2005, interconnection rates per minute for call termination included local transit rates equal to 0.0068, single transit rates equal to 0.0097 and double transit rates equal to 0.0147, each based on a three-minute call made during peak hours. We published the latest version of our reference offer for unbundled access to our local loops in September 2005 and since then have made available to its competitors, where technical and space conditions are available, all of our local switches, 191 of which are co-located. Co-location means providing space and technical facilities to competitors to the extent necessary to reasonably accommodate and connect the relevant equipment of the competitor. See *Regulation Portugal Unbundling of the Local Loop* and *Regulation Portugal Number Portability and Carrier Selection* .

Wholesale traffic is generated by the interconnection portion of our wholesale business, which decreased by 8.8% in 2005 compared with 2004. This decrease was primarily due to a decrease in Internet traffic, which was partially compensated for by increases in indirect access traffic. The following table sets forth the total amount of wholesale domestic traffic on our fixed line network during the period 2001 through 2005.

Wholesale Domestic Traffic

(millions of minutes)

	Year ended December 31,				
	2001	**2002**	**2003**	**2004**	**2005**
Mobile(1)	1,061	998	959	912	880
Internet	6,916	6,581	5,023	3,151	1,818
International(2)	1,343	1,420	1,318	1,413	1,581
Other(3)	2,336	2,831	3,008	3,753	4,139
Total	11,656	11,830	10,308	9,229	8,418

(1) Reflects mobile-to-fixed calls terminated on our fixed line network.

(2) Includes incoming international traffic (both fixed and mobile), outgoing international traffic from other operators using our network and transit traffic.

(3) Includes fixed-to-fixed calls terminated on our fixed line network, calls originated on our network through indirect access through other operators and other traffic.

International wholesale mobile traffic accounted for approximately 43% of the Portugal Telecom group s total outgoing international traffic and approximately 34% of total incoming international traffic in 2005. We estimate that, in 2004, these percentages were approximately 44% and 37%, respectively.

Leased Lines. We lease lines to other telecommunications providers for fixed, mobile and data communications services, including our other subsidiaries and competitors. Since 1996, we have been leasing lines to resellers who offer voice services to corporate networks and closed user groups. Leased line services involve making a permanent point-to-point connection with dedicated and transparent capacity between two geographically separate points. We offer a minimum set of leased lines (up to 2 Mbps) at the retail level to medium and large businesses, and we offer terminating segments and trunk segments at the wholesale level to telecommunications providers. Our Concession requires us to provide leased lines to third parties.

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The three current mobile telephone operators in Portugal, which include our subsidiary TMN, Vodafone Portugal and Optimus, are among our wireline business largest leased line customers. Our wireline business leases lines to TMN and TV Cabo on a basis that does not discriminate against other customers.

***Prices*.** The net prices and fees we receive from providing access to our fixed line network on a wholesale basis are less per minute than those we charge for domestic and international fixed line telephone services.

Domestic interconnection revenue per minute for calls terminated on our network declined by 10.1% in nominal terms in 2005 compared with 2004. International interconnection revenue per minute declined by 18.1% in nominal terms in 2005 compared with 2004. In accordance with EU and Portuguese regulations, our interconnection prices are based on our costs (which are audited by ANACOM) plus a margin.

Data and Corporate

We provide data and corporate services within our wireline business to top corporate and business customers that need complex telecommunications solutions, including:

- digital leased lines;
- broadband data and IP/MPLS Ethernet solutions;
- networking and systems integration solutions;
- Internet-related services and applications including Intranet and Extranet services;
- interactive systems and related applications;
- outsourcing of telecommunications application systems;
- consultancy services;
- Web design and site management;
- fixed line and mobile convergence services;
- business-to-business e-commerce;
- security and disaster recovery solutions;
- housing and hosting solutions, including application service provider, or ASP, and enterprise resource planning, or ERP; and

telephone services using Internet protocol.

We are the leading supplier of the full range of these services in Portugal. Data and corporate operating revenues contributed 244.9 million and 242.0 million to our wireline operating revenues in 2005 and 2004, respectively.

Services. We have developed a full range of telecommunications services for businesses, and we integrate these services (together with other services we offer, such as fixed line services and domestic mobile services) to provide our customers with service packages. By combining our communications capabilities with our software-based integrated systems and applications, we offer integrated voice, data and image solutions, virtual private networks, convergence solutions, consultancy and outsourcing. We believe we are the primary service provider in Portugal capable of offering customers a full range of integrated and customized services. Despite increasing competition, overall demand for data and corporate services has been increasing. As a result of competition, we have reduced our prices for leased lines and data services.

We offer services in partnership with leading operators and service providers such as Telefónica, British Telecom, Equant and Infonet. We use systems and networks in partnership with Siemens, Alcatel, Cisco Systems, Motorola, Nortel Networks and Matra/EADS Telecom.

We lease lines and broadband capacity to large businesses for data communications and other private uses and provide related services. We also provide integrated voice and data services to corporate customers. We offer X.25/X.32 synchronous services and X.28 asynchronous services and other switched and non-switched data communications services, such as frame relay, virtual private networks over IP for data communications, broadband services, security/firewall services and VSAT satellite communications services. In addition, we offer a new range of data, voice and Internet services, such as Intranet, Extranet and managed services, including VoIP. We use IP-based solutions to improve interconnections between companies and their employees and between customers and commercial partners through remote access. These solutions enable customers to integrate voice, video and data services in a flexible cost-effective manner with add-on capacity. The offering of web contact center solutions represents an evolution of the classic call center for customers.

We provide a range of broadband solutions to corporate customers. The type of solution depends on the type (voice, data or image), volume, priority level and stability of information flow required by our customers.

We also provide reporting services targeted to special customers to control service level agreements and the overall performance of the network.

In addition, we provide outsourced corporate network services for our customers. For example, we operate and manage the SIBS network, as well as the corporate networks of our strategic partners Caixa Geral de Depósitos, Banco Espírito Santo and CTT.

Networks. We provide services over the largest IP/MPLS backbone in Portugal, with PT Prime leasing the necessary fixed line capacity from PT Comunicações. We have points of presence in all major cities throughout Portugal, and we link our network to our customers premises through switches and access points that we own. This broadband data transmission network provides high capacity, flexibility and security and can progressively incorporate current voice and data infrastructures at lower costs than alternative networks. We also provide high speed Internet access through ADSL and xDSL. PT Prime supplies full IP and broadband connectivity for the entire PT group.

When we receive revenues from services offered through lines leased by PT Prime from PT Comunicações, we typically divide the revenues between PT Prime s own direct billings to its customers and leased line revenues from the wholesale business of PT Comunicações. Revenues from fixed line voice services for corporate customers are not reflected in PT Prime s revenues, as they are included in retail revenues.

Systems Integration. We offer an integrated range of telecommunications and information technology services to the business market. Our goal is to service all of our customers telecommunications needs and to leverage the traditional offering of products and services from our group.

We have a strong and competitive position in the development of information technology solutions where communications are an integral part of the services provided. To reinforce our position as a leader in this area, we are pursuing a partnership strategy with the primary information technology suppliers in the market, particularly software and hardware providers.

To support these new services and to respond to the increasing demand of e-business integrators, we developed Corporate Internet Data Centers in Lisbon and Oporto, and we are currently upgrading the Lisbon center. These facilities allow us to provide services, such as co-location, sophisticated web hosting, ISP services, data storage, disaster recovery and ASP services.

We also offer services focused on the integrated management of networks ranging from local area networks, or LANs, to software applications, including PC management.

Marketing and Customer Care. We focus significant resources on marketing and customer care. Account managers are given clear incentives to meet and exceed sales targets. We are upgrading our sophisticated customer relationship management platform to increase focus on market and Internet efficiency.

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We seek to compete in Portugal on the basis of the quality of our services as well as our position as the leading supplier of integrated telecommunications and IT services. We price our various service offerings on the basis of volume, the duration of service agreements and the scope of the services offered to each customer.

We offer our corporate customers services available from other companies in our group. Our subsidiary PT.com, for example, provides significant support for product development and the marketing of Internet and ADSL access.

Other Wireline Services

Other wireline services include primarily our directories business and sales of telecommunications equipment.

Directories. Operating revenues from our directories business amounted to 120.4 million in 2005 and 129.7 million in 2004. We subcontract to Páginas Amarelas (an associated company 25% owned by us) for the publication and distribution of telephone directories throughout Portugal in return for an annual payment of approximately 64% of its gross revenues from the sale of advertising space.

Sales of Telecommunications Equipment. Revenues from sales of telecommunications equipment amounted to 34.2 million in 2005 and 36.1 million in 2004, including the sale of handsets, modems and other telecommunications equipment.

Domestic Mobile Business

TMN, our Portuguese mobile operating company, is the leading provider of mobile voice, data and Internet services in Portugal in terms of the number of active mobile telephone cards connected to its network and by revenues, margins and profits.

TMN contributed 1,557.1 million and 1,606.3 million to our domestic mobile business operating revenues in 2005 and 2004, respectively.

The use of mobile services has grown considerably in Portugal in recent years. As of December 31, 2005, there were approximately 108.7 active mobile telephone cards per 100 Portuguese inhabitants. This was more than the number of wireline main lines per 100 Portuguese inhabitants as of December 31, 2005, which was 40%, according to ANACOM. The table below provides statistical information relating to TMN.

	As of December 31,				
	2001	**2002**	**2003**	**2004**	**2005**
TMN Portugal					
Number of subscribers (thousands)	3,905	4,426	4,887	5,053	5,312
Subscribers growth per annum (%)	33	13	10	3	5
Number of subscribers per 100 inhabitants (including competitors subscribers)	77.2	81.9	89.8	95	108.7
Estimated market share by number of subscribers (%)(1)	49.0	51.9	48.7	48.8	47.6
Churn rate (%)(2)	23.5	25.3	23.5	27.7	27.6
Number of employees	1,194	1,192	1,109	1,133	1,184

(1) Source: ANACOM and TMN.
(2) TMN defines the churn rate as the percentage of TMN mobile subscribers that end their use of TMN s mobile services either by terminating their service or by changing their mobile handset and card number without terminating their existing TMN service.

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Services. TMN provides mobile telephone services using the GSM and UMTS technologies. GSM and UMTS are European and worldwide standards using digital technology. Through roaming agreements, TMN s subscribers can use GSM and UMTS services to make and receive mobile calls throughout Europe and in many other countries around the world.

TMN provides GSM services in the 900 MHZ and 1800 MHZ band spectrums. TMN began to offer GSM 1800 services in 1998 in addition to the GSM 900 service it already offered. TMN s strategy has been to use GSM 1800 services to offer an increased number of channels in high traffic density areas without compromising the quality of the network. Dual-band handsets, which select available channels from either frequency band, enable users to benefit from the wider range of available channels.

In 2000, the Portuguese government opened a tender for licenses for UMTS services, and TMN received one of these licenses. Licenses were also awarded to Vodafone Portugal and Optimus. In 2004, TMN began providing UMTS services to its customers, with an emphasis on new services, such as video telephony and high-speed data. In 2004 and 2005, we have pursued a strategy of gradual improvements to network coverage, using existing GSM sites where possible in order to minimize the need to install costly new sites. At the end of 2005, TMN s UMTS population coverage was approximately 73%, and its geographic coverage was about 28%, or 1,300 municipalities out of a total of 4,600 in Portugal, including every municipality with over five thousand inhabitants.

In April 2006, TMN launched HSDPA (High Speed Downlink Packet Access), the first step in the evolution of mobile broadband UMTS services. This technology will evolve in the coming years, positioning mobile operators as competitors in the high speed internet services market.

TMN paid spectrum fees in 2004 and 2005 of 29 million and 27 million, respectively, for the use of its 900 MHZ and 1800 MHZ GSM network and its UMTS network. These spectrum fees are recorded as an operating expense under indirect taxes in our financial statements.

We expect the development of third generation services to require additional investments. TMN made direct investments of 50.8 million in 2004 and 77.1 million in 2005 in building out its third generation network and services. In 2005, the investments made by TMN in connection with UMTS represented more than 45% of its total capital expenditures in 2005.

During 2004 and 2005, TMN continued to introduce new products and services in Portugal, such as:

+Perto and Plano , two new packages of minutes targeted to postpaid customers;

Out Mail , access to the e-mail service in a continuous basis: anywhere at anytime;

Krava , a new service whereby prepaid and postpaid customers are allowed to make calls that will be paid by the receiver;

Mix , a new tariff plan for prepaid and postpaid customers using a single card;

Check in , a service to customers who mainly use international calls;

Visa card TMN , a credit card that offers to TMN s customers benefits and discounts in calls and equipment, such as handsets and other accessories;

Lost Calls Service , an automatic service that advises you which numbers tried to call you when your mobile phone is disconnected or is unavailable;

Videosharing , the first commercial video sharing service launched in Portugal, in partnership with Nokia;

TMN backup , a service that provides remote back-up of all personal content on a TMN customer s handset;

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Localizz , a new service of mobile localization for the corporate segment, which allows on-line visualization (through an Internet page) of all mobile phones of the company;

Giga access , connectivity to e-mail or internet in a mobile basis;

Music edition , a service that allows customers to share, hear and transfer music;

Walkman , the first service in Portugal that allows customers to keep up to 10 music CDs;

Euro 2004TMN I9 , the first prepaid access to a wide range of services and contents (May 2004);

third generation video call centers and videomail;

the installation of UMTS networks in every town where the European football championship took place (May 2004);

Travel Mate and City Guide , which are targeted at foreign users who visit Portugal (June 2004);

MMS Funny in partnership with Unisys, which allows customers to send pre-formed video multimedia messages and personalize them with the sender s voice; and

Wayfinder , a GPS based system.

Peer-to-peer, or P2P, messaging services via SMS or MMS continue to account for a significant portion of TMN s data revenues and are an area where TMN continues to experience significant growth, particularly through MMS, as MMS-enabled handsets are made available to a larger number of customers. In addition, TMN offers a wide range of other services in its data service portfolio, such as a multimedia mobile portal (I9-Inove) and a standard mobile portal (myTMN), multimedia content services (including Logos & Ring Tones or Java games), access to third-party branded content, connectivity to e-mail or the Internet via GPRS/UMTS, corporate solutions and mobile payment services. GPRS, or General Packet Radio Service, is a mobile data service standard for GSM handsets.

TMN s multimedia portal I9-Inove optimizes the current capabilities of GPRS/UMTS systems to provide customers with faster, easier access and a wider range of services and content, such as Java Games, mobile TV, messaging services, goals from the Portuguese football league in video, TV Cabo s programming guide and the Lusomundo cinema ticketing service, the first m-commerce service in Portugal. As of December 31, 2005, I9-Inove had reached approximately 1.1 million TMN customers. On the myTMN website (www.mytmn.pt), TMN customers can also access and buy a wide range of content (such as logos, ring tones and alerts), allowing personalization of their mobile phones.

In keeping with its emphasis on innovation, TMN has a strong focus on offering services that meet customers expectations. For example, TMN recently launched a service called tmn Backup , which provides remote backup of all personal content on a handset (such as contacts, SMS messages, photos, ring tones, games and other downloads) that would be lost if the handset were stolen or misplaced.

Another innovative service is the 12400 Video service, launched in 2004, which provides news and entertainment programs from the major Portuguese TV stations to customers through videocall. The 12400 Video is simple, practical and functional and is still the only such service in Portugal. To access the service, TMN s 3G clients need only make a videocall to the number 12400 and choose the content they wish from a simplified menu.

TMN s portfolio of services also includes Logos & Ring Tones (monophonic, polyphonic and true tones), Multimedia Messaging Services, or MMS (including the ability to send messages to other operators customers), Java Games and My Message 4u (a service that allows customers to personalize the welcome message or to send voice messages with music, dedications or jokes). A customer can also create his or her own MMS album, with holiday souvenirs, cards and similar items.

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TMN also offers a variety of Internet access and multimedia services, such as Wi-Fi, GPRS and UMTS Internet access and the ability to receive or send a fax over a mobile handset. These services are available to every TMN subscriber, including users of all prepaid services and corporate customers.

TMN offers data services specifically focused on the corporate segment, such as SMS and MMS Express and the POS Mobile service. SMS and MMS Express allows users to send messages to a mailing list in a quick, automatic and easy form. POS Mobile allows TMN corporate clients to use POS (point of sale) mobile equipment to receive debit or credit payments at any place with total security. TMN also launched Localliz, which is a location-based service that allows mobile management and localization of a company s resources (such as handsets, cars, machines and containers) through an Internet website.

TMN offers an m-payment service called Telemultibanco that allows the payment of utility bills by mobile phone.

Data service usage has grown considerably as customers have become increasingly familiar with TMN data services, service offerings have been expanded and access speed has increased through the introduction of UMTS. We are working to further increase data speeds to improve performance and the attractiveness of the TMN package of products, which we expect will result in a higher contribution of data services (beyond P2P messaging) to overall revenues in the future. One example of the potential growth is the recent launch of a Mobile TV that allows customers to access a package of 21 live channels.

In June 2005, TMN introduced a low-cost brand Uzo that targets low cost subscribers and uses TMN s GSM network. Uzo offers a very simple service to its customers with no obligatory recharges and one tariff for voice calls and SMSs to all networks of 16 cents per minute and 8 cents per message, respectively. However, if the customer recharges its card with 15 or more, he or she is allowed to speak and to send messages to all networks for 12 cents per minute and 6 cents per message, respectively, for a period of 30 days. Uzo focuses primarily on selling SIM cards and low-cost mobile phones to its customers. Uzo s products and services are offered through the Internet, Uzo s call centers (which are separate from TMN s call centers) and independent news stands and shops located throughout Portugal.

Subscribers and Traffic. TMN is the market leader in mobile services in Portugal. At December 31, 2005, TMN had approximately 5.3 million subscribers, representing an increase of 5.1% from December 31, 2004. At December 31, 2005, TMN s subscribers represented 47.6% of the total mobile subscribers in Portugal. During 2005, TMN s share of new mobile subscribers (net additions) was 23.8%, according to ANACOM. Over the course of 2005, TMN s churn rate, which means the percentage of TMN mobile subscribers that ended their use of TMN s mobile services either by terminating their service or by changing their mobile handset and card number without terminating their existing TMN service, was 27.6%. TMN s churn rate was 27.7% in 2004.

In addition to the increase in the number of subscribers, mobile usage grew during 2005. TMN s voice traffic in terms of minutes grew by 4.7% to 7,486 billion minutes in 2005, compared to 7,148 billion minutes in 2004. Average monthly usage per subscriber increased 0.5% to 121.6 minutes in 2005, compared to 121 minutes in 2004. In terms of traffic from data transmission services, SMS increased by 3.1% during 2005 and there was an average of 25.4 SMS messages per month per user in 2005, 1.0% less than the average of 25.7 SMS messages per month per user in 2004. This decrease in the average SMS messages per month per user occurred primarily as users increasingly used other data services instead of SMS messages. Traffic from WAP services supported by GPRS and UMTS networks increased by 105.9% in 2005.

Prices and Revenue Breakdown. We believe that mobile services in Portugal are priced lower than the European average and are among the lowest in Europe. Mobile telephone charges are not regulated. Traffic charges, sales of handsets and connection and subscription fees represented approximately 88.5%, 9.4% and 2.1%, respectively, of TMN s revenues in 2005, and approximately 88.3%, 9.5% and 2.2%, respectively, of TMN s revenues in 2004. Monthly subscription fees range from 8.26 (+Perto; Plano) to 40.91 (Extra), excluding VAT.

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However, fixed-to-mobile and mobile-to-mobile interconnection charges are regulated by ANACOM and have a significant impact on TMN s business. In February 2005, ANACOM declared all mobile operators to have significant market power in call termination in mobile networks market. ANACOM has accordingly imposed price controls on interconnection rates for the termination of calls on mobile networks. In 2005, interconnection rates (both fixed-to-mobile and mobile-to-mobile) were reduced by an average of 24% compared with 2004 rates. In 2006, we expect these rates to be further reduced by an average of 18.4% compared to the 2005 rates. These reductions have had, and are expected to continue to have, a significant impact on TMN s interconnection revenues and consequently its earnings.

Products and Marketing. TMN offers a variety of innovative products. It was the first operator in the world to offer pre-paid services, and its prepaid and discount products are popular. We estimate that at the end of 2005, approximately 82.3% of its subscribers were using TMN s prepaid products. In order to improve customer retention and segmentation, TMN redesigned its entire offer of prepaid pricing plans in 2004. TMN has been expanding its subscriber base through increased advertising and the use of its own distribution network. TMN has recently focused on encouraging the use of mobile services by young people through SMS incentive packages. TMN experienced a 12.4% increase in the number of postpaid subscribers in 2005 as a result of a promotional campaign aimed at stimulating a switch from prepaid to postpaid services and also as a result of continued marketing efforts directed at corporations and in the middle and high-end segment of the market.

