PORTUGAL TELECOM SGPS SA
Form 6-K
March 17, 2010
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

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

Securities Exchange Act of 1934

For the month of March 2010

Commission File Number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of registrant as specified in its charter)

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

(Address of principal executive office)

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

Form 20-F x Form 40-F o

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

Yes o No x

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Portugal Telecom

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

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Portugal

Wireline Euro 1,948 million (revenues)	• Retail, large corporates voice and data, ISP and broadband services [PT Comunicações100%] • SMEs voice and data [PT Prime 100%]
Mobile Euro 1,518 million (revenues)	• TMN 100%

Main international assets

			Revenues (Euromillion)
Vivo 29.71%	• Brazil	• Mobile	3,138
Unitel 25% (*)	• Angola	• Mobile	1,120
CTM 28%	• Macao	• Wireline, mobile	219
MTC 34% (*)	• Namibia	• Mobile	124
CVT 40% (*)	• Cape Verde	• Wireline, mobile	71
Timor Telecom 41.12%	• East Timor	• Wireline, mobile	35
CST 51% (*)	• São Tomé e Príncipe	• Wireline, mobile	12
UOL 28.78%	• Brazil	• ISP, contents and Internet	n.a.

(*) These stakes are held by Africatel, which is controlled 75% by PT.

Support companies

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

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

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

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Chairman s message

In 2009, PT consolidated the strategic path initiated at the end of the mandate of the 2006-08 triennium with the implementation of the plan that was presented to the Shareholders and that was approved by a large majority in the most participated Shareholders Meeting of PT s history, which took place on 2 March 2007. This plan was further extended and consolidated, in April 2008, with the approval of the strategic plan by the Board of Directors, which builds the foundations for future profitable growth.

Also during 2009, PT consolidated its presence in the markets where it operates, by continuing to launch new products and services that allowed the Company to maintain a leading competitive position in each respective market.

A new Board of Directors for the period between 2009 and 2011 was elected in the Annual General Meeting that took place in April 2009. This new Board of Directors will continue to define and implement PT s strategy, focused on the relentless pursuit of opportunities to grow and consolidate further PT s presence in the markets where the Company operates.

Despite the adverse economic environment, in 2009, PT s revenues grew by 0.9% y.o.y to Euro 6.8 billion and its EBITDA grew by 0.9% to Euro 2.5 billion. As a result of the strong focus in PT s international geographies, 51.5% of revenues and 44.0% of EBITDA were generated by international assets. PT delivered net income of Euro 684 million, up by 18.7% y.o.y, which represented an earnings per share of Euro 0.78, up by 22.9% y.o.y. I am fully convinced that this performance reflects the growth strategy defined by the Board of Directors and implemented by the Company. The diversification within different geographies has enabled PT to have a good growth profile and at the same time a stable cash-flow generation, which has allowed for a strong shareholder remuneration policy and the required investment for the sustainability of PT s business.

PT is committed to having Portugal as one of the most advanced nations in information society

During 2009, PT reinforced its commitment and investment in the development and implementation of new technologies, services and products to further promote the information society and the info-inclusion of all citizens in the market where it operates.

In Portugal, PT announced an ambitious project to cover one million households with fibre-to-the home (FTTH), thus taking a decisive and firm step to improve the speed and quality of the broadband access, turning Portugal a reference case in the development of next generation access networks. PT also continued to invest significantly in the next generation access wireless networks, with the continued development of the 3G and 3.5G technologies, both in terms of coverage and also in terms of capacity. PT also continued to promote the convergence of fixed and mobile networks and the convergence of telecoms, multimedia and information services as a means to develop further the access of individuals to information at anytime and anywhere and to develop further the services offered and fulfil the communication needs of corporations, SMEs and SOHOs.

In Brazil, PT also continued to promote the coverage of 3G and 3.5G technologies through Vivo. In the other international operations and geographies, PT, together with its partners, also continued to deploy efforts in the coverage and capacity of its wireless and fixed networks, thus further contributing to the development of the information society in all countries where PT operates.

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Shareholder remuneration policy

In May 2009, PT announced a new shareholder remuneration policy consisting of the proposal to pay dividend per share of Euro 0.575 for the fiscal years 2009-11, the mandate of the new Board of Directors. With the announcement of this remuneration policy, PT aimed to provide clear, visible, predictable and attractive remuneration profile to its shareholders. This programme was proposed following a thorough assessment of PT s operational and financial prospects and intends to, while adequately remunerating shareholders, maintain the PT s operational and financial flexibility, thus allowing a continued investment in the development of new products and services and the ability of PT to continue to design and establish a growth paradigm in the markets where it operates.