TMN markets its services through more than 2,100 points of sale, including TMN s sales force, Portugal Telecom retail shops, TMN shops, supermarket chains and independent dealers.

Network and Capital Investment. In recent years, TMN has made significant investments in its second and third generation networks. As a result of its investments, TMN has a technologically advanced high capacity network that provides extensive coverage across Portugal. As of the end of 2005, TMN s digital network had 4,102 GSM base stations, including 138 base stations added during 2005, and 1,894 UMTS B nodes, including 1,035 B nodes added during 2005. As of December 31, 2005, these GSM base stations covered more than 95% of continental Portugal and 99% of the Portuguese population, and the UMTS B nodes covered approximately 28% of continental Portugal and 73% of the Portuguese population.

Since November 2005, TMN has been one of 18 operators in the world that are members of the Global Certification Forum, an industry group aimed at ensuring compatibility of mobile telecommunications systems.

Roaming. Roaming agreements between operators allow their subscribers to make and receive voice calls automatically, send and receive data, or access other services when traveling outside the geographical coverage area of the home network, by using a visited network. As of the end of 2005, TMN had entered into GSM roaming agreements with a total of 289 operators (in 209 countries or regions), 84 GPRS roaming agreements (in 60 countries or regions) and 32 3G roaming agreements (in 23 countries or regions).

Equipment Sales. TMN sells mobile phones and related equipment in Portugal. Equipment sales contributed 146.3 million and 153.3 million to TMN s operating revenues in 2005 and 2004, respectively.

Multimedia Business

We provide multimedia services in Portugal through our subsidiary PT Multimédia and its subsidiaries. PT Multimédia and its subsidiaries contributed 628.5 million and 598.8 million to our multimedia business operating revenues in 2005 and 2004.

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***Formation and Development*.** Portugal Telecom formed PT Multimédia in July 1999 and transferred to the new company certain of its cable and satellite pay-TV activities, as well as its Internet-related activities focused on residential customers and the small office home office and small- and medium-sized enterprise markets, including:

- our cable television pay-TV operations through cable and DTH satellite;
- cable and direct-to-home satellite programming activities;
- the provision of Internet access; and
- our minority stake in the leading Portuguese telephone directories business.

Since its initial public offering in November 1999, PT Multimédia s ordinary shares have been traded publicly in Portugal. During the course of 2002 and 2003, we acquired 2.43% and 1.08%, respectively, of PT Multimédia in the open market. As of December 31, 2005, and following the capital reduction after the share buyback program completed in May 2005, Portugal Telecom held 58.43% of PT Multimédia. Through equity swap contracts, as of December 31, 2005, we had access to an additional 9.89% of PT Multimédia s share capital.

In March 2000, PT Multimédia created PT Conteúdos to hold its interests in programming ventures, and PTM.com, to which it transferred its Internet-related assets.

In April 2000, PT Multimédia acquired 42.0% of Lusomundo, a leading media and entertainment company in Portugal, through a tender offer on the Euronext Lisbon Stock Exchange. On March 26, 2001, PT Multimédia acquired 57.9% of Lusomundo, after approval from the Portuguese competition authorities in January 2001, thereby increasing its ownership interest in Lusomundo to 99.9% of Lusomundo s share capital. Approval was given on condition that PT Multimédia ensure that content produced by and supplied to Lusomundo, in which it does not face significant present or future competition, be made available to third parties in accordance with normal market practice and the policy of transparency and non-discrimination that applies to other members of the Portugal Telecom group.

In October 2002, we entered into an agreement with PT Multimédia to acquire its 100% interest in PTM.com, its 24.75% interest in Páginas Amarelas and its 50% interest in Sportinveste Multimédia. These acquisitions took effect in September 2002 and were completed at an aggregate acquisition price of 199 million. In addition, we also acquired 401 million in shareholder loans that PT Multimédia had extended to PTM.com and Sportinveste Multimédia. This transaction reduced the net debt of PT Multimédia by 600 million to 139 million. Since October 2002, PT Multimédia has not consolidated the financial results of PTM.com, which are included in our wireline business. PTM.com was renamed PT.com in December 2004. See *Wireline Business Retail ASDL Services and ISPs* , above.

On February 28, 2005, PT Multimédia announced the disposal of its 100% interest in Lusomundo Serviços, SGPS, S.A., including an 80.91% shareholding in Lusomundo Media, through the execution of a promissory sale and purchase agreement with Controlinveste, SGPS, S.A. Through these companies, PT Multimedia previously ran a newspaper publishing and distribution business and a radio programming business. The sale was completed on August 25, 2005 after approval by the Portuguese Media Authority (Alta Autoridade para a Comunicação Social) and the Portuguese Competition Authority (Autoridade da Concorrência). The proceeds for PT Multimédia from the sale were 173.8 million, of which 10.1 million was paid to Portugal Telecom in connection with the acquisition of its 5.94% interest in Lusomundo Media, which was agreed prior to the closing of the transaction. The stake held by Portugal Telecom had been acquired from Fidelity Investments on October 16, 2003 for 9 million.

***Overview*.** PT Multimédia s segments consist of:

- cable and satellite television through TV Cabo;

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broadband Internet access through cable modem provided by TV Cabo;

TV programming activities through PT Conteúdos and its subsidiaries and affiliates;

cinema distribution, negotiation of cinema rights for all film exhibition windows and distribution of DVDs, videos, and videogames through Lusomundo Audiovisuais; and

cinema exhibition through Lusomundo Cinemas.

The diagram below shows PT Multimédia s major lines of business and the subsidiaries operating in each of those businesses as of December 31, 2005.

***TV Cabo*.** PT Multimédia provides cable television and direct-to-home satellite television services through TV Cabo, its wholly owned subsidiary, and TV Cabo s subsidiaries in Madeira and Azores. TV Cabo is also involved in advertising sales. In addition, it provides multimedia services, such as broadband cable Internet access and certain interactive digital television services.

Cable Television and Direct-to-Home Satellite Television Services. TV Cabo is the leading cable television operator in Portugal. At December 31, 2005, TV Cabo s cable network passed, or provided potential access to, approximately 2.66 million homes, representing approximately 73% of the total TV households in Portugal. At December 31, 2005, TV Cabo had approximately 1.09 million cable customers, an increase of 2.2% over the end of 2004. TV Cabo s cable television subscribers are charged an installation fee, a monthly subscription fee for programming packages and, for those with access to premium channels, an annual or monthly rental fee for set-top boxes.

In 2005, TV Cabo replaced its customer relationship management, billing and provisioning systems. In the migration to the new systems, not all customer accounts were transferred correctly. During 2005, we adjusted our database as necessary to correct these errors and did not consider revenues from certain subscribers that were incorrectly shown to have past due receivables. Also, inactive customers were removed from the reported database.

Since September 1998, TV Cabo has also distributed a direct-to-home, or DTH, satellite television service in Portugal. TV Cabo distributes its DTH satellite service using Hispasat Satellite broadcasting capabilities. TV Cabo s DTH satellite service is the only DTH digital multi-channel service specifically marketed in Portugal. TV Cabo s DTH satellite subscribers are charged an installation fee and a monthly subscription fee and are required either to purchase or rent from TV Cabo a satellite dish and a digital set-top box. TV Cabo s DTH satellite service is mainly targeted at people whose homes are not served by TV Cabo s cable television network.

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Because it offers cable and DTH satellite services, TV Cabo can distribute programming and advertising across Portugal. As of December 31, 2005, TV Cabo had approximately 1,479 thousand customers, of which 389 thousand were DTH satellite subscribers. At December 31, 2005, approximately 52.3% of TV Cabo s subscribers subscribed to its premium channels, for which it charges additional fees.

Programming Content. As of December 31, 2005, TV Cabo offered 65 channels in its extended basic package (of which 40 were included in its basic package) and nine premium channels to cable and DTH satellite subscribers in continental Portugal. Over half of the channels distributed by TV Cabo, including Lusomundo channels (Premium, Gallery, Action and Happy) and Sport TV, which is described below, consist principally of programming that is in Portuguese or that has been dubbed or subtitled in Portuguese. The rest of the channels are mainly in English, with some channels in other European languages such as Spanish, French and German.

TV Cabo launched a 60-channel extended basic digital package in the second quarter of 2005 called Funtastic Life. In October 2005, the extended basic package was further improved with the introduction of five new channels, bringing the number of channels to 65. This extended basic package includes 14 channels of exclusive TV Cabo content, including Sport TV 2, Fox channels, Nickelodeon, MTV and Discovery channels. In addition, in May 2005, PT Multimédia launched a premium cinema channel exclusively dedicated to comedy movies. This channel, Lusomundo Happy, fits into PT Multimédia s strategy of increasing Pay-TV service segmentation, thereby meeting the diverse needs of its client base.

Broadband Internet Service. As of December 31, 2005, TV Cabo had approximately 348,000 subscribers for its broadband Internet access product. In addition to its postpaid service, TV Cabo launched the first prepaid broadband product in Portugal in 2004 under the brand name Zzt . TV Cabo was also the first operator to offer 1Mbps downstream speed. In 2005, TV Cabo further improved its broadband Internet service by increasing downstream speeds fourfold without increasing the cost to the customer. In addition, TV Cabo increased customers download capacity within the basic broadband Internet access package in order to encourage customer loyalty.

Digitalization. Throughout 2005, PT Multimédia continued its efforts to digitalize its Pay TV services. Digitalization provides higher security levels in controlling illegal access to content (TV Cabo uses NAGRA s ALADIN conditional access system) and will allow PT Multimédia to make available to customers additional TV channels and services, such as VoD (video-on-demand), EPG (electronic programming guide), multi-game and multi-camera services, which add value to customers and create a competitive advantage. PT Multimédia aims to stimulate the migration of its clients from analog to digital services by offering a greater selection of content and services, as in the introduction of its Funtastic Life package in 2005. At December 31, 2005, PT Multimédia had over 500 thousand set-top boxes enabled for digital services.

Network. TV Cabo has made significant investments in the development of a hybrid fiber-coaxial broadband distribution network. TV Cabo s television signals are transmitted through fiber optic cables owned by our fixed line business under a service agreement regulated by ANACOM. In addition, TV Cabo has used PT Comunicações existing ducts, wherever possible, to build its network. The network has a bandwidth of 750 MHz and 860 MHz in certain areas, and is sufficient to permit gradual migration to digital signals. The current design of the network allows it to increase capacity without significant additional capital expenditure. TV Cabo has activated the two-way capacity of its bandwidth cable network reaching approximately 2.6 million homes, which at the end of 2005 represents 96% of homes passed by its network. We expect network expansions in 2006 and 2007 to allow increases of up to 500 thousand in homes passed by the TV Cabo network.

Marketing. TV Cabo is pursuing aggressive marketing campaigns. It is promoting its premium channels, and highlighting the high level of Portuguese-language content on its channels, the new Funtastic Life service and its broadband Internet access (NetCabo). TV Cabo markets its services through door-to-door selling, telemarketing and through Portugal Telecom shops, its own shops, supermarkets and other retail shops. We believe the alliance with SIC, Sport TV and other content producers has been contributing to the increased penetration of TV Cabo, as the agreement contemplates cross promotions between free and cable TV, and increased advertising initiatives.

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***PT Conteúdos*.** PT Multimédia created PT Conteúdos to manage the Portuguese-language audiovisual programming activities previously managed by TV Cabo. After restrictions on cable operators engaging in any programming business were lifted in 1997, TV Cabo formed two joint ventures to develop programming channels in Portugal (Sport TV and Premium TV) and launched SIC Notícias, as described above. These ventures were aggregated under PT Conteúdos, which is 100% owned by PT Multimédia.

Until June 2003, PT Conteúdos owned 54% of Premium TV, a partnership with Globo and SIC. In June 2003, PT Conteúdos acquired the remaining 46% of the share capital of Premium TV held by Globo and SIC, which produced two premium movie channels Telecine Premium and Telecine Gallery using the film libraries of Globo. Until May 2003, these channels were distributed via cable and satellite, through TV Cabo s platforms. In June 2003, PT Conteúdos replaced Telecine Premium and Telecine Gallery with two premium movie channels (Lusomundo Premium and Lusomundo Gallery), produced in-house using the film libraries of Lusomundo. PT Conteúdos launched Lusomundo Action in 2004 and Lusomundo Happy in 2005, as described above, and in December 2004, Premium TV was merged into PT Conteúdos and ceased to exist as a separate company.

PT Conteúdos also owns 50% of Sport TV Portugal, S.A., or Sport TV, a joint venture with Sportinveste, SGPS, S.A., a subsidiary of Olivedesportos, a Portuguese sports marketing firm. This joint venture produces Sport TV, a premium sports channel, which is distributed by Portuguese cable and satellite operators in exchange for a per-subscriber fee. Sport TV holds a license to distribute most league matches of Portugal s leading football league through 2008 and certain other European football leagues through 2006. Until November 2003, 33.33% of Sport TV was owned by each of PT Conteúdos, PPTV and Rádio Televisão Portuguesa, S.A., or RTP, the Portuguese state television operator. In November 2003, PT Multimédia entered into an agreement to purchase, through PT Conteúdos, an additional 16.67% stake in Sport TV from RTP for 16.3 million, thereby increasing its ownership in Sport TV to 50%. The remaining 50% is now held by PPTV. The purchase was completed in April 2004. The agreement guarantees Sport TV exclusive broadcasting rights to Portuguese football league matches from 2004 through 2008.

PT Conteúdos also holds PT Multimédia s 40% interest in Lisboa TV, the owner of SIC Notícias. See *TV Cabo* , above.

PT Conteúdos is engaged in the wholesale business for content. From 2002 onwards, this company has been responsible for negotiations with content producers of the acquisition of rights to carry pay TV channels and other content. It resells that content to different distribution platforms, including TV Cabo s pay TV and Internet platforms, as well as those of other operators.

PT Conteúdos sells advertising on some of the channels it distributes, where it has acquired the right to sell advertising as part of its content acquisition contracts. PT Conteúdos also manages the sale of advertising for TV Cabo s channels in exchange for an agency fee.

***Lusomundo Audiovisuais*.** Lusomundo Audiovisuais acquires rights for cinema, DVD, video, pay-per-view and television and also produces its own Pay TV premium movie channels and distributes DVDs and videos. Lusomundo Audiovisuais has the right to distribute the following audiovisual content in Portugal:

Theatrical Exhibition: UIP (Universal, Dreamworks and Paramount), BUENA Vista International (Touchstone, Walt Disney Pictures), Spyglass, Revolution Studios and other independent producers; and

Video: BVHE (Walt Disney), Paramount, Spyglass, Revolution Studios and other independent producers.

***Lusomundo Cinemas*.** Lusomundo Cinemas is the market leader in Portuguese cinema exhibition, with 178 screens. In July 2005, PT Multimédia sold its 33% stake in Warner Lusomundo Sogecable, a joint venture with Warner Bros. and Sogecable for cinema exhibition in Spain.

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As discussed above under Multimedia Business, PT Multimédia completed the disposal of its interest in Lusomundo Serviços in August 2005, following clearance from the Portuguese competition authority. As from that date, PT Multimedia ceased to operate in the newspapers and magazine publishing and distribution business and in the radio programming business.

Brazilian Mobile Business

We provide mobile telecommunications services in Brazil through Vivo Participações S.A., or Vivo, the leading mobile company in Brazil with a total of 29,805 million active mobile telephones at December 31, 2005. We hold 50% of Vivo, which is a joint venture with Telefónica Móviles, the Spanish mobile telecommunications company. The joint venture operates in 19 states in Brazil and in the Federal district of Brasília, which provide more than 83% of Brazil s GDP. In its areas of operation, Vivo had an estimated market share of approximately 44.4% at the end of 2005. We believe that the joint venture facilitates our ability to serve our Brazilian subscribers on a seamless basis throughout Brazil.

History and Organizational Structure. Until 2002, our mobile operations in Brazil, a country with a population of about 177 million people, had been active only in the states of São Paulo, Paraná and Santa Catarina. In January 2001, we entered into a strategic agreement with Telefónica Móviles to aggregate all of our combined mobile assets in Brazil to the extent permitted under Brazilian law. The strategic agreement was approved by the European Commission in March 2001. See *Regulation Brazil.* In December 2002, ANATEL formally approved the migration of our Brazilian mobile subsidiaries from the former Mobile Cellular Service (SMC) regime to the SMP regime and the transfer of all of our direct and indirect interests in Brazilian mobile services companies to the mobile joint venture company.

On December 27, 2002, PT Móveis, which holds our interests in Brazilian mobile services companies, and Telefónica Móviles transferred their direct and indirect interests in Brazilian mobile services companies to the joint venture company, named Brasilcel N.V. We and Telefónica Móviles transferred to this company all our and their interests in:

- TCP, which controlled Telesp Celular (the band A operator in the state of São Paulo) and Global Telecom (the band B operator in the states of Paraná and Santa Catarina) and was contributed by Portugal Telecom (which had a controlling position) and by Telefónica Móviles;

- Tele Sudeste Celular Participações S.A., or Tele Sudeste, which controlled Telerj Celular, S.A. (the band A operator in the state of Rio de Janeiro), or Telerj, and Telest Celular, S.A. (the band A operator in the state of Espírito Santo), or Telest, and was contributed by Telefónica Móviles;

- Tele Leste Celular Participações S.A., or Tele Leste, which controlled Telebahia Celular, S.A. (the band A operator in the state of Bahia), or Telebahia, and Telergipe Celular, S.A. (the band A operator in the state of Sergipe), or Telergipe, and was contributed by Telefónica Móviles; and

- Celular CRT Participações S.A., or Celular CRT Participações, which controlled Celular CRT, S.A., or Celular CRT (the band A operator in the state of Rio Grande de Sul), and was contributed by Telefónica Móviles (which had a controlling position) and by Portugal Telecom.

We have described the arrangements by which we and Telefónica Móviles own and manage the joint venture and related issues below in *Strategic Alliances Alliance with Telefónica* . We have described certain regulatory restrictions applicable to Vivo and its subsidiaries which result from their relationship with Telefónica, including the inability of Vivo and its subsidiaries to provide wireline long distance services in Brazil, below in *Regulation Brazil SMP Regulation* .

Before the transfer of these assets to the joint venture, TCP had acquired an 81.61% indirect economic interest in Global Telecom in 2001 through the acquisition of 49% of the voting shares and 100% of the non-voting shares of each of three holding companies that controlled Global Telecom. The total purchase price was R$902.6 million. On December 27, 2002, the same day as the transfer of the assets to the joint venture, TCP acquired the remaining 51% of the voting shares of the three holding companies that owned Global Telecom for US$82.0 million. TCP then owned 100% of the voting and non-voting shares of Global Telecom.

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Although we transferred all of our interests in mobile telecommunications companies in Brazil to Vivo on December 27, 2002, our consolidated statements of income and cash flows for the year ended December 31, 2002 continued to fully consolidate TCP s results. However, our balance sheet as of December 31, 2002 proportionally consolidates all the assets and liabilities of Vivo. Both our consolidated statements of income and cash flow for the years ended December 31, 2003, 2004 and 2005 and our balance sheet as of December 31, 2003, 2004 and 2005 proportionally consolidate the results of Vivo.

On April 25, 2003, TCP acquired 61.1% of the voting capital stock of TCO (a band A operator in the midwestern and northern regions of Brazil) from Fixcel, a Brazilian company, for R$1,529 million. As a result, TCO s assets and liabilities as of December 31, 2004 and 2005 are reflected in our consolidated balance sheets for these years through our proportional consolidation of Vivo, and TCO s income and cash flows for the years ended December 31, 2004 and 2005 are reflected in our consolidated statements of income and cash flows for the year ended December 31, 2004 and 2005 through our proportional consolidation of Vivo s statements of income and cash flows.

On November 18, 2003, TCP acquired an additional 25.5% of the common shares of TCO in a tender offer to TCO minority shareholders for R$538.8 million. Following the tender offer, TCP held 86.6% of the voting capital stock and 28.9% of the total capital stock of TCO, including treasury shares held by TCO.

In October 2004, TCP successfully completed a tender offer for additional shares of TCO, thereby increasing its economic interest in TCO to 50.6%, for total consideration of approximately R$902 million. Concurrently with this transaction, Avista, a holding company owned by Vivo, was created for the purpose of acquiring additional interests in Vivo s operating companies. On October 8, 2004, Avista completed a tender offer for additional shares of Tele Sudeste, Tele Leste and Celular CRT Participações. As a result of the successful completion of the tender offer, Vivo increased its interest in Tele Sudeste to 91.0%, in Tele Leste to 50.7% and in Celular CRT Participações to 67.4%, for a total of approximately R$607 million.

The diagram below presents, in a simplified way, the ownership structure of Vivo as of December 31, 2005:

Recent Corporate Reorganization. On February 22, 2006, the requisite percentages of the voting shareholders of the Vivo companies approved a corporate reorganization. The corporate reorganization consisted of a merger of shares under Brazilian law (*incorporação de ações*) of TCO with TCP and the merger of companies under Brazilian law (*incorporação de empresas*) of Tele Leste, Tele Sudeste and Celular CRT

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Participações with TCP. Pursuant to the mergers, holders of common shares, preferred shares and ADSs of TCO, Tele Leste, Tele Sudeste and Celular CRT Participações are entitled to receive:

- 3.0830 common shares, preferred shares or ADSs of TCP for each TCO common share, preferred share or ADS, respectively, they hold;
- 3.8998 common shares, preferred shares or ADSs of TCP for each Tele Leste common share, preferred share or ADS, respectively, they hold;
- 3.2879 common shares, preferred shares or ADSs of TCP for each Tele Sudeste common share, preferred share or ADS, respectively, they hold;
- 7.0294 common shares or preferred shares of TCP for each Celular CRT Participações common share or preferred share, respectively, they hold.

We refer to these mergers collectively as the Merger . In connection with the Merger, TCP was renamed Vivo Participações S.A. On March 31, 2006, common shares and preferred shares of Vivo began trading on the São Paulo Stock Exchange under the ticker symbols VIVO3 and VIVO4 , respectively, and ADSs of Vivo began trading on the New York Stock Exchange under the ticker symbol VIV .

Vivo undertook the Merger in order to align the interests of shareholders of the Vivo companies, to increase the liquidity of the securities held by those shareholders, to simplify the shareholding and organizational structure of the Vivo business and expand its shareholder base, and to take advantage of important synergies among the companies.

The diagram below presents the ownership structure of Vivo as of March 31, 2006:

As of March 31, 2006, Brasilcel held 89.03% of the common shares of Vivo Participações, 47.53% of its preferred shares and 62.40% of its total share capital.

***Regions*.** Vivo provides telecommunications services in Brazil through the following subsidiaries and in the regions described below:

- Telesp Celular provides mobile telecommunications services on the A Band frequency range in the State of São Paulo, covering approximately 248,209 square kilometers, representing approximately 2.9% of Brazil s territory. This area includes more than 40.7 million people, representing 22.0% of Brazil s population, and 63 municipalities with populations in excess of 100,000, including the City of São Paulo, Brazil s largest city, with more than ten million people.

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Global Telecom provides mobile telecommunications services on a frequency range known as B Band in its authorization area, which encompasses the states of Paraná and Santa Catarina. This area is composed of 294,661 square kilometers, representing approximately 3.5% of Brazil s territory, with a population of approximately 16.2 million people, representing 8.8% of Brazil s population, and 22 municipalities with populations in excess of 100,000 people.

Tele Sudeste provided, and following the Merger, TCP (renamed Vivo Participações S.A.) provides, mobile telecommunications services on the A Band frequency range in the states of Rio de Janeiro and Espirito Santo through its subsidiaries Telerj and Telest, over an area covering approximately 89,774 square kilometers, representing approximately 1.1% of Brazil s territory. This area is home to 18.9 million people, representing 10.2% of Brazil s population. Tele Sudeste covers 100% of the municipalities and 96.8% of the population in this area.

Tele Leste provided, and following the Merger, TCP (renamed Vivo Participações S.A.) provides, mobile telecommunications services on the A Band frequency range in the states of Bahia and Sergipe through its subsidiaries Telebahia and Telergipe. Tele Leste s area encompassed 16 metropolitan areas with populations in excess of 100,000 people, with 15.9 million people and representing 8.6% of Brazil s population. Tele Leste covers 33.1% of the municipalities and 70.3% of the population in this area, which is composed of 586,603 square kilometers, representing approximately 6.9% of Brazil s territory.

Celular CRT Participações provided, and, following the Merger, TCP (renamed Vivo Participações S.A.) provides, mobile telecommunications services on the A Band frequency range in the state of Rio Grande do Sul through its subsidiary Celular CRT. Celular CRT s area covers 281,749 square kilometers, representing approximately 3.3% of Brazil s territory and more than 10.9 million people, representing 5.6% of Brazil s population.

TCO provides mobile telecommunications services directly and through its subsidiaries in Brazil s Federal District and in 11 Brazilian states: Federal District, Acre, Goiás, Tocantins, Mato Grosso, Mato Grosso do Sul and Rondônia as a frequency range known as A Band and Pará, Amazonas, Amapá, Roraima and Maranhão on a frequency range known as B Band. TCO s authorization areas cover 5.8 million square kilometers and 33.8 million people, representing 68.0% of Brazil s territory and 18.4% of Brazil s population and 34 municipalities with populations in excess of 100,000 people.

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Operating and Other Data. The table below sets forth certain operating and other data for Vivo for 2003, 2004 and 2005.

	2003	2004	2005
Vivo Operating Data			
Cellular lines in service at year-end (in thousands)	20,656	26,543	29,805
Customer growth during year	3,847	5,887	3,262
Prepaid lines in service at year-end (in thousands)	15,817	21,357	24,061
Minutes of use (MOU)(1)	101	89	78
Average revenues per user (in Reais)(2)	39.5	32.8	28.7
Churn(3)	25.0%	22.4%	21.8%
Penetration at year-end(4)	28.2%	37.0%	46.6%
Estimated market share(5)	56.2%	50.9%	44.4%
Estimated market share of net additions(5)	43.0%	38.1%	21.8%
***Vivo Financial Data*(6)**			
TCP Consolidated:(7)			
Net operating revenues (in millions of Reais)	6,046.3	7,341.0	7,473.2
Net income (loss)(in millions of Reais)	(640.2)	(490.1)	(909.2)
Global Telecom:			
Net operating revenues (in millions of Reais)	669.0	801.5	820.7
Net income (in millions of Reais)	(436.0)	(180.3)	(270.7)
TCO:			
Net operating revenues (in millions of Reais)	1,958.9	2,210.4	2,771.5
Net Income (in millions of Reais)	463.4	507.1	339.1
Tele Sudeste:			
Net operating revenues (in millions of Reais)	1,892.5	1,927.0	2,078.0
Net income (in millions of Reais)	156.2	92.9	111.2
Tele Leste:			
Net operating revenues (in millions of Reais)	441.3	487.0	561.8
Net income (loss) (in millions of Reais)	(42.7)	(34.2)	(92.1)
Celular CRT Participações:			
Net operating revenue (in millions of Reais)	1,032.7	1,174.3	1,182.3
Net income (in millions of Reais)	189.4	182.0	129.3

(1) Monthly average, in minutes, of traffic per customer.
(2) Net revenues from services per month divided by the monthly average of customers.
(3) Churn is the number of customers that leave Vivo during the year, calculated as a percentage of the sum of the monthly average of customers.
(4) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
(5) Source: ANATEL.
(6) Data taken from the consolidated financial statements of each of the Vivo companies prepared under Brazilian GAAP.
(7) Reflects the full consolidation of Telesp Celular, Global Telecom and TCO for 2004 and 2005.

Services. Vivo provides mobile telecommunications services using both digital and analog technologies. Vivo s network provides both CDMA digital service and AMPS, or analog services, through Telesp Celular, Global Telecom, Tele Sudeste and Tele Leste. TCO and Celular CRT provide mobile telecommunications services using CDMA/TDMA digital technology and AMPS analog technology. All Vivo s services are provided in the 850 MHz frequency range.

Vivo offers voice service, ancillary services, including voicemail and voicemail notification, call forwarding, three-way calling, caller identification, short messaging, limitation on the number of used minutes,

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mobile chat room, and data services, such as WAP, through which clients can access WAP sites and portals. At December 31, 2005, approximately 57% of Vivo s total subscribers already had WAP-enabled handsets. Vivo offers high speed data services that (i) provide direct access to the Internet through either PCMCIA cards designed to connect compatible PDA s and laptops to 2.5G service or through 2.5G mobile phones by cable connection and (ii) offer corporate subscribers secure access to their intranet and office resources.

In 2004, Vivo launched innovative services, such as locating services, virtual games and videostreaming. Vivo also made initial investments toward the development, and launch in Curitiba, of EV-DO, making it possible to offer third generation extra-high speed services featuring data transmission speeds of up to 2.4 Mbps. At the end of 2005, EV-DO was available in São Paulo, Rio de Janeiro, Salvador, Brasília, Curitiba, Porto Alegre, Campinas, Niterói, Florianópolis, Vitória and other major cities.

Vivo offers roaming services through agreements with local mobile service providers throughout Brazil and other countries that allow its subscribers to make and receive calls while out of its concession areas. Vivo also provides reciprocal roaming services to subscribers of those mobile service providers while they are in its concession areas. See *Roaming* .

Subscribers and Traffic. At the end of 2005, there were approximately 86.2 million wireless subscribers in Brazil, and there was an estimated total market penetration rate of approximately 46.6% in Brazil as a whole, according to information published by ANATEL. In 2005, the Brazilian market experienced a 31.4% increase in the number of wireless subscribers and a 28.6% increase in those areas where Vivo operates. The greatest increase in subscribers was in the Brazilian states of São Paulo, Rio de Janeiro, Rio Grande do Sul and the Cento Oeste region. As of December 31, 2005, Vivo had approximately 29.8 million wireless subscribers, with an estimated market share of 44.4% in its areas of operation and 34.6% in Brazil.

The subscriber growth in Vivo s operating companies was also supported by the launch of new products and services, including prepaid products and new messaging services, the growth of the digital capacity of the network, the improvement in CRM systems, marketing campaigns and promotions, and the restructuring and expansion of sales networks.

Marketing. Vivo closely follows developments in the markets where it operates and often launches new segment-specific promotions through direct marketing, including mailing and telemarketing campaigns, as well as promotions to its competitors major customers. Efforts to acquire new customers for the pre-paid and post-paid services were mostly made through voice and data services promotions designed to increase on-net traffic and stimulate the use of data services. With the simultaneous goal of maintaining its existing customer base, Vivo s promotions were also open to existing customers who wanted to change their mobile handsets. Vivo s operators were actively involved in a high-value customer loyalty program, offering competitive discounts on mobile phones through direct marketing actions.

Customer Service. As part of its strategy to standardize customer service provided by Vivo s operators, Vivo has outsourced 100% of its customer service while maintaining full management control. Customer service is available on a 24-hour basis from Vivo s call centers and through its website. Customer satisfaction is evaluated regularly, and Vivo often conducts surveys across Brazil to gather opinions about customer assistance, technical assistance, products and services.

Vivo has trained or qualified staff to assist and provide explanations to customers in connection with any requests or doubts they may have concerning services provided. Vivo attempts to respond to all customer requests.

Vivo s operating companies were ranked first for the third time in 2005 in a nationwide survey conducted by the IBRC (Brazilian Institute of Customer Relations) entitled Companies that Most Respect Consumers , the results of which were published in the Consumidor Moderno (Modern Consumer) magazine.

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Network and Capital Expenditures. Vivo s networks are connected primarily through fiber-optic transmission systems leased from incumbent wireline operators in the areas in which it operates, consisting of mobile switches, base stations and other network elements, such as voicemail, prepaid service, Short Message Service, Home Location Registers, Signaling Transfer Point, PDSN and gateways. Vivo s main suppliers are NEC do Brasil S.A., Nortel Networks, Motorola do Brasil Ltda., Lucent Technologies do Brasil, Ind. e Com. Ltda. and Ericsson Telecomunicações S.A.

Vivo s operating subsidiaries networks use analog and digital technology, and Vivo has undertaken investments and promotional activities to encourage migration of customers from analog to digital service. Digitalization offers certain advantages, such as greater network capacity and additional revenue through the sale of value-added services. Digital mobile telecommunications service also reduces the risk of fraud. Vivo continues to increase network capacity and coverage to improve the quality of service and to meet customer demand. In January 2005, Vivo entered into contracts with certain other operating companies to allow authentication of calls made while roaming in order to improve controls on improper use of the network.

At December 31, 2005, Telesp Celular s telecommunications network, which provides both CDMA digital and AMPS analog services, covered 100% of the municipalities in the state of São Paulo.

Global Telecom only offers services through CDMA digital technology. At December 31, 2005, Global Telecom s telecommunications network covered 59.0% of the municipalities, or 92.3% of the population, in its authorization areas.

At December 31, 2005, Tele Sudeste s telecommunications network, which provides CDMA digital and AMPS analog services, covered 100% of the municipalities in its authorization areas.

At December 31, 2005, Tele Leste s telecommunications network, which provides CDMA digital and AMPS analog services, covered 33.1% of the municipalities, or 70.3% of the population, in its authorization areas.

At December 31, 2005, Celular CRT s telecommunications network, which provides CDMA digital, TDMA digital and AMPS analog services, covered 69.9% of the municipalities, or 95.9% of the population, in its authorization areas. In 2004 and 2005, Celular CRT undertook an overlay of its older TDMA network with a more advanced CDMA network.

At December 31, 2005, TCO s telecommunications network, which provides CDMA digital, TDMA digital and AMPS analog services, covered 44.7% of the municipalities, or 80.4% of the population, in its authorization areas. In 2005, TCO undertook an overlay of its TDMA network with a CDMA network.

Vivo s advanced network management technology increasingly ensures global management and supervision of all its network processes and network performance. The network management centers are located in São Paulo, Brasília, Rio de Janeiro, Salvador and Porto Alegre. The São Paulo network management center monitors the critical network operational parameters of Telesp Celular and Global Telecom. The Brasília network management center monitors such parameters for TCO, as does the Rio de Janeiro center for Tele Sudeste, the Salvador center for Tele Leste and the Porto Alegre center for Celular CRT. These centers are able to identify abnormalities in Vivo s networks and in third-party networks, using the failure and signal monitoring systems. In addition, quality and service standards are constantly monitored. The network management centers are integrated with the maintenance and operations teams that maintain and operate the mobile networks, and with the mobile infrastructure and transmission teams, radio network elements, computing bases, service platforms and communications backbone. Vivo s network is prepared to provide continuity of service for its customers in the event of network interruptions. Vivo has developed contingency plans relating to catastrophes in its switching centers, power supply interruptions and security breaches. In 2004, Vivo created a data process unit and initiated the consolidation of IT platforms, which are helping to improve efficiency and economies of scales across the company. Similar additional projects were implemented in 2005.

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Vivo s capital expenditures over the past three years related primarily to increasing network capacity and coverage. During the year ended December 31, 2005, Vivo s capital expenditures totaled R$2,222.2 million and were mainly related to projects for the improvement and expansion of Vivo s service capacity, the selective implementation of the 1xRTT network, which was overlaid on TCO s and Celular CRT s TDMA networks, the upgrading of Tele Sudeste s, Tele Leste s and Global Telecom s networks to 1xRTT, the offering of new services, the development of a backbone and systems integration at Vivo, and on various consulting projects. Capital expenditures represented 19.7% of Vivo s operating revenues in 2005 as compared to 17.6% in 2004. Vivo s capital expenditures for 2004 and 2003 were R$1,924 million and R$1,147 million, respectively.

Interconnection Charges. With the introduction of personal mobile services through the SMP licensing regime in Brazil, Vivo s operators began working as local operators. This means that each operator is responsible for the traffic originated in its authorization area. Calls placed between authorization areas must use a long distance carrier. As a result, for every call in Vivo s authorization areas, Vivo receives a fee for the use of its network in respect of calls originated on its network. For long distance calls terminated on Vivo s network, Vivo receives a fee from the respective long distance carrier for the use of Vivo s network, regardless of the network that originated the call. For long distance calls between authorization areas originated on Vivo s network, Vivo also receives a fee from the long distance carrier for the use of its network for call origination. Vivo earns revenues from any local call that originates from another mobile or fixed-line service provider s network and connects to one of Vivo s customers. Vivo charges the service provider from whose network the call originates a network usage charge for every minute that Vivo s network is used in connection with the call. See *Regulation Brazil* .

In 2003, Anatel adopted Bill & Keep rules for interconnection charges for traffic between the networks of SMP operators. Under these rules, an SMP mobile operator pays for the use of another SMP mobile operator s network in the same authorization area only if the traffic carried from the first operator to the second exceeds 55% of the total traffic exchanged between them (known as a partial Bill & Keep regime). In that case, only those calls that have surpassed the 55% level will be subject to payment for network usage. In 2005, this regulatory regime contributed to a decrease in Vivo s revenues from interconnection fees charged to other companies.

ANATEL has proposed to replace this partial Bill & Keep regime with a model based on the costs of mobile operators. ANATEL has proposed to implement this new model in mid-2007. This model may, among other things, substitute a different inflation adjustment mechanism, the IST index (Índice de Serviços de Telecomunicações), which may or may not reflect the true effect of inflation on Vivo s prices. However, we cannot predict whether the current regime will remain in place or whether any future regulatory change could have an adverse effect on our operations. While ANATEL analyzes regulatory alternatives, it has maintained the partial Bill & Keep regime, extending these rules through Resolution No. 408, promulgated in 2005. See *Item 3 Key Information Risk Factors The Conditions Applying to Vivo s Subsidiaries Under the SMP Licensing Regime May Result in Reducing Our Revenues and Results of Operations.*

In 2005, ANATEL approved provisional agreements among the local fixed line and mobile operators to determine the interconnection fees for local calls (known as VC1 calls). These agreements provide for a 4.5% annual adjustment of interconnection fees for these calls. In March 2006, ANATEL approved a provisional agreement for interconnection fees for VC2 and VC3 long distance calls, which also provides for a 4.5% annual adjustment to interconnection fees. The annual adjustments under these agreements may not be sufficient to cover Vivo s costs and preserve its margins from interconnections with Vivo s network. In particular, because a significant number of mobile subscribers use prepaid mobile services and generally receive more calls than they make, Vivo s subsidiaries derive an important part of their revenues from the interconnection fees paid to them by the wireline operators for traffic originating on wireline networks and terminating on the subsidiaries mobile networks. In addition, if ANATEL may substitute its proposed cost-based model for this regime in 2007 or at some other time. If the cost-based model were to result in lower annual adjustments to interconnection fees than under the provisional agreements reached in 2005 described above, our revenues and results of operations could be adversely affected.

Roaming**.** Vivo has agreements providing for automatic roaming with all mobile service providers in Brazil and with some wireless service operators abroad. These contracts allow its subscribers to access the network of other mobile service providers when traveling outside its coverage area without having to change their handsets or mobile numbers. Vivo provides reciprocal services to subscribers of other mobile service providers when they are within its coverage area. The agreements require the contracting parties to provide service to roaming subscribers on the same basis as they provide service to their own subscribers. Roaming charges are reconciled monthly.

Vivo offers automatic international roaming in Argentina, Uruguay, Chile, the Dominican Republic and South Korea and through third-party partners in the United States, Mexico, Canada and Japan. Vivo also provides international GSM services through the use of GSM handsets in most parts of Europe, Africa, Asia and Oceania.

In 2005, Vivo launched Globomoto, a handset that operates on both the CDMA and GSM systems. Vivo thus became the first Brazilian operator to offer a cell phone with automatic international roaming in over 170 countries.

License**.** Under the SMP regime, Vivo converted its former concessions to SMP licenses. These SMP licenses have substantially the same terms and conditions as the other SMP licenses issued under the SMP regime, although some of the terms of Vivo s former concessions, such as limits on prices charged to subscribers under its postpaid service plan (the Basic Plan), continue to apply despite conversion to SMP licenses. Conversion to SMP licenses offers Vivo greater flexibility in setting its prices, particularly its interconnection fees. See *Regulation Brazil SMP Regulation* .

By converting its concessions to SMP licenses, Vivo was required to introduce carrier selection on its network to give its subscribers the choice to use another carrier for long distance and international calls. The introduction of carrier selection increased the competitive pressures on Vivo s business. In addition, because the SMP regime permits commercial negotiation of the interconnection rates it charges to wireline operators, Vivo may be forced to reduce these rates in the future. Vivo s SMP licenses expire on the same dates as the concessions were to have expired. Vivo has the same right to apply for renewal as other SMP license holders that migrate to the SMP regime from their existing concessions.

Equipment Sales**.** Although Vivo still has a small number of subscribers using analog service, it has implemented a series of actions, such as providing discounts on digital handsets, discounts on monthly fees for digital services, digital handset rentals and free digital handsets to its high-value subscribers, to encourage remaining analog subscribers to migrate to digital service. Vivo s net revenues from sales of handsets and accessories were R$1.6 billion in 2005, R$2.3 billion in 2004 and R$1.9 billion in 2003.