This new shareholder remuneration package follows the one that was approved in the General Shareholders Meeting that was held in March 2007 and that was fully implemented with the payment, in April 2009, of the dividend related with fiscal year 2008 and that represented the return of Euro 5.8 billion to shareholders through dividends, share buyback and the spin-off of PT Multimedia. This new shareholder remuneration policy will start to be implemented, upon approval by shareholders in the upcoming Annual General Shareholder Meeting, with the payment of the dividend per share of Euro 0.575 related with fiscal year 2009, as proposed by the Board of Directors.

Ambition for the future

PT will continue to develop further its international agenda, aiming at continuing to be a relevant operator in the Portuguese-speaking geographies and in the international landscape. At the same time, PT will continue to position itself as a leading-edge technology operator, aiming at providing advanced and convergent services to meet the needs of all its customers and further enhance its growth profile. PT will also continue to be focused on providing attractive and adequate returns to its shareholders, while at the same time providing adequate compensation and opportunities to all its employees and stakeholders in general.

I would like to thank for the support and confidence we received from our shareholders and to ensure that the Company remains committed to continue to deliver on the strategy defined by the Board of Directors in the best interest of all shareholders.

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CEO s message

Dear Shareholders,

Building on the transformational process initiated in 2008, we set out five strategic business objectives at the onset of our current mandate for 2009-2011, namely:

1. Reach 100 million customers at the end of 2011;

2. Increase the contribution of international revenues to two-thirds of total revenues;

3. Reinforce our leadership in all the markets where we operate;

4. Achieve top quartile operational and financial performance among European peers, and

5. Become a reference in sustainability in all the geography where we operate.

It pleases me to inform you that Portugal Telecom s 2009 results have taken us a step closer to fulfilling these ambitious targets. Based on a business approach clearly focused on innovation and execution, in order to build a structural competitive advantage over time, PT s operational performance in 2009 confirmed the positive trends we started to witness in the previous year, namely:

- The continued success of the Meo triple-play offer in Portugal is supporting market share gains in Pay-TV and broadband, as well as leading to a significant improvement in fixed line disconnections. This has supported an acceleration of wireline retail revenues and positive growth in gross profit in the fourth quarter.

- Post-paid customer growth, underpinned by the success of wireless broadband, is improving the mobile customer mix in Portugal.

- Vivo s leadership in voice and data in Brazil was reinforced, notwithstanding aggressive competitive conditions, and against a backdrop of improving profitability derived from greater scale and efficiency.

- Assets in Africa and Asia continued to post solid growth in terms of customers (+23%) and financial results.

As a result, PT added nine million new customers across all our properties and reached a total of 72 million customers (+15%). During 2009, we continued to increase our international exposure. In fact, our international business now accounts for 84% of our customers,

with a significant portion coming from Brazil, 51.5% of our revenues and 43% of our net income.

Domestic market

Notwithstanding a challenging economic, regulatory and competitive environment, PT performed strongly across all its business segments, adopting an attacker mindset based on continuous innovation and an increased understanding of the shifting customer behaviours and preferences.

In the residential segment, PT continued to market Meo s Pay-TV service aggressively and launched new features aimed at continuously differentiating our offer. We also added new content, through partnerships signed with leading content suppliers, in particular with regard to Portuguese content. Meo continued to provide a disruptive Pay-TV offer in the market, offering access to a wide choice of channels, high-definition, latest

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generation set-top boxes with video recording (PVR), electronic programming guide, and remote PVR. Throughout 2009, we also introduced a number of new features such as a photo sharing service, games and information services, leveraging on the leading internet portal in Portugal (Sapo), which is owned by PT.

In the personal segment, PT continued to pursue several initiatives around mobile internet and TV, launching new smartphones and other data-enabled phones. PT also launched new applications aimed at increasing usage of data and other value added services, namely new interactive applications for social media and also launched a mobile TV offer, leveraging on Meo s brand.

In the SME and SOHO segment, PT continued to leverage on fixed-mobile convergent solutions, aimed at simplifying the communication services offered and also allowing PT to offer increasingly more customised solutions for specific market segments. In the corporate segment, we continued to take advantage of the blurring of the boundaries of telecoms and IT, offering new and more sophisticated high-value services to our customers, essentially with the aim of profitably increasing PT s share of wallet.

Overall, PT continued to strengthen its market share in the domestic market, across both the wireline and mobile platforms. In wireline, we continued to take significant share in Pay-TV, increasing our market share from 13.6% to 23.0% at the end of the year. The success of our triple-play offer also underpinned improving fixed broadband trends, with an increase in market share from 43.4% to 46.2% . Notably, the level of net fixed line disconnections also improved substantially from 173 thousand in 2008 to 96 thousand in 2009, of which only 31 thousand in the second half of 2009. In mobile, we also reinforced our leadership in the market, adding 319 thousand new SIM cards and improving the share of service revenues by 0.5pp to 43.1% . In terms of wireless broadband and smartphones, TMN is clearly the leader in the market with over 50% market share in both cases.

International Market

PT continued to centre its international strategy mainly on Portuguese-speaking countries and on a distinctive vision of continuous customer-driven innovation, bringing to bear best practices across all our operations. We specialised in two core international geographies: Brazil and Sub-Saharan Africa markets that will continue to be driven by significant growth in penetration of wireless services, and where we enjoy close cultural ties.

In Brazil, Vivo continued to build the foundations for future profitable growth, while ensuring the sustainability of its leadership in the Brazilian mobile market. Vivo s market share of customers remained flat at 30% in 2009, supported by strong commercial activity in 4Q09, when market share of net additions reached 37%. In a highly competitive environment, Vivo also improved the profitability of its operations, increasing its EBITDA margin to circa 30% in 2009. As a result, Vivo more than doubled its net income and announced a full payout for the second consecutive year.

Worth highlighting MTC in Namibia, which posted a solid performance during 2009, with customers growing by 27% and EBITDA by 25% in Euros. Against a backdrop of adverse economic and regulatory environment, CVT,

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Cape Verde s telecom operator, continued to invest in the quality of its infrastructure and in the differentiation of its services.

The performance of Timor Telecom was also noteworthy. In 2009, the company invested significantly in the coverage and quality of its services, and repositioned its brand and improved its commercial efforts. As a result, Timor Telecom increased its mobile customer base by 181%, which underpinned top line and EBITDA growth in the range of 30%.

In 2009, PT sold its equity stake in Medi Telecom, which generated a capital gain of Euro 267 million, in line with its commitment to its three core geographies and its strategic and financial discipline.

Investment

It is our belief that we can build a structural competitive advantage if we can bring to bear our investments in leading-edge technology to provide more and better quality services more quickly to our customers. We believe that it can be a key driver for growth in a continuously changing and evolving market.

In 2009, PT developed an ambitious investment programme on next generation access networks, both in fixed in mobile, with this objective in mind. At the end of the year, PT had covered 965 thousand households with fibre-to-the-home (FTTH), thus turning Portugal into a case study in the development of next generation access networks. It is our understanding that FTTH is the right technological investment for those companies that believe that the network is not a commodity and that network architecture can become a structural competitive advantage in the corporate and residential markets. PT also continued to invest significantly in the development of the 3G and 3.5G technologies, in terms of coverage and capacity, in both Portugal and Brazil.

Financial results and remuneration

In terms of financial performance, PT increased revenues and EBITDA in circa 1% in 2009 to Euro 6.8 and 2.5 billion respectively, while net income increased by 19% to Euro 684 million and earnings per share by 23% to Euro 0.78. From financial position standpoint, 2009 results reinforced the company s balance sheet strength, allowing for a reduction in overall indebtedness, notwithstanding the level of investment across all our operations.

With regard to the share price, PT performed very strongly in 2009, providing a total return to our shareholders of 55%, including the Euro 0.575 dividend paid, and which compares very favourably with the peer group that presented a total shareholder return of 19%.

Sustainability

Sustainability and social responsibility continued to be at the very heart of PT s strategy and operations. As a result of the continued investment in a sustainable business model, PT continued to be part of FTSE4Good index and was awarded in Portugal the Sustainable Development 2009 Award and the Citizenship of

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Corporations and Organisations 2009 Award. PT s corporate brand is amongst the fifty most valuable brands of the telecommunications sector across the world, while its two main commercial brands meo and tmn are the leading brands in Portugal in terms of brand recognition.