Management**.** In accordance with the shareholders agreement between Portugal Telecom and Telefónica, Portugal Telecom is responsible for the appointment of Vivo s chief executive officer and Telefónica is responsible for the appointment of Vivo s chief financial officer. As of December 31, 2005, TCP, TCO, Tele Leste, Tele Sudeste and Celular CRT each had nine members on their Boards of Directors, of which three members were independent and the other six members were nominated by the majority shareholders. Following the Merger in February 2006, Vivo Participações S.A. (formerly TCP) continues to be managed by a Board of Directors and a Board of Executive Officers. Vivo s shareholders elect the members of the board of directors. The Board of Directors must have between three and twelve members, each serving a three-year term. The Board of Vivo Participações S.A. continues to consist of nine members, and the terms of the current members of the Board will expire in April 2009, except the term of Antonio Gonçalves de Oliveira, representative of minority shareholders, which will expire in April 2007. The board of directors holds regular quarterly meetings, and the chairman or two board members may call special meetings.

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International Investments

In 2004, we created Portugal Telecom Investimentos Internacionais Consultoria Internacional, S.A., or PT II, to manage all of our international businesses other than our investment in Vivo described above.

Investments in Brazil

We have certain additional investments in Brazil, in addition to our investment in Vivo described above, including, most significantly, Mobitel, a call center company, and UOL, a leading Internet Service Provider. During 2005, we sold our participation in Primesys, a provider of telecommunications business solutions to large corporate clients.

Mobitel. Mobitel provides call center services in Brazil primarily to Vivo s subsidiaries, which represent 85% of its client base. Mobitel s gross operating revenues were R$255 million in 2005 (84 million) and R$165 million in 2004 (45 million). At the end of 2005, our participation in Mobitel was 95.7%.

UOL. UOL is a leading Internet Service Provider in Brazil. In December 2005, we sold a 16% stake in UOL in its initial public offering in Brazil and received net proceeds of R$201.0 million. At the end of 2005, our participation in UOL was 29%.

Investments in Africa

We have certain investments in Africa, including most significantly, our investment in Cabo Verde Telecom, a global telecommunications operator in the Cabo Verde Islands, and in certain other mobile operators in Morocco and Angola.

Cabo Verde Telecom. We own 40% of the share capital of Cabo Verde Telecom. Cabo Verde Telecom provides fixed, mobile and data services in the Cabo Verde Islands, a Portuguese-speaking country off the coast of West Africa.

At December 31, 2005, Cabo Verde Telecom had 71 thousand fixed lines in service, which represents approximately 17 fixed main lines per 100 inhabitants. Cabo Verde Telecom had 82 thousand active mobile telephone cards at December 31, 2005 (approximately 20 active mobile telephone cards per 100 inhabitants), of which 99.4% were prepaid customers. At December 31, 2005, Cabo Verde Telecom reached 5,600 active Internet users.

Cabo Verde Telecom s total gross operating revenues were 55.3 million in 2005, 51.5 million in 2004 and 52.8 million in 2003.

Medi Telecom in Morocco. In August 1999, Medi Telecom, a consortium made up of Portugal Telecom, Telefónica Móviles and certain Moroccan entities, bid for and won a license to operate a GSM mobile network in Morocco. This was the second such license issued by the Moroccan government. The license fee was 9.0 billion Moroccan dhirams (929 million). Medi Telecom entered into a 1 billion project financing facility. We initially held 34.5% of Medi Telecom, having invested approximately 166 million, but in January 2000 we sold 4% of our interest in compliance with a condition of the bid process for the same license. At the end of 2002, following a capital increase, Portugal Telecom raised its equity share to 31.34%, equal to Telefónica s position. During the fourth quarter of 2003, following another share capital increase, Portugal Telecom raised its equity share to 32.18%. At the end of 2005, Medi decreased its share capital from 8.834 million Dirhams (803.0 million) to 4.683 million Dirhams (425.0 million) in order to fulfill required capital ratios in Morocco. Portugal Telecom s share of Medi Telecom s capital remained the same (32.18%).

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Medi Telecom began operations at the end of March 2000. By the end of 2005, it had 4,034 thousand subscribers, which corresponds to an estimated market share of approximately 33.4%. Approximately 96.0% of its active mobile telephone cards are prepaid. We manage the operations of Medi Telecom jointly with Telefónica Móviles.

Medi Telecom s total gross operating revenues were 4,316 million Dirhams (392.0 million) in 2005 and 3,590 million Dirhams (325.8 million) in 2004.

Unitel in Angola. At the end of 2000, we acquired 25% of the share capital of Unitel, a GSM mobile operator in Angola. Unitel s other shareholders are Sonangol, which holds 25%, and other local partners, which hold the remaining 50%. We are the operational manager of the venture, which began operations in Luanda in April 2001. As of December 31, 2005, Unitel had 1,198 thousand subscribers of which 99.8% were prepaid cards.

Unitel s total gross operating revenues were US$445 million in 2005 and US$245 million in 2004.

Cellco in the Democratic Republic of the Congo. In 2005, Portugal Telecom acquired a controlling stake in Cellco Cellulaire du Congo, in the Democratic Republic of the Congo. Cellco has a GSM 900/1800 mobile license and expects to launch its commercial activity during 2006. Cellco s other shareholders are the Congolese fixed incumbent OCPT and other Congolese investors.

Investments in Asia

We have certain investments in Asia, including, most significantly, our investment in CTM.

CTM. We have a 28% interest in Companhia de Telecomunicações de Macau, or CTM, the exclusive provider of fixed line services and a provider of mobile telephone services in Macau. Macau, an enclave situated near Hong Kong on the coast of the Guangzhou Province, China, was a territory administered by the Portuguese government until December 1999 when its administration was transferred to the People s Republic of China. The other shareholders of CTM are Cable & Wireless plc and CITIC Pacific.

At December 31, 2005, CTM had 174 thousand fixed main lines in service. This figure represents approximately 39 fixed main lines per 100 inhabitants. CTM s mobile telephone services are growing rapidly, with 243 thousand active mobile telephone cards at December 31, 2005 and 54 active mobile telephone cards per 100 inhabitants. CTM uses GSM digital mobile technology. In December 1999, CTM entered into a new concession that will be valid until the end of December 2011.

CTM s total gross operating revenues were 1,895 million Patacas (190.0 million) in 2005 and 1,667 million Patacas (167.1 million) in 2004.

Instrumental Companies

PT SI. PT SI is the group unit responsible for data centers, information systems and information technology activities of our business units in Portugal. PT SI provides integrated information systems and information technology services to our business units in Portugal, as well as to our existing and new customers. We hold 100% of the share capital of PT SI, having acquired the remaining 5% held by IBM in 2003. In recent years, PT SI has subcontracted certain information technology services to DCSI-Dados, Computadores e Soluções Informáticas, or DCSI, an information technology company controlled by IBM. In March 2006, we signed a contract with IBM to purchase DCSI.

PT Inovação. PT Inovação is the group unit responsible for research and development activities. Our research and development programs focus on intelligent networks, network management systems, advanced services and systems and network integration. Our research and development activities have been responsible for the introduction of innovative products and services and for the development of in-house technology. These activities have allowed our employees to remain up-to-date in terms of technology and technological development in the telecommunications sector on both a European and a worldwide level. PT Inovação s activities have been a driving force behind the development of new products and services, telecommunications infrastructure and information systems.

PT Contact. PT Contact is the group unit responsible for call center operations in Portugal. PT Contact takes advantage of economies of scale and process alignments to reduce costs in our call center operations.

PT PRO. In February 2003, we created PT PRO to aggregate all our back-office activities in Portugal. PT PRO takes advantage of economies of scale and process alignments throughout our group to reduce costs in back-office activities. The creation of PT PRO has also allowed for a reduction of the execution risk of our financial reporting function through standardization of processes and application of best practices.

PT Compras. In May 2003, we created PT Compras and we transferred our newly created central purchasing unit to this company. PT Compras is optimizing our purchasing function on an integrated basis. Taking advantage of scale and specialization, PT Compras is increasing pressure in reducing suppliers prices and improving the levels of quality and service.

For a list of Portugal Telecom s significant subsidiaries, see Exhibit 8.1 to this Annual Report of Form 20-F, which exhibit is incorporated herein by reference. For further details on our percentage interest in our subsidiaries and their business activities, see Exhibit I.1. to our audited consolidated financial statements.

Strategic Alliances

We have summarized below our principal existing and planned alliances and joint ventures.

Alliance with Telefónica. In 1997, we entered into a cooperation agreement with Telefónica. This agreement focused principally on cooperation in international investments, particularly in Latin America. In 1998 we acquired interests, together with Telefónica, in Brazil. In 1999 we commenced operations with Telefónica in Morocco. See *International Investments Investments in Africa Medi Telecom in Morocco* .

On January 23, 2001, we entered into a strategic agreement with Telefónica to create a mobile joint venture company that would aggregate all our Brazilian mobile assets with the Brazilian assets of Telefónica Móviles, the mobile subsidiary of Telefónica, to the extent permitted under Brazilian law. On December 27, 2002, we and Telefónica transferred all of our respective interests in Brazilian mobile services companies to the joint venture, named Brasilcel and operating under the brand name Vivo since April 2003, with its head office in the Netherlands. We hold our interest in Brasilcel through PT Móveis, and Telefónica holds its interest through Telefónica Móviles. Our agreements governing the ownership and management of Brasilcel have been entered into by those entities.

Brasilcel is managed by a Managing Board of four members and a Supervisory Board of 12 members. We and Telefónica each appoint two members of the Managing Board and six members of the Supervisory Board, and in each case the Chairman is appointed by Telefónica and the Vice Chairman is appointed by us. The Managing Board acts by unanimous decision so long as each party holds at least a 40% interest in Brasilcel, and for certain important decisions, the Managing Board requires the approval of the Supervisory Board. The Supervisory Board acts by majority vote, except that generally so long as each party holds at least a 40% interest in Brasilcel and for six months following the dilution of a party s interest below 40% due to a capital increase, at least one member of the Supervisory Board appointed by each party must approve any action by the Supervisory Board.

In the event that either our or Telefónica s interest is diluted below 50%, but not lower than 40%, due to a capital increase, the diluted party can re-build its interest to 50% within 12 months from the date of dilution. During such period, Brasilcel would be managed on an equal basis. We or Telefónica can maintain our share ownership percentage by contributing with cash or liquid assets. Should the percentage of the share capital in Brasilcel that we or Telefónica holds fall below 40% and remain below 40% for six consecutive months thereafter, our respective numbers of directors on the board will be changed to reflect our proportional shareholdings and the diluted shareholder will lose its right to appoint the CEO or CFO of Brasilcel s subsidiaries, as applicable, as described below.

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If a deadlock over an important issue in the decision-making of Brasilcel cannot be resolved by the chairmen and CEOs of us and Telefónica, then the issue will be settled by reference to a committee of third party wise persons .

Potential acquisitions of wireless and mobile telephone operators in Brazil may be pursued by Brasilcel or by us or Telefónica and subsequently contributed to Brasilcel. New acquisitions by Brasilcel require the approval of a majority of the board of directors of Brasilcel. If either we or Telefónica acquire a mobile operator in Brazil, the acquiring party must offer the right to a 50% participation in the acquisition to the other party.

Under the agreement, we select the CEO of each subsidiary of Brasilcel, including Vivo Participações S.A. (formerly known as TCP), and Telefónica selects the CFO. So long as the board of directors of any subsidiary of Brasilcel consists of nine members (as is the case with Vivo Participações S.A.), we and Telefónica will each nominate three members to the board of directors. We and Telefónica have agreed to coordinate our votes for meetings of the boards of directors of Brasilcel s subsidiaries at the level of Brasilcel.

In the event of a change of control of either us or Telefónica, the unaffected party shall have the right to sell the shares that it owns in Brasilcel to the affected party at a value determined pursuant to an independent appraisal. A change of control occurs if 15% or more of the voting rights of Portugal Telecom or Telefónica S.A. are acquired by another telecom operator not acting in concert with the other party, if a corporate transaction is affected by virtue of which the voting share capital of Portugal Telecom or Telefónica S.A. is at least doubled and there is a change in the majority of the board of directors of that party or, in the case of any entity or affiliate of the Portugal Telecom or Telefónica group that holds an interest in Brasilcel (other than Portugal Telecom and Telefónica S.A.), if the majority of the voting rights of that entity or affiliate is transferred to another telecom operator and there is a change in the majority of its board of directors. In addition, if we are diluted to below a 40% interest in Brasilcel and fail to increase our interest to 40% within a six-month period, we will have the right to sell our interest in Brasilcel to Telefónica within one year from the expiration of the applicable six-month period at a price to be determined by a third party.

If either party wishes or is required to transfer all or part of its equity interest in Brasilcel to a third party, the non-transferring party will have a right of first refusal to purchase the equity interest or, alternatively, a tag-along right to sell its equity interest under specified conditions.

As part of our initial agreement with Telefónica, we acquired 1.0% of Telefónica s share capital and Telefónica acquired 3.5% of our share capital. We and Telefónica also gave each other a right of first refusal on any transfer of our respective interests. In addition, a member of our board who is an executive officer is serving on Telefónica s board as a non-executive director, and a member of Telefónica s board who is an executive officer is serving on our board as a non-executive director. Under the terms of our strategic agreement with Telefónica, we may acquire up to 1.5% of Telefónica s share capital, and Telefónica may increase its ownership interest in our share capital up to 10%. As of December 31, 2005, Telefónica increased its interest in our share capital to 9.96%. As of December 31, 2005, neither party controls the operations or management of the other.

Alliance with Banco Espírito Santo and Caixa Geral de Depósitos. In April 2000, we signed a strategic partnership agreement with the Banco Espírito Santo group, or BES, and Caixa Geral de Depósitos, or Caixa, to develop new economy initiatives. Pursuant to this agreement, BES increased its stake in Portugal Telecom to 6% of Portugal Telecom s share capital, and in August 2000 we acquired a stake in BES of 3% of its share capital. As of December 31, 2005, BES owned 8.36% of Portugal Telecom s share capital. In accordance with this arrangement, an executive officer of BES serves as a non-executive member of Portugal Telecom s board of directors. An executive member of Portugal Telecom s board of directors also serves as a non-executive member of the board of directors of BES.

Under this strategic partnership agreement, we launched various initiatives in business-to-consumer and business-to-business e-commerce and new mobile service areas in business-to consumer and e-finance, business-to-business and M-commerce and payment services.

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Properties

Our principal properties consist of buildings and telecommunications installations. These include various sizes of exchanges, transmission equipment, cable networks, base stations for mobile networks and equipment for radio communications. They are located throughout Portugal and internationally.

We own several office buildings in Portugal. Our main proprietary office space is located at the following addresses:

R. General Humberto Delgado, 342/368, Coimbra, Portugal (13,321 square meters);

Largo do Carmo, Faro, Portugal (11,452 square meters);

R. Andrade Corvo, 10/14, Lisboa, Portugal (10,300 square meters);

R. Postiguinho Valadares, 12, Castelo Branco, Portugal (9,464 square meters);

Av. Carvalho Araújo, 629, Vila Real, Portugal (9,030 square meters);

R. Alves da Veiga 145/169, Porto, Portugal (7,203 square meters);

Travessa dos Correios, Torres Novas, Portugal (7,112 square meters);

Av. Liberdade, 643, Braga, Portugal (5,380 square meters);

Rua 9 de Julho, Beja, Portugal (5,331 square meters); and

R. D. Estefânia 78/82, Lisboa, Portugal (4,441 square meters).

We also have some leased offices, which are located at the following addresses:

Av. Fontes Pereira de Melo, 38/40, Lisboa, Portugal (61,534 square meters);

R. José Ferreira Pinto Basto, Aveiro, Portugal (36,030 square meters);

Av. Álvaro Pais, 2, Lisboa, Portugal (31,800 square meters);

Tagus Park, Lt 35, Oeiras, Portugal (27,800 square meters);

R. Entrecampos, 28, Lisboa, Portugal (22,820 square meters);

R. Tenente Valadim, 431/453, Porto, Portugal (21,400 square meters);

R. Afonso Costa, 4, Lisboa, Portugal (13,266 square meters);

Tagus Park, Edifício Inovação II, 414, Oeiras, Portugal (7,126 square meters);

Av. 5 de Outubro, 208, Lisboa, Portugal (6,976 square meters)

Praceta Nuno Rodrigues dos Santos, 9, Lisboa, Portugal (5,735 square meters); and

R. Maria Veleda, 1, Lisboa, Portugal (4,333 square meters).

We have registered our important trademarks, such as Portugal Telecom, PT Comunicações, PT Prime, Telepac, Sapo, TMN, PT Multi TV Cabo, Netcabo , and their related logos, in Portugal. We have also applied for a European Community trademark for Portugal Telecom and our logo. Telesp Celular has registered its important trademarks in Brazil. Brasilcel, through one of its Brazilian subsidiaries, is in the process of registering the trademark Vivo in Brazil and Spain; in Portugal, the trademark Vivo was approved in 2004. Trademarks registered in Brazil may be subject to less legal protection in Brazil than registered trademarks in Portugal or the United States. We do not own any registered patents or copyrights which are material to our business as a whole.

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Competition

We face substantial and increasing competition. The Portuguese telecommunications sector has been open fully to competition since January 1, 2000. We have competitors able to compete with us in each of our service areas. We describe the competitive conditions of each of our business segments below.

Competition Facing Our Wireline Business

Since January 1, 2000, we no longer have the exclusive right to provide domestic and international public switched fixed line telephone services or to install and operate the related telecommunications networks in Portugal.

Retail. Our wireline business faces increasingly strong competition from new fixed-line operators as well as from mobile telephone service providers, including our own mobile service provider, TMN. The number of subscribers to mobile services in Portugal now outnumbers the number of wirelines in Portugal. At the end of 2005, there were approximately 108.7 active mobile telephone cards per 100 inhabitants in the Portuguese market. This growth comes as more residential subscribers add mobile cards for family members and as businesses add mobile cards for their employees. Vodafone Portugal and Optimus are already marketing their mobile services as an alternative to our wireline telephone services, and we compete with them for market share. For example, Optimus has launched a service called Optimus Home that uses its GSM mobile network but uses a fixed line phone number. The low-cost brands launched by TMN (Uzo) and Optimus (Rede 4) and Vodafone s product (Directo) designed to reach the lower end segment of the mobile market have also had an effect on our fixed line retail service, exacerbating the trend among consumers toward switching from fixed line to mobile service.

Vodafone Portugal and Optimus (owned by Sonae and France Telecom) have major shareholders that can provide them with substantial resources. In addition to strengthening their position in the mobile telephone market, these resources enable them to compete directly and aggressively with our fixed-line telephone services.

At December 31, 2005, according to ANACOM figures, PT Comunicações, which provides retail services as part of our wireline business, had an estimated 89.3% market share of access lines (93.3% in 2004). At December 31, 2005, according to ANACOM figures and our estimates, PT Comunicações had an estimated 78.2% market share of total outgoing traffic (in minutes), a decrease of 5.5 percentage points from December 31, 2004, and an estimated 74.2% market share of domestic outgoing voice traffic (in minutes), a decrease of 3.9 percentage points from December 31, 2004.

Our primary competitors in the wireline voice market include Tele 2, Novis (owned by Sonae and France Telecom), Oni Telecom Infocomunicações, S.A. (owned by Electricidade de Portugal, Banco Comercial Português and Brisa Autoestradas Portugal), Ar Telecom (formerly Jazztel) and Colt. All of the new entrants have focused on providing their customers national and international services over their networks without direct interconnection. These customers must still connect to our competitors services through our fixed lines.

The cable operator, Cabovisão, offers a package of Internet, cable TV and voice services to the residential segment. Cabovisão has attracted some of our local customer market and may continue to do so.

Measures such as call-by-call selection (introduced on January 1, 2000) and carrier pre-selection (introduced on October 1, 2000), as well as number portability (introduced on July 1, 2001), make it easier for our competitors to attract our customers to their services. At December 31, 2005, we estimate that there were approximately 575 thousand lines in pre-selection. For example, Tele 2 has been effective in using carrier pre-selection to increase its market share.

We are losing revenues from our international telephone services because we no longer have the exclusive right to provide fixed-line telephone services, and large telecommunications users lease lines through which they connect to networks outside Portugal. At December 31, 2005, according to ANACOM data and our estimates, PT Comunicações had an estimated 73.0% market share of international traffic (in minutes), a decrease of 4.4 percentage points from December 31, 2004. In addition, we are losing revenues from our international telephone services as mobile operators establish direct international interconnections with mobile or fixed-line networks outside of Portugal, enabling them to offer international telephone services without using our network. We also face indirect competition in international fixed-line telephone services from calling cards and rerouting of calls by other international operators. Together with falling international call prices worldwide, these factors put pressure on us to reduce international fixed-line telephone prices.

In response to full competition, we have been lowering the prices of our wireline telephone services. In 2005, prices reduced by 22.5% for regional calls and 22.3% for domestic long distance on average, compared with 2004. We believe our price structure is now competitive and that we are meeting the challenge of full competition.