At the environmental level, PT continued to certify the energy performance of its buildings and reinforced the programme to replace lighting and cooling equipments by new and more efficient solutions. At the social level, PT developed several initiatives, of which it is worth highlighting the programme to support its unemployed customers, through a special offer, and the partnership with AMI to support the medical treatment of the dengue disease in Cape Verde. PT also continued to invest in the social inclusion in the communities where it is present, for example through the distribution of laptops and computers in countries like Cape Verde, São Tomé e Principe and East Timor.

Future prospects

We have set an ambitious growth agenda along the five strategic business objectives outlined above. In light of our business vision, which is underpinned by long-term investments to build a structural competitive advantage in our markets, we are challenging the status quo in our industry and laying the foundations to secure lasting growth and prosperity for our company and the creation of value for our shareholders. Internationally, we intend to manage our footprint depending on opportunities and our ability to create value, always abiding by a strict strategic and financial discipline.

On 14 May 2009 PT announced a new three-year dividend plan, which proposes to distribute a dividend per share of Euro 0.575 per annum. This plan offers an attractive and predictable remuneration policy to our shareholders, combined with above-average growth prospects, by leveraging on our international portfolio and improving domestic operations.

Finally, I would like to thank the support we received from our shareholders, the commitment and professionalism of our employees and the trust provided by both our customers and our suppliers, without all of whom these results would not have been possible.

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Macroeconomic environment

2009 was marked by a severe slowdown in activity in the largest economies areas as a consequence of the global financial crisis that began in 2007. This evolution was determined above all by the deterioration of economic agents, translated into a decline in demand and a collapse of the flow of international commerce during the first half of the year. The recession took place in a framework of less availability of liquidity in financial markets and, therefore, in a more restrictive financing environment. The authorities responded by lowering reference interest rates to levels close to zero, by injecting liquidity into the financial system and, in terms of budgetary policy, by using tax incentives to promote the consumption of durable goods and an increase in the public expenditure in infrastructures.

GNP Growth, Selected Economies (%)

Source: IMF, National Statistics Institutes.

As a result of the aggressiveness of these incentives, there were clear signs of acceleration of economic activity and also of financial stabilisation in 2H09, especially in 4Q09. This latter translated into a gradual narrowing of the spreads in the monetary and credit markets, reflecting a decrease in risk-aversion and an increase in the confidence levels of financial institutios. In the Euro Zone, as the main ECB interest rate decreased from 1.5% to 1%, the 3-month Euribor rate decreased throughout the year, from 2.89% to 0.7% . Although still at higher levels than before the crisis, credit spreads have narrowed, as the iTraxx Financials index, relative to Credit Default Swaps, has decreased from a maximum of 206 bps in March to 75 bps at the end of the year.

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Liquidity Premium, Financial Sector

(Cash Bonds vs. CDS Spreads, base points)

Source: Bloomberg.

Although oil prices soared in 2009 (from USD 42 to USD 77 per Brent barrel) the productivity increase observed in the main economies allowed growth to take place in an environment of low inflation and interest rates. This fact has benefited stock markets, especially from 2Q09 onwards. In the United States, Dow Jones, Nasdaq and S&P500 indices have increased by 18.8%, 43.9% and 23.5% per annum, respectively. In the Euro Zone, DAX, CAC 40 and IBEX indices have increased by 23.9%, 22.3% and 29.8%, respectively. As a reflection of the more favourable perspectives for emerging markets, the Bovespa (Brazil), Shanghai Composite (China) and Sensex (India) indices have increased by 82.7%, 79.9% and 81%, respectively.

Year-on-Year Inflation Rate (%)

Source: Bloomberg.

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Main Stock Indices

Source: Bloomberg.

International Economic Environment

The US economy was marked in 2009 by high levels of uncertainty as to the evolution of economic activity and the stability of the financial system, as the GDP fell in 1H09 (-6.4% and -0.7% in annual terms, in 1Q09 and 2Q09, respectively). Against this backdrop, the US authorities have reacted decisively. As to monetary policy, the Federal Reserve Bank, after bringing the reference interest rate to levels between 0% and 0.25% and adopting several measures to increase liquidity in 2008, increased the use of non-conventional measures in 2009. These included, among others, a program for the acquisition of mortgage-backed securities (up to USD 1,200,000 million) and another for the acquisition of public debt bonds (up to USD 300,000 million). The Fed s measures have contained the increase of 10-year Treasury yields (from 2.21% to 3.38% throughout the year). In terms of the US budget, there have been several incentives, such as the American Recovery and Reinvestment Act, involving an amount of nearly USD 800,000 million, comprised of tax reductions, fiscal credits for the acquisition of home and durable goods, social and financial support for the unemployed, and a reinforcement of public expenditure, particularly as regards infrastructures and energy.