The overall effect of full competition partly depends on the prices that other mobile and wireline network operators pay us to interconnect with our network. Portuguese law requires us to lease lines to our competitors. It also obliges us to interconnect our network with our competitors networks or lines leased by them. Our interconnection rates are subject to regulatory review. See *Regulation Portugal Pricing of Wireline Services Interconnection Prices*. New entrants and resellers of lines leased from existing operators have made very rapid inroads into other EU telecommunications markets that have also opened up to full competition, and we see the same trends in Portugal.

***Wholesale*.** Mobile operators, other than TMN, are establishing direct international interconnections with mobile or wireline operators outside Portugal, enabling them to offer international telephone services without using our network. This is reducing our wholesale revenues generated from connecting mobile operators in Portugal to operators abroad.

Our interconnection business faces more direct competition now that other operators may install and operate their own public wireline telephone networks. Mobile and wireline networks, which are our interconnection customers, can interconnect with these new networks rather than with ours. Other competitors may also establish local networks using other technologies such as local radio systems, fiber optic technologies and new mobile systems that may be used to complete calls which are currently made to our subscribers.

***Data and Corporate*.** We face significant competition from several operators. Our principal data communications and business solutions competitors include companies associated with Oni Telecom, Novis, Colt, Ar Telecom (formerly Jazztel) and Vodafone Portugal. These companies compete with us in providing data communications, voice and Internet services to business customers. Such service providers can use lines leased from us or their own networks. This market is now highly competitive. These customers tend to have large volumes of traffic and complex virtual private network services with data, voice and video integration.

Our competitors may use satellite-based networks, the infrastructure of public network operators, leased lines and their own infrastructure to offer telecommunications services to customers. These are all alternatives to leasing lines from us for data communications. As a result of competition, we have reduced our prices for leased lines and are focusing on value-added solutions based on Internet Protocol Virtual Private Networks, or IP VPN.

Competition Facing TMN in Portugal

TMN competes with Vodafone Portugal and Optimus, the two other mobile operators licensed to provide mobile telephone services in Portugal. According to figures from ANACOM, at the end of 2005, in terms of the number of active mobile telephone cards in the Portuguese market, TMN had a 47.6% market share. TMN has made maintaining its market share a priority. As a result of a very competitive market, TMN s market share of mobile subscribers decreased 2.4 percentage points in 2005 compared to 2004.

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TMN s competitive strategy includes focusing on excellent subscriber care and innovative services. As a result of its customer service, TMN received an honorable mention in the Call Centre 2005 awards for companies with the best telephone customer service in the telecommunications sector. In addition, TMN and Tektronix Inc., which designed the software that allows TMN to evaluate the performance and efficiency of its second and third generation networks, received an award for the Best Network Quality Initiative at the GSM Association Awards 2006 in February 2006.

Vodafone Portugal and Optimus each have major shareholders that could provide them with substantial resources to compete aggressively against us in the Portuguese mobile telephone market. Sonae and France Telecom are the major shareholders in Sonaecom, the holding company that controls Optimus.

Competition is increasing in the mobile services sector in Portugal as TMN and its competitors develop new services. In addition, the commercial introduction in Portugal of third generation mobile services has heightened competition and reduced the profitability of providing third generation services. Moreover, ANACOM may open the mobile market to mobile virtual network operators, or MVNOs, which do not have their own network infrastructure and thus would not have the fixed cost burdens facing our current GSM and UMTS services. Competition from companies providing WLAN services, which can deliver wireless data services more cheaply than UMTS in concentrated areas, may also affect the market and pricing for third generation services. We believe that our mobile competitors, Vodafone and Optimus, will continue to market their services aggressively. In mid-2005, Optimus introduced a low-cost brand Rede 4 in response to our new brand Uzo . Vodafone also launched a similar product called Directo in mid-2005 targeting the same market as Uzo and Rede 4.

Competition Facing PT Multimédia s Pay TV and Broadband Internet Business

Certain cable television operators are authorized to provide services in Portugal in addition to PT Multimédia s subsidiary, TV Cabo. PT Multimédia s competitors operate principally in Portugal s major cities and include Cabovisão, Parfitel, TV TEL and Bragatel. According to ANACOM figures, we estimate that at the end of 2005, TV Cabo s competitors had approximately 17% of the total number of subscribers in the pay-TV market.

TV Cabo currently has control over nine cable authorizations covering 125 counties in seven regions in continental Portugal and the Madeira and Azores Islands, all of which expire in May 2009. In February 2004, a new regulatory framework was introduced under which no specific authorizations or licenses for the provision of cable television services are required. After the current authorizations expire, the existing licenses will not be renewed, and the new regulatory framework will apply. See *Regulation TV Cabo s Cable Television Authorizations* . We therefore expect competition to increase as a result of this regulatory flexibility.

PT Multimédia competes for advertising revenue with terrestrial television companies (free-to-air channels) and other forms of media such as newspapers, magazines, radio, billboards and the Internet. It also competes with terrestrial television companies for the acquisition of programming to attract viewers. Such competition can increase program acquisition costs.

PT Multimédia competes with cable companies, such as Cabovisão, in the provision of broadband Internet services.

In August 2001, the Portuguese government granted an authorization to Plataforma de Televisão Digital Portuguesa, S.A., or PTDP, to provide digital terrestrial television services. ANACOM instructed PTDP that it must begin operations before March 1, 2003. As PTDP had difficulty complying with the instruction, ANACOM, with PTDP s agreement, proposed to the Ministry of Economy that PTDP s authorization be revoked. By order of the Minister of Economy, dated March 25, 2003 (Ministerial order 6973/2003, published on April 9, 2003), the authorization was revoked. In 2005, the Portuguese government announced that it intends to reopen competitive bidding for a license to provide digital terrestrial television services in Portugal, which could result in increased competition for TV Cabo.

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As existing technology develops and new technologies emerge, competition is likely to intensify, in particular with regard to products and services related to subscription TV and the Internet. PT Multimédia s cable and satellite business face competition from broadband local loop access based on wireless technologies (Broadband Wireless Access). In 2005, Ar Telecom (formerly Jazztel), a direct competitor, launched broadband wireless service in the geographic areas where it operates. Also, we expect video over ADSL to increase competition. Novis is expected to launch an IP television offer in 2006 that would compete with PT Multimédia s television services.

Competition Facing PT Multimédia s Audiovisuals Business

In the four main sub-segments of this business segment (film distribution, cinema exhibition, video distribution and distribution of rights for TV broadcasting), PT Multimédia faces competition from various entities that differ from segment to segment, as follows:

Film distribution: Filmes Castello Lopes, LNK Filmes, Columbia Tristar Warner Filmes de Portugal, Atlanta Filmes and Sociedade Distribuidora Vitoria Filmes;

Cinema exhibition: Socorama Sociedade Comercial de Cinemas, Medeia Filmes, New Lineo Cinemas de Portugal, UCI Cinemas United Cinemas international and AMC;

Video distribution: LNK Filmes, Ecovideo, Universal Home Video, Warner Home Video; Castello Lopes, Selecções Readers Digest and Planeta Agostini; and

Distribution of rights for TV broadcasting: Warner Television, Columbia Television, Fox Television, Paramount Television, Buena Vista International Television, Universal Television, LNK, Ecofilmes and Castello Lopes.

In all of the activities mentioned above, except in the distribution of rights for TV broadcasting, where the free-to-air TV stations are basically supplied by the international market, Lusomundo Audiovisuais and Lusomundo Cinemas are market leaders in Portugal in terms of the number of movie titles distributed and the number of movie theaters owned, according to ICAM, the Portuguese Cinema, Audiovisual and Multimedia Institute.

Competition Facing Vivo in Brazil

Throughout 2005, Vivo faced increasing competition not only from its established competitors, but also from new operators in some of the markets where Vivo operates. As of December 31, 2005, Vivo had 29.8 million subscribers, corresponding to a market share of 44.4% in its areas of operation, compared with 50.9% in 2004. Vivo s major competitors are Claro (Telecom Américas), TIM (Telecom Itália Mobiles) and Oi.

Telesp Celular s principal competitor is Claro, and it also competes with TIM. In addition, Telesp Celular competes for subscribers with wireline telephone service providers. The main wireline service provider in São Paulo state is Telefónica, through Telecomunicações de São Paulo S.A. Telesp.

Global Telecom s principal competitor is TIM Sul, and it also competes with Claro and Brasil Telecom. Of these competitors, Brasil Telecom is the most recent entrant, beginning mobile operations at the end of 2004 in the states of Paraná and Santa Catarina using GSM/GPRS technology. Global Telecom also competes with the primary wireline service provider in its areas, Brasil Telecom.

Tele Sudeste s principal competitor in 2005 was Claro, and it also competed with Oi (which is controlled by Telemar Norte Leste S.A., or Telemar, a wireline operator) and TIM. Tele Sudeste also competed in 2005 with the primary wireline service provider in its areas, Telemar.

Tele Leste s principal competitor in 2005 was Oi, and it also competed with TIM and Claro. Tele Leste also competed in 2005 with the primary wireline service provider in its areas, Telemar.

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Celular CRT s principal competitor in 2005 was Claro, and it also competed with Brasil Telecom and TIM. Of these competitors, Brasil Telecom is the most recent entrant, beginning mobile operations in 2004 in the state of Rio Grande do Sul using GSM/GPRS technology. Celular CRT also competed in 2005 with the primary wireline service provider in its areas, Brasil Telecom.

TCO s principal competitor in the region encompassing the states of Acre, Rondônia, Mato Grosso, Goiás, Mato Grosso do Sul, Tocantins and in the Federal District is Claro, and it also competes with TIM and Brasil Telecom. Of these competitors, Brasil Telecom is the most recent entrant, beginning mobile operations in 2004 in these states using GSM/GPRS technology. TCO also competes with Brasil Telecom as the primary wireline service provider in that region. TCO s principal competitor in the region encompassing the states of Amazonas, Pará, Maranhão, Roraima and Amapá is Amazônia Celular S.A., and it also competes with Oi, Claro and TIM. TCO also competes with the primary wireline service providers in that region, Telemar.

In 2004, ANATEL auctioned off a band E license for rendering services in the State of Minas Gerais, granting the licenses to two operators (Stemar, which is owned by Claro, for the whole state, and Telemig Celular for an area that includes 59 municipalities in that state). In March 2006, ANATEL conducted an additional auction for certain remaining band E licenses, but no operator won those licenses and the bands remain unused.

Regulation

The telecommunications industry has traditionally been heavily regulated in most countries of the world, including Portugal and Brazil. Over the last several years, both countries (Portugal beginning in 1990 and Brazil in 1998) have substantially privatized their state-held telecommunications operators and have been opening their telecommunications markets to competition. Portugal, a member of the European Union, opened its telecommunications market to full competition as of January 1, 2000. Portugal is pursuing further EU-led initiatives aimed at increasing the competitiveness of its market. Brazil has also been introducing further measures designed to increase competition. In this section, we explain the main laws and regulations in Portugal and Brazil that affect our operating companies in these two countries.

Portugal

In the increasingly competitive Portuguese telecommunications market, the regulatory measures which most affect our operations, our revenues and our costs, concern:

- restrictions on the products we offer and the prices we charge in our wireline retail business;
- obligations to allow our competitors to interconnect with and use our wireline network;
- certain wireline services that we are obliged to provide to the public under our universal service obligation ;
- measures that are intended to make it easier for our customers to migrate to our competitors services, including carrier pre-selection, number portability, unbundling of the local loop and, beginning in 2005, wholesale line rental; and
- the terms of our concession and our licenses, including the new third-generation mobile license that TMN received at the end of 2000.

In February 2002, the European Union agreed upon a new regulatory framework for electronic communications networks and services, consisting of five directives governing procedures, authorizations, access, universal service and data protection; one decision on the availability and use of radio spectrum; and a recommendation on relevant product and service markets within the electronic communications sector subject to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and Council on a common regulatory framework for electronic communications networks and services. Four of the five directives

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that make up the new EU framework were adopted into law in Portugal on February 10, 2004 as part of Law 5/2004, the Basic Law of Electronic Communications (which we refer to as Law 5/2004). The fifth directive was adopted into law on August 18, 2004.

The implementation of the new EU framework is changing the current regulatory framework applicable to us. The new EU directives and recommendations, which adopt competition law principles such as market dominance for the designation of significant market power and the definitions of relevant product and geographic markets which may be subject to *ex ante* regulation, will result in significant changes and refinements to the current regulatory regime applicable to us in Portugal.

Under the new regulatory regime, regulatory obligations can be imposed on operators having significant market power in any one of 18 relevant retail and wholesale markets identified by the European Commission. Since we are active in all of these markets, the new regulatory regime could result in an increase in the regulatory measures affecting our businesses and operations. Under the EU framework directive, ANACOM is required to analyze the 18 retail and wholesale markets and identify which electronic communications operators and service providers it considers to have significant market power in such markets in Portugal and notify the European Commission with respect to its findings.

ANACOM has analyzed 16 of the 18 retail and wholesale markets. ANACOM considers the Portugal Telecom group to have significant market power in all the markets it has analyzed except for one in which it did not find any operator to have significant market power (wholesale transit services) and one in which the results of its analysis are pending (the MVNO market). These markets include the following: (1) retail markets access to the public telephone network at a fixed location (residential and business), publicly available local and/or national telephone services provided at a fixed location (residential and business), publicly available international telephone services provided at a fixed location (residential and business), and leased lines; and (2) wholesale markets call origination on the fixed telephone network provided at a fixed location, call termination on individual public telephone networks provided at a fixed location and wholesale unbundled access to local metallic loops, wholesale leased lines (trunk segments and terminating segments) and wholesale broadband access. ANACOM has notified the European Commission regarding its conclusions about the markets it has already analyzed. In addition, ANACOM added a nineteenth market, covering telephone services at a fixed location using non-geographic numbers, such as toll-free numbers, and has declared the Portugal Telecom group to have significant market power in this area.

In addition to the Portugal Telecom group, all other wireline operators in Portugal were determined to have significant market power in the call termination on individual public telephone networks provided at a fixed location wholesale market. ANACOM has not yet started the analysis of the two remaining wholesale markets, which are roaming services and broadcasting.

Final decisions with respect to the existence of significant market power in each of the relevant markets is expected during the course of 2006.

In addition, Law 5/2004 has made more flexible certain other aspects of the former regulatory scheme, such as the basis upon which we and other operators in Portugal can use public rights-of-way and the rules governing access to ducts.

Regulatory Institutions

ANACOM. The Autoridade Nacional das Comunicações, or ANACOM, created in January 2001 (formerly The Instituto das Comunicações de Portugal, or ICP), is the Portuguese telecommunications regulator. Since it commenced operations in 1989, it has been closely involved in developing the telecommunications regulatory framework in Portugal. It advises the Portuguese government on telecommunications policy and legislation and monitors compliance with concessions, licenses and permits granted to telecommunications providers in Portugal.

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ANACOM is accountable to the Ministry of Public Works, Transport and Communications. The Ministry of Public Works, Transport and Communications retains basic responsibility for telecommunications policy in Portugal. Together with the Ministry of Finance, it has ultimate responsibility for monitoring our compliance with our Concession. It also has certain supervisory powers with respect to our activities. The Portuguese government delegated a significant number of those powers and functions to ANACOM in our Concession.

Over the past several years, the Portuguese government has substantially increased the autonomy of ANACOM and allowed it to become a more effective and independent regulatory body. ANACOM acts on complaints against us by our competitors, our customers and other interested parties. It can impose fines on us if we do not meet our obligations under our Concession, including our obligations to supply public switched wireline telephone services, leased lines and other services to our competitors on a timely basis. ANACOM has, from time to time, addressed complaints against us by our competitors. However, such complaints have been resolved in a manner that has not had a material adverse effect on our businesses or operations. ANACOM s decisions are subject to possible reconsideration and can be submitted for judicial review.

EC Commission. Most of the EU competition rules have the force of law in all EU member states and therefore apply to us in Portugal. The current priority of the European Commission is to ensure that EU member states fully and correctly implement EU requirements in national law. The European Commission routinely monitors the status of EU member states in implementing EU directives.

The Directorate-General for Competition of the European Commission is responsible for considering, on its own initiative as well as in response to complaints by interested parties, potential claims that our business activities or Portuguese government regulations are inconsistent with the key provisions of the Treaty of Amsterdam, also known as the EC Treaty, relating to competition in the EU. Article 81 of the treaty prohibits agreements or coordinated action between competitors that may affect trade between EU member states and have as their objective or effect the prevention, restriction or distortion of competition within the EU. Article 82 of the treaty prohibits any abuse of a market-dominating position within the EU, or a substantial part of the EU, that may affect trade between EU member states. The Directorate-General for Competition enforces these rules in cooperation with the national competition authorities. In addition, national courts have jurisdiction over violations of EU competition law. In 2005, Sonaecom filed a complaint with the Directorate-General for Competition of the European Commission relating to our activities and the regulatory framework of the Portuguese government. However, the Commission responded that the complaint should be addressed by the Portuguese Autoridade da Concorrência. To our knowledge, proceedings before the European Commission relating to this complaint are now closed. See *Item 3 Key Information Risk Factors EU Regulation Regarding Abuse of Dominant Position Could Adversely Affect our Business* and *Item 8 Financial Information Regulatory Proceedings* .

We understand that at the end of 2001 the Directorate-General for Competition and the Directorate-General for Information Society of the European Commission requested information from the Portuguese government regarding the telecommunications rights-of-way regime in Portugal, which provided PT Comunicações with the exclusive right to use public rights-of-way free of municipalities fees and taxes. However, the rights-of-way regime was modified in 2004 through Law 5/2004, as described below in *Summary of Our Concession and Existing Licenses* . Since we have not been party to the communications between the Directorates-General and the Portuguese government, we are unable to assess whether or not Law 5/2004 has resolved any concerns the Directorates-General may have had regarding the regulation of rights-of-way in Portugal.

Autoridade da Concorrência. Our activities are also overseen by Autoridade da Concorrência (formerly Direcção Geral do Comércio e da Concorrência, or DGCC), which is responsible for enforcement of Portuguese competition law. It is also responsible for considering complaints relating to our business practices or other business arrangements. We expect the Autoridade da Concorrência to take a more active role in matters relating to pricing and to the determination of which companies have significant market power and the regulatory implications for such companies.

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On February 10 and 11, 2004, the Autoridade da Concorrência conducted an unannounced search of the offices of PT Comunicações and PT Prime, seizing several documents, in order to investigate alleged abusive practices, including predatory pricing, price discrimination at the wholesale level, price discrimination at the retail level in the wireline telephone market and margin squeezes. The potential penalty for such practices could be as high as 10% of our turnover in the preceding fiscal year. This administrative investigation is still in a preliminary stage involving document collection and review. The Autoridade da Concorrência periodically requests that we provide them with additional information regarding the documents they seized in February 2004, which we have responded to in a timely manner. We expect that the next phase could involve the Autoridade da Concorrência formally charging us with the alleged abusive practices, which would result in an administrative proceeding, referred to as a statement of objections , in which we would defend our position before the competition authority. If we were unsuccessful in our defense, the competition authority could issue a fine in connection with such abuses. We are permitted under Portuguese law to appeal any adverse decision of the Autoridade da Concorrência to the Commerce Court. To our knowledge, the Autoridade da Concorrência has not yet reached any decision on this matter. See *Item 3 Key Information Risk Factors Regulatory Investigations and Litigation May Lead to Fines or Other Penalties* and *Item 8 Financial Information Legal Proceedings Regulatory Proceedings* .

To our knowledge, there are also several other complaints relating to our activities pending before the Autoridade da Concorrência, including complaints against: (i) PT.com (this complaint was formerly against Telepac, which was merged into PT.com in December 2004) and TV Cabo regarding alleged anti-competitive practices in the broadband Internet market; (ii) TV Cabo and Sport TV by TV TEL, a cable TV company operating in the Oporto area, for alleged refusal to supply advertising space; (iii) TMN by Optimus for alleged abuse of dominant position in the call termination market; (iv) PT Comunicações for alleged anti-competitive practices in the public wireline telephone market and for granting discriminatory discounts on leased lines; and (v) PT Conteúdos for alleged anti-competitive practices in connection with media content and its strategic partnership with SIC. The Autoridade da Concorrência has requested information with respect to these complaints, which we have responded to in a timely manner.

In addition, in 2004, the Autoridade da Concorrência initiated a proceeding against PT Comunicações, referred to as a statement of objections , alleging that PT Comunicações was denying access to the ducts in which the basic telecommunications network is installed. PT Comunicações has responded to this statement of objections and does not believe it has violated applicable law and regulations. In June, 2005, the Autoridade da Concorrência issued a revised statement of objections on this matter. In September 2005, the Autoridade da Concorrência also brought allegations against PT Multimédia and TV Cabo for practices allegedly in violation of Article 4 of Law 18/2003 (the Portuguese Competition Law) following the execution in 2000 of a partnership agreement among PTM, TV Cabo and SIC-Sociedade Independente de Cominicação, S.A. (SIC) in connection with SIC s acquisition of Lisboa TV Informação e Multimédia, S.A. PTM and TV Cabo have contested these allegations.

Pricing of Wireline Services

Decree Law 458/99 required that ANACOM, DGCC and the provider or providers of the universal service in Portugal enter into a new pricing convention that governed only prices for services that we provided under universal service obligations. We are currently the only universal service provider in Portugal. See *Universal Service Obligations* , below. On December 30, 2002, we, ANACOM and the DGCC entered into a new pricing convention pursuant to article 11 of Decree Law 458/99. The pricing convention established the price regime applicable to the following universal services provided by PT Comunicações: (i) wireline services for subscribers, including traffic and subscription to analog lines within Portugal; and (ii) wireline services for public pay telephone calls made within Portugal, as well as making telephone directory and information services available. In addition, the pricing convention governed certain obligations of PT Comunicações to provide services to retirees, low income pensioners, low consumption residential users and customers with special needs.

Under the pricing convention, the prices of universal services were adjusted based on actual costs, and the prices charged had to comply with the principles of transparency, non-discrimination and cost orientation. As a

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result, PT Comunicações was required to maintain a system of cost accounting, which enabled it to monitor the costs of the services it provides, and it was required to publicize current prices. For wireline subscribers, the pricing regime means that the weighted average variation of the prices they paid for domestic services did not exceed CPI minus 2.75% in 2003. PT Comunicações was also obligated under the pricing convention to make available an optional pricing plan for the benefit of residential customers with low consumption and for low income pensioners. This pricing convention expired on December 31, 2003. However, under new Law 5/2004, until the full implementation of the new pricing regime, which was established by ANACOM in accordance with the new EU regulatory framework on December 14, 2004, the rules governing domestic prices established by the preceding pricing convention remained in effect. As a result, the average variation of domestic prices in 2004 did not exceed CPI minus 2.75%.

On May 7, 2004, ANACOM approved the 2004 fixed telephone service prices proposed by PT Comunicações, which are applicable to wireline customers. These prices comply with the price cap of CPI minus 2.75%, in terms of average annual change and assuming an inflation range of 1.5% to 2.5% as per the Portuguese State Budget for 2004. These prices became effective in August 2004, with a line rental increase of 2.9% and a decrease of 20.7% and 28.0% in the cost of regional and domestic long distance calls, respectively. See *Our Businesses Wireline Business* .

The new pricing regime for wireline services, which was established by ANACOM on December 14, 2004 in accordance with the terms of the new EU regulatory framework, has created the following regulatory obligations for the retail market for telephone services at a fixed location:

- In 2005, the price-cap applying to residential access and domestic calls is CPI minus 2.75% (new prices for 2005 within this price cap became effective as of July 1, 2005);

- The fixed component of fixed-to-mobile calls (residential and non-residential) is required to be in line with the cost orientation principle;

- The tariffs of domestic payphone calls are required to correspond to a maximum of three times the tariff of a residential phone call; and

- PT was released from its obligations under the low user scheme, as well as certain discount schemes for retired people, except for the monthly fee discount for retired people that is financed by the Portuguese government.

In addition, general regulatory obligations of transparency, non-discrimination, cost orientation, cost accounting and account separation apply to access to the fixed line network and to the telephone services at a fixed location.

Other Requirements. The regulatory framework requires PT Comunicações to submit periodic reports on quality of service and comply with specified indicators. Penalties may occur if we do not achieve such indicators. We must also provide white page directories and certain other facilities to certain specified categories of subscribers free of charge. In addition, a new Regulation of Quality of Service for voice services at fixed locations was published in June 2005 (Regulamento 46/05).

Interconnection Prices. Law 5/2004 establishes the new access and interconnection regime in Portugal in accordance with the requirements of the new EU regulatory framework. During 2005, PT Comunicações published several versions of its reference interconnection offer, between March 3 and December 20, to reflect changes in prices for 2005, processes and points of interconnection. See also *Interconnection* , below.

Prices for Leased Lines. Prices for our leased lines are subject to price controls as a result of obligations imposed by ANACOM, based on its finding that we have significant market power in retail leased lines, wholesale termination and trunk segments. Our leased line prices must be cost-oriented and follow the retail-minus rule (which provides for a 26% minimum margin between our wholesale and retail leased line prices).

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Universal Service Obligations

Law 91, the Concession and Decree Law 458/99 of November 5, 1999 imposed universal service obligations on us in Portugal. These obligations include providing connection to the public telephone network at a wireline location. They also include providing access to public switched wireline telephone services, including enabling users to make and receive local, national and international telephone calls, facsimile communications and data communications. They also include providing public pay telephones, publishing directories and making available at least one telephone directory enquiry service covering all public voice telephone subscribers numbers.

Decree Law 415/98, which implemented the EU Interconnection Directive in Portugal, and Decree Law 458/99, which implemented the EU universal service regulation in Portugal, addressed the pricing mechanism and the financing procedures regarding the universal service obligations, as well as those who must contribute to its cost. Law 91 required that operators of public telecommunications networks and providers of voice services must contribute to the costs of our universal service obligation. Decree Law 415/98 and Decree Law 458/99 required us to disclose to ANACOM our negative margins involved in meeting the universal service obligations. ANACOM will establish and publish the criteria for contributions to the cost of universal service. It will also determine, on an annual basis, the amounts and timing of contributions by other operators and service providers. Decree Law 458/99 also required that we, ANACOM and the DGCC enter into a new pricing convention governing the prices of services provided pursuant to the universal service obligation. As discussed above, we entered into a new pricing convention on December 30, 2002. See *Pricing of Wireline Services* .

According to Law 5/2004, enacted to promulgate the new EU framework directive, if ANACOM determines that the provision of universal service obligations has become an excessive burden, it may compensate us accordingly. We believe that obtaining significant compensation under this provision of the law will be very difficult and may not be possible.

Interconnection

The Interconnection Framework. The EU Access and Interconnection Directive requires that interconnection services be made available in a non-discriminatory manner. The EU Access and Interconnection Directive encourages commercial negotiations among operators but requires national regulatory authorities to establish mechanisms for effective dispute resolution. According to the EU Access and Interconnection Directive, all telecommunications companies with significant market power in the call origination or termination markets must:

- make interconnection access to their networks available to other network operators;
- not discriminate between interconnection customers;
- provide to those requesting interconnection the information and technical specifications necessary for them to interconnect their networks;
- offer interconnection prices that are transparent and cost-oriented and do not discriminate between interconnection customers; and
- maintain a separate accounting system for interconnection activities.

Law 5/2004 implemented the EU Access and Interconnection Directive in Portugal and established the general conditions for access and interconnection among telecommunications operators in competitive markets. It guarantees the rights of new entrants to obtain interconnection from telecommunications operators with significant market power.

Pursuant to Law 5/2004, ANACOM is entitled to review and modify our proposed interconnection rates and arrangements in our reference interconnection offer. ANACOM has established in Portugal an overall

interconnection framework based on cost and consistent with the EU legal framework for both wireline and mobile services. We expect that convergence of interconnection rates and practices in Portugal with those in the EU will occur in a step-by-step process over the next several years.

Through its competition directorate, the European Commission may become involved in complaints with respect to interconnection arrangements and practices brought by new entrants against incumbent telecommunications operators. Although the European Commission often defers to initiatives undertaken by national regulatory agencies with respect to interconnection-related matters, there can be no assurance that the European Commission will not further investigate or become actively involved in matters concerning the establishment of interconnection arrangements in Portugal on its own initiative or in response to a complaint by another telecommunications operator.

Wireline Interconnection. As a result of the enactment of Law 5/2004, ANACOM adopted a measure in March 2004 on call origination on fixed telephone networks provided at a fixed location and call termination on individual public telephone networks provided at a fixed location and on significant market power designation in these fixed locations, declaring the Portugal Telecom group to have significant market power in these markets. As a result, we are subject to price controls in these markets based on our costs and other factors and must publish a reference offer that includes these prices and quality of service standards.

Mobile Interconnection. In February 2005, all mobile operators were declared to have significant market power in call termination in mobile networks market. ANACOM has accordingly imposed price controls on interconnection rates for the termination of calls on mobile networks. In 2005, interconnection rates (both fixed-to-mobile and mobile-to-mobile) were reduced by an average of 24% compared with 2004 rates. In 2006, we expect these rates to be further reduced by an average of 18.4% compared to the 2005 rates. These reductions have had, and are expected to continue to have, a significant impact on TMN s interconnection revenues and consequently its earnings. See *Item 5 Operating and Financial Review and Prospects Results of Operations* .

ANACOM is in the process of determining who has significant market power in the call origination on mobile networks market. A decision is expected during 2006.

Internet Access. The interconnection regime for access to our network by ISPs provides for a number of different billing structures. Under the first method, ISPs pay us a call origination charge, and, if the ISPs request that we invoice customers on their behalf, they also pay us the corresponding charge for the invoicing service. Under a second method, we charge the ISPs a wholesale flat rate and the ISPs bill their own customers. On September 23, 2003, ANACOM decided that data traffic and Internet traffic should be included in our Reference Interconnection Offer, which previously applied only to interconnection for voice telephony services. Accordingly, we now offer two access regimes to ISPs: (1) the Reference Offer for Internet Access, which includes the two pricing methods described above, and (2) the Reference Interconnection Offer, which includes a pricing method based on call origination. On March 16, 2004, ANACOM issued a new administrative decision regarding the billing structure for our Reference Interconnection Offer. As a result, the call origination pricing arrangements with ISPs now include two billing structures. The primary differences between the two billing structures relate to origination prices, the manner in which ISP infrastructures are connected to our wireline network and billing arrangements. The regime introduced in March 2004 has lower origination charges, involves the use of leased lines and does not require us to maintain billing arrangements with ISPs. The ISPs determine which billing regime will apply to their arrangements to connect with our wireline network.

Number Portability and Carrier Selection

An amendment in September 1998 to the EU Interconnection Directive required member states to introduce number portability among telecommunications operators in most EU countries by January 1, 2000. Where implemented, number portability allows a subscriber at a specific location to change service providers without having to change telephone numbers. PT Comunicações introduced number portability for wireline services on July 1, 2001. Number portability for mobile services was introduced in January 2002.

ANACOM has required call-by-call carrier selection to be offered by us for long distance and international calls since January 1, 2000. We have been offering it for local and regional calls since January 1, 2001 and for fixed-to-mobile calls since October 1, 2000. Call-by-call carrier selection enables customers to select the carrier of their calls by dialing a code connecting them to the selected carrier.

Law 5/2004 requires that all wireline network operators with significant market power must offer carrier pre-selection. Carrier pre-selection allows customers to select the carrier that will be their default carrier. They then do not need to dial any code to connect to their selected carrier when they make their calls. ANACOM introduced interim carrier pre-selection using auto dialers on July 1, 2000 and full carrier pre-selection has been available throughout Portugal since October 15, 2000.

ANACOM also introduced call-by-call carrier selection for mobile operators, including TMN, on March 31, 2000. Following this introduction, mobile operators are required to offer call-by-call carrier selection for international calls only.

Number portability regulations were revised in 2005 through Regulamento 58/2005 of August 18, 2005, but the revisions did not have a significant impact on our business. New regulations for carrier pre-selection were also published in early 2006, extending carrier pre-selection to non-geographic services.

Unbundling of the Local Loop

On December 18, 2000, the European Commission approved a regulation requiring wireline network operators to make the local loop between their customers and the local switches on their networks available to competitors. Such a requirement also exists in Law 5/2004. This allows such competitors to connect their networks to the copper local loop and use it to provide their services directly to those customers without having to rely upon the network operator s relationship with the customers. According to the regulation and Law 5/2004, we are required to maintain a reference offer for unbundled access to our local loops and related facilities and to meet reasonable requests for unbundled access to our local loops and related facilities under transparent, fair and non-discriminatory conditions. Prices charged must be cost-oriented. ANACOM has announced that unbundling of the local loop should be available in Portugal in accordance with the terms of the EC regulation and Law 5/2004. Our PT Comunicações wholesale unit published its last version of the reference offer for unbundled access to our local loops on November 24, 2005. The reference offer is in accordance with terms established by ANACOM.

We have made available to our competitors all of the local switches for remote and physical co-location where technical and space conditions are available, 191 of which are co-located. Co-location means providing space and technical facilities to competitors to the extent necessary to reasonably accommodate and connect the relevant equipment of the competitor.

Internet and Related Services

Various regulatory developments may affect our Internet business. Portugal has adopted Decree Law 290-D/99 regarding digital signatures, which established a legal framework for electronic documents and digital signatures. This framework is a key component for developing e-commerce business. Portugal is expected to enact further measures pursuant to the EU Electronic Signature Directive, adopted in December 1999. The EU Electronic Commerce Directive, which was implemented in January 2002, further promotes the free movement of electronically provided services and commerce within the EU. For example, it requires EU member states to absolve information carriers and host-services providers from liability for the content of information transmitted over the Internet. Such provisions provide us with legal protection that is important in carrying out our business. The 1995 EU Data Protection Directive, which was implemented in Portugal in 1998, places restrictions on the use by Internet companies of personal data stored on their networks. It is not possible at this time to ascertain the burden that data protection schemes or other self-regulation and content-monitoring requirements may impose on our Internet business.

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EU Competition Directive

The European Commission issued a directive on September 16, 2002 (Directive 2002/77/EC) that requires member states to enact legislation directing incumbent telecommunications operators to separate their cable television and telecommunications network operations into distinct legal entities. We believe that steps already taken to operate our cable television business in Portugal through PT Multimédia, a separate legal entity that has independent shareholders, satisfy the requirements of the directive implemented in Portugal.

Licensing Framework

The EU Authorization Directive (Directive 2002/20/EC of March 7, 2002) prohibits any limitation on the number of new entrants in telecommunications markets, except as required to ensure an efficient use of radio frequencies.

Pursuant to this Directive, which is part of the EU electronic communications framework, Law 5/2004 has established a new authorization regime, whereby an operator must have a general authorization for the provision of electronic communications networks or services. A license can e required for the use of radio frequencies or numbering resources. ANACOM is responsible for issuing regulations to implement this authorization regime.

Summary of Our Concession and Existing Licenses

Our Concession is for the provision of universal service and for the operation of the terrestrial broadcasting network in Portugal, and it permits us to provide public switched wireline telephone, packet switched data (the rights to which were transferred to our subsidiary PT Prime) in X.25 mode, leased lines and telex and telegraphy services in Portugal. We also provide mobile telephone services, cable television and data communications services under licenses granted to our subsidiaries by the Portuguese government. The subsidiaries holding the licenses are subject to separate financial reporting and other requirements.

Our Wireline Concession. The Portuguese government granted Portugal Telecom a Concession on March 20, 1995. The Concession had an initial term of 30 years, expiring in 2025, and could be renewed for successive minimum periods of 15 years by agreement between us and the Portuguese government. As part of the reorganization of our businesses, Portugal Telecom transferred the Concession to its subsidiary PT Comunicações. The Council of Ministers approved this transfer in a Decree Law that came into effect upon publication in the Portuguese Official Journal on September 9, 2000. The Concession confers rights with respect to provision of transmission infrastructure and leased circuit services as well as wireline telephone, telex and telegraphy services in Portugal.

The Concession granted to us the right to install, manage and operate the infrastructure that forms part of the basic telecommunications network and the terrestrial broadcasting network. Some of our assets that are part of the basic telecommunications network (as defined in Portuguese legislation) were treated as being within the public domain under the terms of the Concession. During the term of the Concession, we were permitted to receive economic benefits from the use of public domain assets as if we owned them completely. However, such public domain assets would have reverted to the Portuguese government without compensation when the Concession expired.

On December 11, 2002, we agreed to prepay the future rental payments due under the Concession in exchange for full ownership of the basic telecommunications network and to ensure that there will be no reversion of the assets related to the provision of Concession services to the government in 2025. On December 27, 2002, Portugal Telecom acquired full ownership of the basic telecommunications network for 365 million, which included the 2002 Concession fee in the amount of 16.6 million. As a result of this acquisition, the terms of the Concession have been modified so that PT Comunicações no longer is obligated to pay a concession fee to the Portuguese government and ownership of the network and assets related to the Concession will not revert back to the Portuguese government in 2025. On February 17, 2003, Decree Law

31/2003 was enacted, establishing the basic regulatory principles supporting the terms of our modified Concession. On April 3, 2003, we entered into an agreement formally modifying the terms of our Concession with the Portuguese government.

The Portuguese government retains the ability to suspend or terminate our rights under the Concession. In cases of serious non-performance by us of our obligations under the Concession, the Portuguese government may, on a provisional basis, take over the development and operation of services authorized under the Concession. The Concession may also be terminated in cases of severe, continual or insoluble failure to perform our obligations. We believe that we have the resources to fulfill all our obligations under the Concession.

In addition, after 2010 the Portuguese government may revoke the Concession upon at least one year s notice if it deems such action to be justified in the public interest. In that event, we have the right to compensation in an amount equal to the value of the assets which constitute the infrastructure of the basic telecommunications network, including other of our assets included in our infrastructure development plan, net of depreciation and revaluation. This compensation would be payable prorated over the remaining term of the Concession. We would also be entitled to additional compensation equaling our annual average net profits for the five years prior to notification of revocation multiplied by the number of years remaining before the Concession expires.

Our modified Concession provides that we are exempt from all taxes, fees and charges with respect to the usage of public rights-of-way for our telecommunications infrastructure. However, Law 5/2004 establishes a new rights-of-way regime in Portugal whereby each municipality may establish a fee, up to a maximum of 0.25% of each wireline services bill, to be paid by the customers of those wireline operators whose network infrastructures are located in each such municipality. This regime was implemented in 2005 pursuant to Regulation No. 38/2004, which was published in September 2004. The new regime replaces Law 91/97, which granted us an exemption from municipal taxes and rights-of-way and other fees with respect to access to and installation and use of our telecommunications network in connection with our obligations under the Concession. Our exemption from municipal taxes prior to the enactment of Law 91/97 is still being challenged in the Portuguese courts by the Municipality of Oporto. See *Item 8 Financial Information Legal Proceedings Claims for Municipal Taxes and Fees* .

We are required to provide special telephone prices to certain eligible retired and pensioner Portuguese citizens. The costs of providing these special prices are directly reimbursed by the Portuguese government. In addition, we offer supplementary discounts to certain retired and pensioner Portuguese citizens without reimbursement from the Portuguese government. The cost of these discounts for our wireline business was approximately 8.7 million in 2004 and 7.8 million in 2005.

The Concession imposes a universal service obligation on us. See *Universal Service Obligations* , above.

The Ministry of Finance is responsible for monitoring financial issues with respect to the Concession. The Ministry of Economy is responsible for all other issues under the Concession. ANACOM is authorized to monitor and assess penalties up to a maximum of 500,000 if we fail to fulfill our obligations under the Concession or other obligations imposed by law. Disputes concerning the application and interpretation of the Concession are dealt with by arbitration.

***Our Data Licenses and Registrations*.** Our subsidiary PT Prime holds:

- a renewable, non-exclusive license, valid until 2015, to provide wireline services;
- a renewable, non-exclusive license, valid until 2015, to be a Public Telecommunications Networks operator; and
- due to our reorganization, all the former Telepac licenses, including a data communications license, valid until 2010.

Our data communications license authorizes us to provide X.25/X.32 synchronous services and X.28 asynchronous services and other switched and non-switched data communications services, including frame relay and virtual private networks for data communications. The license also authorizes us to provide value-added services such as electronic data interchange and videotext services. In addition, the license authorizes us to construct certain networks infrastructure in connection with licensed services. With respect to packet switched data, the data communications license is valid for 30 years and renewable by right thereafter for 15-year periods, unless our wireline Concession is terminated earlier. The license is valid for 15 years for other data transmission services. Licenses have also been granted to other providers of data communications and Internet access services, including companies associated with major international telecommunications providers. However, under Decree Law 381-A/97, and in accordance with the EU licensing regime, companies are not required to have a license to provide data communications services and Internet access. Instead, it is sufficient to register their intended services with ANACOM under its service registration scheme.

In April 1997, ANACOM granted PT Prime a license to provide data communications services using satellite infrastructure.

In April 1997, ANACOM also granted PT Prime a license to offer voice services to corporate networks and other closed groups of users. This license is valid for 15 years. Other providers of data communications services have also been issued licenses to provide such voice services, including Global One and Oni-Solutions.

Our Mobile Service Licenses. Mobile telephone service licenses are valid for 15 years and are issued by ANACOM under Decree Law 381-A/97. These licenses authorize the installation of base stations, base station controllers and control switching centers and require the licensee to construct networks capable of reaching at least 75% of Portugal s population within a specified period of time. Charges for the provision of mobile telephone services are not subject to regulation.