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Balance of the US Federal Reserve

Source: Reuters EcoWin Pro.

As a result of monetary and budgetary incentives, the US economy showed a trend toward recovery in 2H09, with annualised growth of 5% in 4Q09. In this context, the GDP fell by only 2.6% in 2009. Private consumption and investment decreased in annual terms but with significant improvements in 2H09, particularly in the consumption of durable goods and residential investment. The beginning of a favourable cycle for investment in stock replenishment a more visible stabilisation of the housing sector and the impact of the USD depreciation on the competitiveness of American exports contributed also decisively to the improvement of economic activity.

USD, Effective Exchange Rate

Source: Reuters EcoWin Pro.

The commitment of the US authorities to economic and financial stability had an important impact on the confidence levels of economic agents, enabling the return of optimism to the markets right after March. This was expressed as a strong valuation of the main stock market indices and a narrowing of credit spreads.

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Besides the improvement in the economic outlook, the financial markets also benefited from the expectations of low inflation (-0.3% in 2009), along with high excessise productive capacity (of which unemployment, hitting 10% of the active population at the end of the year, noteworthy). The low interest rate environment has contributed to making the USD the main instrument of carry trade, financing investments in assets of higher return, especially in emerging and commodity-exporting economies. This fact has sustained USD depreciation, which surpassed 16% in effective terms between March and December.

The economy of the Euro Zone performed differently in 1H09 and 2H09. 1H09 was marked by a strong contraction in activity (declines of 2.4% and 0.2% q-o-q in 1Q09 and 2Q09, respectively) following the recession, which started in 2Q08, with declines in exports and investment. This performance should be analysed in the context of the consequences of the financial crisis, which was at its peak in September and October 2008. The contraction of liquidity and the strong deterioration in confidence levels in the last months of 2008 led to a general decrease in confidence and demand, translating into a strong contraction of external demand. This had an especially negative impact in Germany, with an expected GDP decrease close to 5% in 2009, the worst result since World War II. Several economies of the Euro Zone continued to suffer the effects of a recession in the housing sector, which amplified the negative adjustment of demand. Throughout the year, the GDP of the Euro Zone fell close to 4%.

3Q09 and 4Q09 showed, however, a return to positive activity growth (variations of 0.4% and 0.6% q-o-q, respectively) after five consecutive quarters of contraction. This performance benefited from an improvement in exports, a favourable effect of replenishment investments in stock (favouring industrial activity), and government monetary and budgetary incentives. Internal demand, however, has demonstrated poor performance, marked by restrictions in the financing of private consumption and investment, deterioration of the conditions of the labour market (especially the progressive increase in the unemployment rate up to 10% of the active population at the end of the year), and an increase in precautionary savings.

Refi and Euribor Rates (%)

Source: Bloomberg.

As to prices, the average annual inflation was marginally above 0% (after 3.3% in 2008), as a result of the absence of upward pressures on prices from demand, as well as from the evolution of energy prices, with the statistical effect of the decrease in oil prices compared to 2008. In this context, until May, the European

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Central Bank implemented a policy of reduction of the reference interest rates. The European monetary authority lowered its main interest rate 50 base points twice in January and March and 25 base points twice in April and May. Since October 2008, the interest rate was reduced from 4.25% to 1% and the marginal lending and deposit rates were also reduced in 125 and 175 base points, respectively. Moreover, it supplied ample liquidity to the banking system as three unlimited 12-month operations to supply liquidity stand out (amounting to EUR 614,000 million), the first two with a fixed rate of 1% and the third one at a rate indexed to the refinancing operations.

Euro Zone Spreads of Yields of

10-Year Public Debt Bonds

Source: Bloomberg.

The expansionist budgetary policies carried out by national governments, aiming at stimulating internal demand, led to considerable deterioration of public accounts, as the budget deficit in the Euro Zone as a whole increased from 2% to 6% of GDP. The Current Accounts Deficits of Greece, Ireland and Spain are noteworthy, surpassing 10% of the GDP. This evolution translated itself into a deterioration of the sovereign risk (a widening of the public bond yield spread of these governments relative to German bonds) that especially penalised Greece and Ireland, which suffered downgrades of the respective ratings at the end of the year, as well as other economies of the periphery of the Euro Zone, such as Italy, Spain and Portugal, the last two suffering downgrades in the outlook of their respective ratings.

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EUR/USD

Source: Reuters EcoWin Pro.

Economic Developments in PT s main geographies

Portugal

Reflecting the effects of the global economic crisis, there was a 2.7% GDP contraction in the Portuguese economy. This performance was less intense than in Portugal s main partners within the European Union (GDP drops of 3.7% in Spain, 2.8% in France and 4.5% in the United Kingdom). Besides a less severe recession, Portugal was one of the first EU economies to abandon the cycle of negative variations of the GDP, right after the 2Q09.

This behaviour is explained by the fact that the demand was not affected, as in other economies, by strong negative richness-effects related to adjustments in the real estate market, nor by situations of instability in the financial system. Therefore, the recession of the Portuguese economy in 2009 was the result of the slump of external demand as well as of natural deterioration of trust levels of companies and families, with a negative impact on consumption and above all on investment. These two indicators were also affected by stronger restrictions of financing criteria of economic activity, as the result of less liquidity available in international financial markets. Therefore, in 2009, exports fell by 12.3% after having decreased by 0.5% in the previous year. This decrease was due to most goods and services, as well as most export destinations of the European Union. Reflecting the contraction of internal demand, imports fell by 10.7% throughout the year, after having increased by 2.1% in 2008.

The deterioration of expectations considering the evolution of internal and external demand, the high levels of uncertainty and tighter credit availability have weighed decisively on investment levels, which fell in real terms by 12.6% . Apart from fixed capital expenditures, this evolution was also due to a reduction of the level of stocks, which increased the negative contribution of investment to the GDP. Thus, the investment of companies fell in real terms by circa 15%, which was not compensated by the strong increase in public expenditure (circa 13%), the main expression of budgetary incentives to economic activity (public expenditure increased in real terms by 2%). Family investment in housing enhanced the downward trend observed in the previous year, which was close to -12%.

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A decline in confidence levels and increased uncertainty translated into a fall of around 0.8% in private consumption. This evolution took place in spite of a raise of the available income of families as the result of the fall of the interest rates and above all of the increase of the State transfers, being explained mostly by an attitude of precaution adopted by families. Therefore, 2009 was marked by a significant increase of the savings rate, to a value slightly above 8% of the available income. This increase interrupted a continued downward trend in family savings observed since 2002. The negative evolution of private consumption is explained by the strong decline of consumption of durable goods, as expenses in non-durable goods increased marginally above zero. Purchasing power of families took advantage of negative inflation throughout 2009. In average annual terms, inflation fell from 2.6% to -0.8% . This fact contributed in the first place to a strong increase in the price of raw materials (especially oil), but it is also result of the recession environment in 2009, which strongly restricted the abilty of companies to increase prices.

Portugal Main Macroeconomic Indicators

Real growth rates (%), except when indicated.	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009 E**
GDP	0.8	-0.8	1.5	0.9	1.4	1.9	0.0	-2.6
Private Consumption	1.3	-0.1	2.5	2.0	1.9	1.6	1.6	-0.8
Public Expenditure	2.6	0.2	2.6	3.2	-1.4	0.0	0.5	2.0
Investment	-4.7	-8.3	2.5	-1.5	-0.3	3.2	-0.1	-12.6
Exports	1.5	3.9	4.0	2.0	8.7	7.5	-0.5	-12.3
Imports	-0.7	-0.8	6.7	3.5	5.1	5.6	2.1	-10.7
Inflation (Consumer Price Index)	3.6	3.3	2.4	2.3	3.1	2.5	2.6	-0.8
Budget Deficit (% of GDP)	-2.8	-2.9	-3.4	-6.1	-3.9	-2.6	-2.7	-9.3
Public Debt (% PIB)	55.5	56.9	58.3	63.6	64.7	63.5	66.4	76.6
Unemployment Rate (% of active population)	5.1	6.4	6.7	7.6	7.7	8.0	7.6	9.2
Current Accounts Deficit(% of GDP)	-6.0	-3.3	-5.7	-8.3	-9.3	-8.1	-10.5	-8.3

Sources: INE, Bank of Portugal, Ministry of Finance, European Commission, OECD, ES Research.

Notwithstanding the negative evolution of exports, 2009 was marked by a correction of the Current Accounts Deficit or External Deficit, from 10.5% to a value around 8.3% of the GDP. This fact reflects the process of deleverage undertaken by the private sector in 2009, as well as a reduction of the energy deficit. The reduction of the needs of financing of the private sector meant an increase in the needs of financing of the Public Administrations mainly as a result of the budgetary incentives to economic activity, but also reflecting the effects of the bottom phase of the economic cycle on public accounts. In this framework, the budget deficit rose from 2.7% to 9.3% of the GDP.