Through TMN, we hold a renewable, non-exclusive license to provide traditional and GSM digital mobile telephone services throughout Portugal. This license is valid until 2007 and may be renewed thereafter by authorization of the Portuguese telecommunications regulator. Two other operators hold licenses to provide GSM digital mobile telephone services on substantially the same terms as those applicable to us. Vodafone Portugal was awarded its license in 1991. Optimus was awarded a license in 1997 and began operations in September 1998. We believe that our license will be renewed, based on the results of the public consultation held by ANACOM in July 2005 regarding the renewal of the GSM licenses held by TMN and Vodafone.

We are required to comply with a number of mobile telephone service criteria. These include satisfying minimum quality standards regarding blocked call rates, network effectiveness and servicing time, and providing certain services. We are also required to provide ANACOM with monthly information about our mobile telephone operations, including the number of customers, number and average duration of calls and quarterly information about the development of infrastructure.

In 2000, ANACOM conducted a tender for four licenses for universal mobile telecommunications services, known as UMTS. UMTS services are the European version of the globally accepted technical standards for third generation mobile communications. UMTS constitutes a significant advance over the second generation digital GSM mobile services currently provided. The first generation services were traditional analog mobile services. The broadband capacity of the frequency spectrum to be allocated under the UMTS licenses will enable operators to supply video and Internet content to mobile handsets at higher transmission speeds.

The UMTS licenses were issued by ANACOM at the end of 2000. The licenses cover all of Portugal and are valid for 15 years. The license fee was 100 million per license. TMN and the other two main mobile operators in Portugal were each awarded one of these licenses at the end of 2000. and TMN s license expires in January 2016. One of the licenses was also awarded to Oniway, a new entrant in the Portuguese mobile market. However, Oniway decided not to participate in the provision of third generation mobile services, and TMN, Vodafone and Optimus requested that the Oniway license be transferred to them, dividing the cost and the resulting spectrum. This request was granted by a special ministerial order in January 2003.

In April 2004, TMN launched UMTS in Portugal with an emphasis on new services, such as video telephony and high-speed data. In 2004 and 2005, we have pursued a strategy of gradual improvements to network coverage, using existing GSM sites where possible in order to minimize the need to install costly new sites.

UMTS License holders are required to offer their services to:

- at least 50.7% of the Portuguese population by the end of the first year;
- 65.7% by the end of the third year; and
- 77.3% by the end of the fifth year.

To ensure a competitive market develops in the new services, license holders are limited in the amounts of share capital that they and their shareholders may hold of any other license holder. Neither a license holder nor a shareholder of a license holder may hold, directly or indirectly, more than 10% of the share capital of another license holder.

TV Cabo s Cable Television Authorizations. Under the new regulatory framework set out in Law No. 5/2004, of February 10, 2004, the provision of cable television networks and services is subject only to a general authorization regime, which depends on the compliance with the rules provided for in the law and regulations. That is, the new framework does not require specific authorizations or licenses from ANACOM.

Currently, TV Cabo and its subsidiaries Cabo TV Açoreana and Cabo TV Madeirense, hold nine cable television authorizations to provide cable television services in 125 counties in continental Portugal and the Madeira and Azores Islands. All of these authorizations expire in May 2009 and will not be renewed, allowing the new regulatory framework to take effect. Currently, certain other operators are also authorized to provide cable television services in Portugal. See *Competition Competition Facing PT Multimédia s Pay TV and Broadband Internet Business* . All these authorizations permit the construction of cable distribution centers and networks. They also contain quality of service standards and, in most cases, obligations to construct networks capable of reaching 80% of the population of the authorized area. The remaining 20% of the population may request connection at an extra charge. The charges for the provision of cable television services are not subject to regulation.

Although not considered public domain assets and not subject to our wireline Concession, the cable television infrastructure that TV Cabo has installed and operates in areas in the public domain may be subject to reversion or transfer to third parties without compensation. Although under the terms of Law 5/2004, cable operators are ensured the right to install cable infrastructure on public property and such right may not be extinguished before the end of the period for which it was granted, there may be situations in which such right could be withdrawn, subject to the right of the operator to receive compensation.

Under Portuguese law, advertising on TV Cabo s channels is generally restricted on the same terms as on broadcast TV. These restrictions include a ban on alcohol advertisements before 10 p.m. and a complete ban on tobacco advertisements. Advertising on premium channels cannot take up more than 10% of air time, and advertising on basic channels cannot take up more than 15% of air time.

Portuguese law currently permits television operators to produce and broadcast their own television programming if they have national coverage. In addition, Portuguese legislation permits the use of two-way signaling capability over cable television networks. The ability to transmit and receive signals allows the introduction of pay-per-view, home shopping and similar products in Portugal.

Brazil

General. Our Brazilian mobile business, the services they provide and the prices they charge are subject to regulation under the General Telecommunications Law and various administrative enactments, which regulate the services provided by Brazilian telecommunications operators.

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ANATEL is the agency that regulates telecommunications under the General Telecommunications Law and the July 2001 Regulamento da Agência Nacional de Telecomunicações, known as the ANATEL Decree. ANATEL is financially autonomous, and administratively independent of the federal government. ANATEL maintains a close relationship with the Ministry of Communications. Any regulation proposed by ANATEL is subject to a period of public comment, which may include public hearings. ANATEL s actions may be challenged in the Brazilian courts under Brazilian administrative law. On November 25, 1998, ANATEL enacted Resolution 73 Regulation of Telecommunication Services, which regulates in detail the new comprehensive framework for the provision of telecommunications services in Brazil established by the General Telecommunications Law.

***Concessions and Authorizations*.** Prior to January 2000, ANATEL had only authorized two mobile service providers in each of the ten franchise areas under bands A and B. Band A and band B mobile service providers, including Vivo s operating subsidiaries, were granted concessions pursuant to the *Lei Mínima*, or the Minimum Law. Each concession is a specific grant of authority to supply cellular telecommunications services, subject to certain requirements contained in the applicable list of obligations appended to each concession. If a mobile service provider wishes to offer any telecommunications service other than those authorized by its concession, it may apply to ANATEL for an authorization to offer such other services.

In accordance with the General Telecommunications Law, a concession relates to the provision of telecommunications services under the public regime, as determined by the public administration. A concession may only be granted upon a prior auction bidding process. As a result, regulatory provisions are inserted in the relevant concession agreements and the concessionaire is subject to public service principles of continuity, changeability and equal treatment of customers. The government authority is also entitled to direct and control the performance of the services, to apply penalties and to declare the expiration of the concession and the return of assets of the concessionaire to the government authority upon termination of the concession. Another distinctive feature is the right of the concessionaire to maintain an economic and financial balance of the concession agreement. The concession is granted for a limited duration and is generally renewable once.

An authorization is a permission granted by the public administration under the private regime, which may or may not be granted upon a prior auction bidding process, to the extent that the authorized party complies with the objective and subjective conditions deemed necessary for the exploitation of the relevant type of telecommunications service in the private regime. The authorization is granted for an indeterminate period of time. Under an authorization, the government will not guarantee an economic and financial balance, as guaranteed under a concession.

***SMP Regulation*.** In November 2000, ANATEL adopted certain regulations for the issuance of new licenses to provide wireless communications services through SMP rules to compete with the then existing cellular operators in the various regions of Brazil. These regulations divided Brazil into three main regions covering the same geographic area as the concessions for the fixed-line telecommunications services. ANATEL organized auctions for three new licenses for each of those regions. The new licenses provided that the new services would be operated in the 1800 MHz radio frequency bands, and they were denominated band C, band D and band E. These new licenses were auctioned by ANATEL and awarded during the first quarter of 2001, at the end of 2002 and in September 2004.

Under these new licenses:

- services are to be provided using the 1,800 MHz frequency;
- each operator may provide domestic and international long-distance services in its licensed area, subject to the regulations;
- existing cellular service providers, as long as they do not have partnerships with fixed-line operators, as well as new entrants into the Brazilian telecommunications market, can bid for C Band, D Band and E

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Band licenses. However, fixed-line operators, their controlling shareholders and affiliated cellular providers can only bid for D Band and E Band licenses;

a cellular operator, or its respective controlling shareholders, may not have geographical overlap between licenses; and

current A Band and B Band cellular service providers can apply for an extra frequency range.

Pursuant to the SMP services regulation, each of the three main regions is divided into registration areas, or tariff areas.

Vivo s operating subsidiaries all held concessions prior to the introduction of the SMP regime. Subsequent to its introduction, they have migrated to the new SMP regime and their concessions have been converted into licenses to use the radio frequency spectrum in their respective bands and provide services in the regions in which they operate. See *Our Businesses Brazilian Mobile Business* . In order to migrate services to the SMP regime, Telesp Celular and other operators owned by Vivo were required to comply with several technical and operational conditions, including, among others, the adoption of a carrier selection code for long distance calls originating from their networks.

Each SMP license consists of two licenses one to provide mobile telecommunications services, and another to use the frequency spectrum for a period of 15 years. The frequency license is renewable for a second 15-year period upon the payment of an additional license fee.

According to the General Telecommunications Law and Decree No. 2056/96, control of a concession can only be transferred after five years from the date of privatization in the case of band A concessions, or the commencement of services in the case of band B concessions. On the other hand, under the SMP system, a licensee can be transferred through merger or incorporation of the relevant mobile service provider, whether they are providing services under the band A or band B.

Interconnection. Under the General Telecommunications Law, telecommunications service providers are classified as providers of either collective or restricted services. All mobile operators, including SMP service providers, are classified by ANATEL as collective service providers. All providers of collective services are required to provide interconnection upon request to any other collective service providers.

Under the SMP regime, an SMP mobile operator pays for the use of another SMP mobile operator s network in the same authorization area only if the traffic carried from the first operator to the second exceeds 55% of the total traffic exchanged between them (known as a partial Bill & Keep regime). In that case, only those calls that have surpassed the 55% level will be subject to payment for network usage. ANATEL has proposed to replace this partial Bill & Keep regime with a model based on the costs of mobile operators, which it proposes to implement in mid-2007. This model may, among other things, substitute a different inflation adjustment mechanism, the IST index (Índice de Serviços de Telecomunicações), which may or may not reflect the true effect of inflation on Vivo s prices. However, we cannot predict whether the current regime will remain in place or whether any future regulatory change could have an adverse effect on our operations. While ANATEL analyzes regulatory alternatives, it has maintained the partial Bill & Keep regime, extending these rules through Resolution No. 408, promulgated in 2005.

Under the SMP regime, interconnection fees for the termination of calls on mobile networks are determined through free negotiation between Vivo s subsidiaries and other telecommunications operators. If the parties do not reach an agreement, the matter is determined through arbitration, which is conducted by ANATEL. In 2005, ANATEL approved provisional agreements among the local fixed line and mobile operators to determine the interconnection fees for local calls (known as VC1 calls). These agreements provide for a 4.5% annual adjustment of interconnection fees for these calls. In March 2006, ANATEL approved a provisional agreement for interconnection fees for VC2 and VC3 long distance calls that also provides for a 4.5% annual adjustment to interconnection fees. This system of adjustments may be replaced if ANATEL implements the cost-based regime described above.

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The general instructions governing interconnection are contained in the Interconnection Regulation , which provides the basic principles and rules on interconnection between telecommunications networks and systems. It governs the commercial, technical and legal aspects of interconnection. The criteria for remuneration of mobile network usage are set forth in ANATEL Resolution #319. A period of public consultation on the new interconnection rules ended on October 18, 2004. The proposals considered during the public comment period included (1) a proposal that two SMP operators controlled by the same economic group receive only one interconnection charge for calls originated and terminated on their networks rather than the current two charges, (2) a proposal for new negotiation rules for interconnection charges under which ANATEL would have a role in determining the charges rather than the current free negotiation of the charges and (3) a proposal for interconnection charge unification among SMP providers of the same economic group having significant market power according to criteria still to be defined. If new regulations along these lines take effect, they could have an adverse effect on Vivo s results of operations because (1) interconnection charges could drop significantly, thereby reducing Vivo s revenues, (2) ANATEL may allow favorable prices for economic groups without significant market power and (3) the prices Vivo charges in some regions in which it operates are higher than those in some other regions, and consolidation of those prices, competitive pressures and other factors could reduce Vivo s average prices and its revenues.

With regard to the new regulations discussed in the preceding paragraph, ANATEL has published only the new General Regulation of Interconnection (RGI Regulamento Geral de Interconexão Resolution number 410/2005), the Regulation of Separation and Allocation of Costs (Resolution number 396/2005) and the Regulation of Industrial Exploration of Dedicated Lines (EILD Exploração Industrial de Linha Dedicada Resolution number 402/2005). ANATEL has not yet published final regulations relating to the cost-based regime described above or the specific proposals described in the preceding paragraph.

In 2005, ANATEL began a public consultation period for proposed alterations to the SMP regime. The period for comments ended in January 2006, but final regulations have not yet been promulgated. These proposals address such matters as (1) requiring mobile operators to have a physical location to serve customers in each city in their areas of coverage, (2) increases in the periods of validity of prepaid cards, (3) extending the period in which customers are blocked from using cell phone service after an insolvency and (4) eliminating periods imposed by operators in which customers are not permitted to leave service plans. Vivo has presented its views on these proposals to ANATEL. ANATEL will decide whether to issue new regulations and what their content will be. If these new regulations take effect, they may negatively affect our revenues and results of operations.

Limitation on Provision of Wireline Long Distance Services. Because ANATEL considers the operators owned by Vivo to be affiliated with Telefónica, which already provides wireline long distance services in the state of São Paulo and was awarded a license to provide these services nationwide, ANATEL will not award wireline long distance licenses to the operators owned by Vivo. Though Vivo, through its operating subsidiaries, has requested that ANATEL revise the current SMP regime, there can be no assurance it will do so.

Obligations of Telecommunications Companies. As telecommunications service providers, the companies operating under the Vivo brand are subject to regulations concerning quality of service and network expansion, as established in their SMP licenses and their original concession agreements.

Any breach by the companies of telecommunications legislation or of any obligation set forth in their authorizations may result in a fine of up to R$50 million.

Our Brazilian mobile businesses SMP licenses impose obligations to meet quality of service standards, such as the system s ability to make and receive calls, call failure rates, the network s capacity to handle peak periods, failed interconnection of calls and customer complaints. ANATEL published the method for assessing these quality service standards on April 23, 2003 (ANATEL Resolution No. 335/03).

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Rate Regulation. SMP licenses continue to provide for a price-cap mechanism to set and adjust rates on an annual basis. The cap is a maximum weighted average price for a package of services. The package consists of the services in Vivo s Basic Plan, including activation fees, monthly subscription fees, and certain roaming charges, which are charged for the use of mobile services under the SMP regime. The price cap is revised annually to reflect the rate of inflation as measured by the IGP-DI. However, mobile operators are able to freely set the rates for alternative service plans.

The initial price cap agreed to by ANATEL and Vivo s operating subsidiaries in their SMP licenses was based on the previously existing or bidding prices, and was adjusted annually on the basis of a formula contained in their licenses. The price cap has been revised to reflect the rate of inflation as measured by the IGP-DI. The weighted average price for the entire package of services may not exceed the price cap, but the price for individual services within the package may be increased.

***Competition Issues*.** ANATEL is required to consult with the Brazilian competition authority, Conselho Administrativo de Direito Econômico, or CADE, in carrying out certain of its responsibilities, including those related to the review of acquisitions and joint venture agreements entered into by telecommunications operators. In turn, CADE does not exercise its responsibilities without initially seeking the views of ANATEL and would not intervene with respect to any proposed acquisition or agreement affecting competition in the telecommunications sector without first seeking the views of ANATEL. Telecommunications operators must concurrently seek review from ANATEL and CADE of acquisitions and joint venture agreements.

ITEM 5 OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion in conjunction with our audited consolidated financial statements and the accompanying notes included elsewhere in this report. Our audited consolidated financial statements have been prepared in accordance with International Financial Reporting Standards, or IFRS, as adopted by the European Commission for use in the European Union. IFRS differs in significant respects from U.S. GAAP. For a discussion of the principal differences between IFRS and U.S. GAAP, as they relate to us, see *U.S. GAAP Reconciliation and Recent Accounting Pronouncements* below and Notes 46, 47 and 48 to our audited consolidated financial statements.

The U.S. Securities and Exchange Commission, or the SEC, has adopted an accommodation permitting eligible foreign issuers for their first year of reporting under IFRS to file two years rather than three years of statements of income, changes in shareholders equity and cash flows prepared in accordance with IFRS. We are required to prepare our financial statements for the year ended December 31, 2005 for the first time in IFRS, and this Annual Report on Form 20-F has been prepared in reliance on the SEC accommodation. As a result, the operating and financial review that follows covers the fiscal year 2005 and comparable fiscal year 2004. Unless otherwise indicated, the following discussion relates to our IFRS financial information.

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Overview

Our Business and Revenue Reporting Categories

Portugal Telecom, SGPS, S.A. is a group holding company. Our business operations are conducted by our subsidiaries, which are classified for financial reporting purposes according to the general type of telecommunications services provided. Portugal Telecom s business segments consist of the following:

Wireline Business	Offering the following wireline services:
	Retail services, including fixed line telecommunications service and Internet services to residential customers;
	Wholesale services; and
	Data and corporate services, including data communications, leased lines, outsourcing and net solutions, and Internet business-to-business.
Domestic Mobile Business	Offering mobile services, such as voice, data and Internet-related services, through TMN.
Multimedia Business	Offering multimedia and Internet-related services for the residential market through PT Multimédia and its subsidiaries, including:
	Cable and satellite television through TV Cabo;
	Broadband Internet access through cable modems provided by TV Cabo
	TV programming activities through PT Conteúdos and its subsidiaries and affiliates;
	Cinema distribution, negotiation of cinema rights for all film exhibition windows and distribution of DVDs, videos, and videogames through Lusomundo Audiovisuais; and
	Cinema exhibition through Lusomundo Cinemas.
Brazilian Mobile Business	

Offering mobile services, such as voice, data and Internet-related services, through Vivo and its subsidiaries, including:

- Telesp Celular, which operates in the Brazilian state of São Paulo;
- Global Telecom, which operates in the Brazilian states of Paraná and Santa Catarina;
- TCO, which operates in the Northern and Midwestern regions of Brazil;
- Tele Sudeste, which operates in the Brazilian states of Rio de Janeiro and Espírito Santo;
- Tele Leste, which operates in the Brazilian states of Bahia and Sergipe; and
- Celular CRT, which operates in the Brazilian state of Rio Grande do Sul.

Other	International investments other than Vivo, instrumental companies and the Portugal Telecom, SGPS, S.A. holding company. Our international investments other than Vivo mainly include: Mobitel, providing call center services in Brazil, which we fully consolidate in our audited consolidated financial statements; Cabo Verde Telecom, providing fixed and mobile telecommunications services in the Cabo Verde Islands, which we fully consolidate in our audited consolidated financial statements; Medi Telecom, providing mobile telecommunications services in Morocco, which we account for using the equity method; Unitel, providing mobile telecommunications services in Angola, which we account for using the equity method; and CTM, providing fixed and mobile telecommunications services in Macao, which we account for using the equity method.

Consolidation Treatment of Vivo and Sport TV

Vivo. On December 27, 2002, we transferred our interest in TCP to our mobile joint venture with Telefónica Móviles in Brazil, originally named Brasilcel and rebranded Vivo in April 2003. The following assets were transferred to Brasilcel in December 2002:

- the controlling interest in TCP (which holds 100% of Telesp Celular and 100% of Global Telecom since December 27, 2002 and a minority interest in Celular CRT Participações (which holds 100% of the mobile operator in the Brazilian state of Rio Grande do Sul), which we used to hold; and

- the controlling interest in Tele Sudeste (which has 100% of the mobile operators in the Brazilian states of Rio de Janeiro and Espírito Santo), Tele Leste (which holds 100% in the mobile operators in the Brazilian states of Bahia and Sergipe) and Celular CRT Participações, which Telefónica Móviles used to hold.

On April 25, 2003, TCP acquired a controlling interest in TCO, a mobile telecommunications operator in the midwestern and northern regions of Brazil.

We proportionally consolidate the financial results of Vivo in our consolidated financial results for the years ended December 31, 2004 and 2005. See *Presentation of Financial Information* and *Item 4 Information on the Company Our Businesses Brazilian Mobile Business* for more information regarding corporate changes at Vivo that affect the comparability of results for our Brazilian mobile business from year to year.

On February 22, 2006, the requisite percentages of the voting shareholders of the Vivo companies approved a corporate reorganization. The corporate reorganization consisted of a merger of shares under Brazilian law (*incorporação de ações*) of TCO with TCP and the merger of companies under Brazilian law (*incorporação de empresas*) of Tele Leste, Tele Sudeste and Celular CRT Participações with TCP. As a result of the corporate reorganization, TCO has become a wholly owned subsidiary of TCP, which has been renamed Vivo Participações S.A., and Tele Leste, Tele Sudeste and Celular CRT Participações have been dissolved. Following completion of the merger, Brasilcel held 89.0% of the common shares of TCP, 47.5% of its preferred shares and 62.4% of its total share capital.

Sport TV. We acquired an additional 16.67% stake in Sport TV in a purchase completed in April 2004, increasing our ownership in that company to 50%. We proportionally consolidate the financial results of Sport TV in our consolidated financial results for the years ended December 31, 2004 and 2005.

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Business Drivers and Measures

The businesses of each of our segments are affected by a number of significant industry trends. In operating our businesses and monitoring their performance, we also pay attention to a number of operational and other factors. We summarize some of these trends and factors for each of our business segments below.

Wireline Business

Traffic Trends. Since 2002, we have experienced a continuing decrease in traffic on our fixed line network, primarily as a result of the trend among consumers to use mobile phones rather than fixed line service and increasing competition from mobile operators, other fixed line operators and, more recently, cable and VoIP providers. This decrease in traffic has negatively affected both our retail and wholesale revenues. We have also experienced strong increases in customers of our ADSL broadband Internet services, as well as a corresponding decrease in dial-up Internet use, which had an overall impact of increasing our wireline retail revenues. See *Item 4 Information on the Company Our Businesses Wireline Business Fixed Line Network* and *Traffic* .

Decreasing Fixed Line Calling Prices and Greater Focus on Pricing Plans. Retail calling prices, particularly for regional, national and international calls, have been decreasing steadily in recent years, which has negatively affected our retail revenues. One or our strategies in response to this trend has been to aggressively market a variety of pricing plans to promote customer loyalty in our competitive market. Our pricing plans tend to increase our revenues from fixed charges but sometimes decrease our traffic revenues, particularly with respect to the growing percentage of pricing plans that offer calls at a flat rate. In our wholesale business, the decrease in regulated fixed-to-mobile interconnection charges has also affected our revenues because our wholesale wireline unit records revenue from international incoming calls through our network that terminate on the networks of mobile operators, although the impact on our results of operations relating to wholesale services has not been significant. Decreases in transit traffic (calls that use our network but neither originate nor terminate on our network) also have affected our wholesale revenues. See *Item 4 Information on the Company Our Businesses Wireline Business Retail Fixed Line Telephone Services* and *Wholesale Prices* .

Workforce Reductions and Post Retirement Obligations. We expect to continue to use workforce reductions to decrease our labor costs and increase our productivity over time. In 2005, we reduced our workforce in Portugal by 1,272 employees, incurring expenses of 314.3 million to do so. Workforce reductions in our fixed line business will continue to be a significant feature of our cost management in 2006. In addition, we have substantial unfunded liabilities for unfunded pension and healthcare benefits. In 2005, we established an autonomous fund, to which we contributed 300.0 million to finance our post retirement healthcare obligations, and we also made contributions to our pension funds. We expect that contributions to these funds will continue to represent significant outflows in the coming years. See *Post Retirement Benefits* below.

Domestic Mobile Business

Decreasing Interconnection Charges. In 2005, ANACOM declared all mobile operators, including TMN, to have significant market power in call termination in the mobile networks market. As a result ANACOM imposed price controls on interconnection charges that caused interconnection rates (for both fixed-to-mobile and mobile-to-mobile calls) to decrease by an average of 23.5% in 2005 compared to 2004. We expect these rates to decrease further by an average of 18.4% in 2006 compared to 2005. These reductions have had, and are expected to continue to have, a significant impact on TMN s revenues and results of operations. See *Item 4 Information on the Company Our Business Domestic Mobile Business Prices and Revenue Breakdown* .

Continuing Roll-Out of 3G Services. One of the ways in which we respond to intense competition in the mobile networks market is by continuing to develop and bring to market innovative third generation (3G) services that increase revenues and customer loyalty. We list several of our recently launched

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services in *Item 4 Information on the Company Domestic Mobile Business Services*. Remaining competitive requires continuing investments to build out our third generation network and develop new services, and our capital expenditures on our third generation network have increased in recent years.

Multimedia Business

Shift from Analog to Digital Service. In order to remain competitive, PT Multimédia will complete the shift of the premium content cable signal from analog to digital. Digitalization of cable television business both creates a platform for offering more value-added and competitive services, while facilitating our ability to restrict illegal access to our content. In addition, shutting down the analog signal for premium content improves cable network capacity by allowing, for example, further increases in broadband internet download speeds. PT Multimédia also expects to face increasing competition from other broadband providers and from new technologies, including video over ADSL and IP television. See *Item 4 Information on the Company Our Businesses Multimedia Business TV Cabo Digitalization* and *Network* .

Effect of Macroeconomic Factors on Premium Services Provided. PT Multimédia s revenues are affected by general macroeconomic conditions in Portugal, which result, for example, in higher disconnection levels on Pay TV and Internet services, thereby affecting PT Multimédia s customer base. The weak macroeconomic conditions are expected to continue in 2006.

Brazilian Mobile Business

Shift to Prepaid Services. The Brazilian mobile market has been influenced in recent years by a shift to prepaid services. Prepaid services generate usage charges and interconnection charges but do not generate fixed monthly charges. Prepaid services have also attracted lower income customers to Vivo s services, and prepaid customers tend to make fewer outgoing calls than contract customers. Because of the importance of contract customers to Vivo s business, the Vivo companies have undertaken initiatives to maintain and develop the contract customer base.

Competition. The Vivo companies face aggressive competition throughout their regions, both from existing competitors and new entrants into the market. In the face of this competition, the Vivo companies have generally pursued a strategic focus on profitability and selective customer growth, rather than a specific focus on gaining market share. Within their strategic focus, the Vivo companies pursue a number of strategies to address these competitive pressures, often including discounts on handsets and accessories, loyalty programs (which have generally contributed to a reduction in revenues from monthly subscription charges in the short term) and marketing and promotional expenses (which increase selling expenses).

Impact of Regulatory Matters. The introduction of carrier pre-selection codes in 2003 has tended to decrease both the outgoing calls revenues of the Vivo companies and the interconnection charges they pay to other companies. At the same time, the partial Bill & Keep regime governing interconnection charges also introduced in 2003 has tended to decrease the revenues received by the Vivo companies from interconnection fees charged to other companies. In addition, significant uncertainty remains regarding future regulation of interconnection charges and other matters by ANATEL. ANATEL has proposed to replace the current interconnection regime with a different cost-based model, but we cannot predict the features of any new regulatory regime that may be implemented. See *Item 4 Information on the Company Regulation Brazil* .

All our business segments are subject to significant competition and operate in highly regulated environments. You should carefully review *Item 4 Information on the Company Competition* and *Regulation* for more information. In addition, you should be aware of the risks to which each of our businesses is subject. See *Item 3 Key Information Risk Factors* .

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Transition to International Financial Reporting Standards

For the first time, we are required to prepare our consolidated financial statements for the year ended December 31, 2005 in accordance with International Financial Reporting Standards, or IFRS. Our 2005 consolidated financial statements also include comparative financial statements for 2004 prepared in accordance with IFRS. Note 45 to our consolidated financial statements contains a description of the primary differences between Portuguese GAAP (the previous GAAP) and IFRS as they relate to our company.

Explanation of Transition to IFRS. Portugal Telecom applies IFRS as adopted by the European Union, and including all interpretations of the International Financial Reporting Interpretation Committee as of December 31, 2005. For Portugal Telecom, there are no differences between IFRS as adopted by the EU and IFRS as published by the International Accounting Standards Board. Portugal Telecom s consolidated financial statements prepared in accordance with IFRS include comparative financial statements for the year ended December 31, 2004. The opening IFRS consolidated balance sheet was prepared as of January 1, 2004 (date of the transition to IFRS in accordance with IFRS 1). IFRS 1 requires that an entity develops accounting policies based on the standards and related interpretations effective at the reporting date of its first annual IFRS consolidated financial statements. These accounting policies must be applied as of the date of transition to IFRS and throughout all periods presented in the first IFRS consolidated financial statements.

In accordance with IFRS 1, assets and liabilities are recognized and measured in accordance with International Financial Reporting Standards required to be applied as of December 31, 2005. The resulting differences between the IFRS carrying amounts and the carrying amounts of the assets and liabilities in the consolidated balance sheet under Portuguese GAAP as of January 1, 2004 are recognized directly in equity at the date of transition to IFRS.

Explanation of Exemptions Applied Under IFRS 1. In general, the carrying amounts of the assets and liabilities in the consolidated balance sheet under Portuguese GAAP for the year ended December 31, 2003 must be recognized and measured retrospectively in the opening IFRS consolidated balance sheet as of January 1, 2004 on the basis of those IFRS in force at December 31, 2005. IFRS 1 nevertheless provides exemptions from this principle in specific cases. The main exemptions applied by Portugal Telecom are explained below:

Cumulative Translation Differences. Under IAS 21, The Effects of Changes in Foreign Exchange Rates , differences from the translation of financial statements prepared in a currency other than the presentation currency of the parent must be recognized as a separate component of equity. In line with the principle of retrospective application of IFRS, these differences would ordinarily be required to be determined retrospectively. However, under an exemption contained in IFRS 1, cumulative translation differences may be deemed to be zero as of January 1, 2004, the date of transition. In the case of subsequent disposal of the entity concerned, only translation differences that arose after the date of transition to IFRS are recognized in profit or loss. Portugal Telecom has applied this exemption. See Note 3(q) to our audited consolidated financial statements for a more detailed discussion of our accounting for cumulative translation differences.

Revaluation as Deemed Cost. Companies that have revalued their assets in accordance with the legislation in force at a particular date prior to first-time adoption of IFRS may establish the related value as deemed cost of the assets and may account for the assets from the date of the revaluation in accordance with the IFRS effective at the date of preparation of the first IFRS financial statements. In prior years, Portuguese legislation allowed companies to perform a revaluation of their tangible assets in accordance with applicable official inflation rates. Portugal Telecom has applied the exemption under IFRS, and, accordingly, the revaluation of its tangible assets performed in accordance with Portuguese legislation prior to January 1, 2004 was included as the deemed cost of the assets for IFRS purposes. See Note 3(c) to our audited consolidated financial statements for a more detailed discussion of our accounting for tangible assets.

Business Combinations. IFRS 3, *Business Combinations* , is not required to be applied retroactively to business combinations that took place before the date of transition to IFRS. Portugal Telecom has applied this exemption and has therefore recorded goodwill relating to business combinations prior to January 1, 2004 as it was recorded under Portuguese GAAP. Since January 1, 2004, goodwill has not been amortized and business combinations since that date have been recorded in accordance with IFRS 3. At the date of transition to IFRS, goodwill was tested for impairment (*i.e*., a reduction in its recoverable amount to below its carrying amount) and was written down, if required. Historical cost and accumulated goodwill amortization were netted for the purpose of preparing the opening IFRS consolidated balance sheet.

Critical Accounting Policies under International Financial Reporting Standards

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with IFRS. Our reported financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie preparation of the financial statements. We base our estimates on historical experience and on various other assumptions, the results of which form the basis for judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our consolidated financial statements.

Property, plant and equipment, and intangible assets. Accounting for property, plant and equipment, and intangible assets involves the use of estimates for determining fair value at the acquisition date, in particular in the case of assets acquired in a business combination, and for determining the expected useful lives of those assets. The determination of the fair values of assets, as well as of the useful lives of the assets is based on management s judgment.

The determination of impairments of property, plant and equipment, and intangible assets involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the telecommunications industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, discontinuance of services, current replacement costs, prices paid in comparable transactions and other changes in circumstances that indicate an impairment exists. The determination of recoverable amounts and fair values are typically based on discounted cash flow methodologies that incorporate reasonable market assumptions. The identification of impairment indicators, the estimation of future cash flows and the determination of fair values of assets (or groups of assets) requires management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows, applicable discount rates, useful lives and residual values. At December 31, 2005 and 2004, Portugal Telecom concluded that the carrying value of these assets does not exceed their recoverable amounts.

Under U.S. GAAP, the recoverability of intangible assets subject to amortization is measured by comparing the sum of the future undiscounted cash flows derived from an asset (or a group of assets) to their carrying value. If the carrying value of the asset (or the group of assets) exceeds the sum of the future undiscounted cash flows, an impairment is considered to exist. If an impairment is considered to exist on the basis of undiscounted cash flows, the impairment charge is measured using an estimation of the assets fair value. Reversal of previously recognized impairment losses is not permitted.

Goodwill. Goodwill arising on consolidation represents the excess of the cost of acquisition over our interest in the fair value of the identifiable assets and liabilities of a subsidiary at the date of acquisition. The assets and liabilities acquired are measured provisionally at the date on which control is acquired, and the resulting value is reviewed in a maximum period of one year from the date of acquisition. Until the fair value of the assets and liabilities has been definitively determined, the difference between the cost of acquisition and the carrying amount of the company acquired is recognized provisionally as goodwill.

Goodwill acquired on or after January 1, 2004 is measured at acquisition cost, and goodwill acquired in previous periods is recognized at the carrying amount at December 31, 2003, in accordance with Portuguese GAAP. In both cases, since January 1, 2004, goodwill has not been amortized, and at the end of each reporting period, goodwill of each cash-generating unit is reviewed for impairment (*i.e.*, a reduction in its recoverable amount to below its carrying amount) and written down if necessary. The recoverability analysis of goodwill is performed systematically at the end of each year or whenever it is considered necessary to perform such an analysis. The recoverable amount is the higher of the estimated selling price of the asset less the related selling costs and value in use. Value in use is taken to be the present value of the estimated future cash flows. In calculating the recoverable amount of goodwill, Portugal Telecom used the value in use approach for all cases, preparing the projections of future pre-tax cash flows on the basis of the budgets most recently approved by our board of directors. These budgets include the best available estimates of the income and costs of the cash-generating units using industry projections, past experience and future expectations. These projections cover the coming five years, and the flows for future years are estimated by applying reasonable growth rates that in no case are increasing or exceed the growth rates of prior years.

Under U.S. GAAP, effective January 1, 2002, we adopted SFAS No. 142, *Goodwill and Other Intangible Assets*. The goodwill impairment test, which is based on fair value, is performed on a reporting unit level. Goodwill on equity method investments continues to be tested for impairment in accordance with Accounting Principles Board (APB) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* (APB 18). The fair value of the reporting units for which goodwill has been assigned was considered to be the best reasonably consistent measurement of fair value measurements that included both income and market approaches, as explained above. Goodwill in each operating segment will be tested for impairment at the year end.

In light of the fact that analyzing the impairment of our recorded goodwill requires a combination of various assumptions and variables, it is very difficult to analyze the sensitivity of the projections to changes in any isolated variable on its own, since a change in one variable may have an effect on one or more of the other variables used.

The goodwill impairment analysis that we conducted as of December 31, 2005 did not suggest that any such impairment was likely in a future period.

Impairment tests**.** The determination of the recoverable amount of a cash-generating unit (under IFRS) or the fair value of an asset group or a reporting unit (under U.S. GAAP) for impairment testing purposes, involves the use of estimates by management. Methods used to determine these amounts include discounted cash flow methodologies and models based on quoted stock market prices. Key assumptions on which management has based its determination of fair value include ARPU (monthly average revenue per user), subscriber acquisition and retention costs, churn rates, capital expenditures and market share. These estimates can have a material impact on fair value under both IFRS and U.S. GAAP and the amount of any goodwill write-down.

Deferred taxes**.** As of December 31, 2005, we recorded deferred tax assets, net of deferred tax liabilities, amounting to approximately 1,052.9 million. This balance consists primarily of (1) temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes and (2) tax losses carried forward. The realization of deferred tax assets is reviewed by our management using each entity s tax results forecast based on budgets and strategic plans. Valuation allowances are considered in respect of deferred tax assets to the extent that the recovery of the related taxes is not considered probable. If our management were to conclude that certain deferred tax assets for which allowances had been made were to be realized, a previously recorded valuation allowance would be fully or partially reversed.

Accrued post retirement liability. As of December 31, 2005, we recorded an accrued post retirement liability amounting to 2,635.9 million to cover for our unfunded obligations regarding pensions and post retirement healthcare benefits. We estimate our obligations regarding post retirement benefits based on actuarial valuations prepared annually by our independent actuaries, which use the projected unit credit method and consider certain demographic and financial assumptions. The key financial assumptions affecting post retirement benefit costs are based, in part, on actuarial valuations, including discount rates used to calculate the amount of the post retirement benefit obligations. The discount rate reflects the weighted average timing (approximately 25 years) of the estimated defined benefit payments. The discount rate premium is determined based on European corporate bonds rated AA. The assumptions concerning the expected return on plan assets are determined on a uniform basis, considering long-term historical returns, asset allocation and future estimates of long-term investment returns. In the event that further changes in assumptions are required with respect to discount rates and expected returns on invested assets, the future amounts of the; post retirement benefit costs may be materially affected.

Provisions. Provisions are recorded when, at the end of the period, we have an obligation to a third party that is probable or certain to create an outflow of resources to the third party, without at least equivalent return expected from the third party. This obligation may be legal, regulatory and contractual in nature. It may also be derived from our practice or from public commitments having created a legitimate expectation for such third parties that we will assume certain responsibilities.

To estimate the expenditure that we are likely to bear to settle its obligation, our management takes into consideration all of the available information at the closing date for its consolidated financial statements. If no reliable estimate of the amount can be made, no provision is recorded; information is then presented in the notes to the financial statements.

Contingencies, representing obligations which are neither probable nor certain at the time of drawing up the financial statements, and probable obligations for which the cash outflow is not probable are not recorded. Information about them is presented in the notes to the consolidated financial statements.

Because of the inherent uncertainties in the foregoing evaluation process, actual losses may be different from the original estimated amount provisioned at the closing date.

Revenue and expense recognition from telecommunications services. Revenues from telecommunications services are recognized when rendered. Billings for these services are made on a monthly basis throughout the month. Operating revenues are reported on a gross basis, with the compensation paid to other telecommunications operators being accounted for as operating expenses in the same period the revenue is recognized. Unbilled revenues from the billing cycle are estimated based on the minutes of usage of the period and the prior month s pattern of traffic revenues, and are accrued at the end of the month.

Unbilled expenses related to telecommunications costs incurred during the period (which primarily consist of interconnection fees paid to other operators) are also estimated based on the traffic information regarding the usage of other operators networks during the period and the prior month s pattern of telecommunications costs.

Differences between estimated and actual unbilled revenues and expenses, which are recognized in the following period, may impact our results of operations in the period that such differences are recorded.

Allowance for doubtful accounts. The allowance for doubtful accounts receivable is stated at the estimated amount necessary to cover potential risks in the collection of overdue accounts receivable balances. A determination of the amount of allowances required is made after careful analysis of the evolution of accounts receivable balances, and, in specific cases, our analysis is also based on our knowledge of the financial situation of our customers. The required allowances may change in the future due to changes in economic conditions and our knowledge of specific issues. Future possible changes in recorded allowances would impact our results of operations in the period that such changes are recorded.

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Results of Operations

Our operating results reflect the changing patterns in our business described above in *Overview*. The key changes over the course of 2004 and 2005 include:

- increasing revenues from Brazilian mobile services and from pay TV and Internet services;
- decreasing wireline telephone service revenues and domestic mobile services; and
- a high level of work-force reduction program costs in 2004 and 2005, as we focus on increasing the efficiency of our wireline business.

The following tables set forth the contribution to our consolidated operating revenues of each of our major business lines, as well as our major consolidated operating costs and expenses, for the years ended December 31, 2004 and 2005.

	Year Ended December 31,				
	2004			2005	
	EUR Millions	% of Operating Revenues	% Increase of Item	EUR Millions	% of Operating Revenues
CONTINUED OPERATIONS					
Operating revenues:					
Wireline business	**2,144.8**	**35.9%**	**(4.4)%**	**2,050.4**	**32.1%**
Retail	1,374.0	23.0%	(4.2)%	1,315.7	20.6%
Wholesale	360.0	6.0%	(8.9)%	328.1	5.1%
Data and corporate	225.6	3.8%	2.4%	231.0	3.6%
Directories	129.7	2.2%	(7.2)%	120.4	1.9%
Sales	35.5	0.6%	(4.9)%	33.8	0.5%
Other	20.0	0.3%	7.5%	21.5	0.3%
Domestic mobile business	**1,462.4**	**24.5%**	**(0.5)%**	**1,455.4**	**22.8%**
Services	1,307.1	21.9%	(0.1)%	1,306.2	20.5%
Sales	149.1	2.5%	4.6%	142.2	2.2%
Other	6.3	0.1%	11.1%	7.0	0.1%
Multimedia business	**597.9**	**10.0%**	**4.9%**	**627.4**	**9.8%**
Pay-TV and cable Internet	511.9	8.6%	7.6%	550.7	8.6%
Audiovisuals	85.2				