Emerging Markets

One of the most significant facts in 2009 was the relative dynamism of emerging economies. Although decelerating in comparison to 2008, the GDP of these economies grew 2.1%, as compared to -3.2% in developed economies and -0.8% in world economy. This dynamism is the result of a lower direct exposure to the financial crisis and, in some economies, of greater speed and aggressiveness in using activity incentives. Nevertheless, more than a mere conjunctural effect, this favourable performance should be associated with a structural trend. The strong growth of urban population and of income per capita in emerging economies demand an enormous effort of investment in infrastructures, including transportation, energy, communications and information. Investment in the main economies of Asia, Latin America, and Africa are thus one of the main drivers of the world s economic growth.

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Growth of World GDP, Emerging vs, Developing Markets
(Quarterly Variations per Annum, %).

Source: IMF, ES Research.

In 2009, in the context of emerging markets, the case of China stands out. The strong Chinese economic growth not only promotes intra-Asian dynamism, but also propels the exporting sectors of the main advanced and emerging economies. Chinese GDP grew by 9% in 2009, accelerating towards the end of the year with double-digit growths, bringing it closer to the dynamism observed before the global financial crisis. The performance of the Chinese economy was mostly the result of strong increase in investment and consumption. China reacted promptly to the recessive cycle of global activity, reorienting the growth pattern towards internal demand, from a strong acceleration of the credit volume (benefiting consumption and housing investment) and an aggressive investment effort in infrastructures.

Latin America, especially Brazil

Altogether, Latin American economies suffered the impact of the global economic crisis due to the increased global restrictions on financial markets and, above all, the decline of the flows of international commerce in the first half of the year. This decline resulted in less favourable evolution of exports, with negative impacts on investment. Within this framework, GDP growth of Latin American economies fell from 4.2% to -2.7% . The performance within the region varied among different economies, where Brazil s economy stood out, with an annual GDP change around 0% and a very visible recovery in the second half of the year.

The resilience of the Brazilian economy vis-à-vis the worst period of the global recession in 2009 enabled a process of quick recovery of the main economic and financial indicators, in line with the other BRIC countries such as China and India. The implementation of an expansionist economic policy similar to the ones adopted by the main global economies did not result in a significant deterioration of the sustainability indicators of the public and external accounts, enabling the country to maintain a positive outlook of reduction of mid- and long-term credit risk indices. Sovereign ratings were confirmed in the first degree of investment grade by Standard & Poor s and Fitch (BBB-) and aligned by Moody s from Baa3 to Baa2 with positive outlook in 2009.

Market perception as to Brazil s recovery capacity allowed its sovereign risk premium, expressed through the spreads of its 5-year Credit Default Swaps to be reduced from 300.5 base points to 122.5 base points throughout 2009. Such narrowing of the risk-aversion reverted the fall of financial flux from USD 48,900 million in 2008 to a net inflow of USD 18,800 million in 2009, increasing the amount of international reserves

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of Brazil s Central Bank to a historical maximum of USD 239,000 million (USD 207,000 million in 2008) and the appreciation of the BRL/USD of 25.5%, to a final value of USD/BRL = 1.74.

BRL/USD, BRL/EUR and

(5-year) CDS spreads, base points.

Source: Bloomberg.

Monetary policy was conducted to contain the negative effects of recession initiated at the end of 2008. In an environment of low inflation, the SELIC rate (the interest rate of reference) was reduced to a historical minimum of 8.75% in July and kept unchanged until the end of 2009, after successive cuts (after reaching 13.75% in December 2008). The inflation rate (IPCA) ended 2009 below the central target of 4.5% but with a 4.3% variation, considering the maximum of 5.9% in 2008.

The budget indicators followed the dynamics of reduction of the economic activity and of adoption of incentives that reduced fiscal revenues in an environment of expenditure reduction, causing an increase in the nominal deficit to 3.2% of GDP until November 2009, compared to the 1.9% deficit observed in 2008. Notwithstanding the effects of interest on public debt, the primary budgetary result until November 2009 was a surplus of 2.25% of GDP, compared to 3.5% in 2008. Consolidated public debt reached 43.4% of GDP until November 2009, compared to 37.3% in 2008, but not much higher than that observed in 2007 (42.8% of GDP).

In this context, Brazilian GDP demonstrated a real variation around 0% in 2009, after a strong expansion of 5.1% in 2008. Nevertheless, between the 1H09 and 2H09, activity indicators showed a very positive evolution, mostly due to internal demand (consumption and investment). Domestic factors had the most significant weight in the evolution of economic activity, especially taking into account the relatively low level of openness of the Brazilian economy. In the 4Q09, GDP showed a q-o-q growth of 4%, and an expansion of the Brazilian economy around 5% is to be expected in 2010.

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Brazil Retail Sales
(y-o-y rate of change, %)

Source: Bloomberg.

The recovery of economic indicators and the reduced reference interest rates enabled the enlargement of the domestic credit volume to 44.9% of GDP through November 2009 (compared to 39.7% at the end of 2008). Such an evolution was the result of a bigger contribution from the credit offered by the public sector and a limited deterioration of the indicators of unsettled credit from the total of credit of the financial system, from 4.4% in 2008 to 5.8% in 2009. The financial system kept solid solvability indices, and the Basel Index kept well above the minimum requirement of 11% (18.4%, according to available data for the consolidated banking system in June 2009, compared to 17.7% in December 2008).

More sensitive to the slump of global economic activity and the subsequent fall in commodity volume and prices, Brazilian exports showed a 21.8% decrease in 2009 (+23.2% in 2008), as imports decreased 25.3% (+43.5%) in 2008. Consequentely, there was a trade surplus of USD 24.9 billion in 2009 compared to USD 25.3 billion in 2008. The current accounts deficit decreased to 1.4% of GDP, compared to 1.8% in 2008. The global decline of the direct investment flows observed in 2009 also affected Brazil, where inflows of financial resources through November amounted to USD 21 billion, compared to USD 45 billion in 2008.

The risk balance evidences the solid base for recovery of Brazilian economy that contributes first of all to a strong reduction of risk-aversion and later on to a growing risk-propensity throughout 2009. This, in turn, as led to an appreciation of assets exposed to the mid- and long- term potential of economic expansion that is best expressed through the circa 83% appreciation of the Bovespa stock market index.

As to other Latin American economies, it is worth mentioning the negative GDP growth observed in Argentina (-2.5%), México (-7.3%) and Venezuela (-2%).

Africa, especially Angola

In Africa, the impact of world recession was initially felt in the economies most integrated in international financial markets, such as South Africa (with an annual GDP decline of 2.2%) . This impact later spread to oil-exporting countries, including Angola, Algeria, Libya and Nigeria, as well as economies that export industrial

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goods such as Morocco and Tunisia. Nevertheless, the recovery of the international trade flows and the stabilisation of financial conditions in the second half of the year translated into a visible recovery of economic activity in the main African economies and a clear improvement of the growth perspectives for 2010 and 2011. Throughout 2009, Africa s GDP grew by 1.9%, well above the world average. Individually speaking, it is worth mentioning, in Northern Africa, the 2.1% growth in Algeria, 5% in Morocco, and 1.8% in Libya. Among Portuguese-speaking African countries, Mozambique and Cape Verde grew by 6.1% and 3.5%, respectively.

In Angola, economic activity was directly affected by the decline in oil exports. On the other hand, the decrease of oil revenues (and consequently fiscal revenues) had a negative impact on liquidity in the economy, penalising investment in non-oil sectors. In this framework, GDP growth fell from 13.2% to circa 2% in 2009.

Angola Oil Production (mb/d)

Source: OPEC.

Nevertheless, the recovery of economic activity at global level and the increase in oil prices observed in the 2H09 contributed to make visible, during the 2H09, signs of acceleration of the Angolan economy both in the oil sector and in the non-oil sectors. In 2009, Angola showed an average oil production level of 1.8 million barrels per day, recovering vis-à-vis the decrease observed during the first months of the year. At the end of the year, Angola was the seventh biggest oil exporter to the US and the biggest to China.

The promotion of recovery of national production by the Angolan authorities, the decrease of the costs of private activities and the improvement of the social conditions of the population contributed to improved conditions in 2H09, maintaining an environment of macroeconomic stability. In this context, a growth close to 10% is to be expected in 2010.

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Angola External Reserves
(USD thousands million)

Source: BNA.

Angola AOA/USD and AOA/EUR

Source: Bloomberg.

Due to the depreciation of the kwanza vis-à-vis the currencies of Angola s main commercial partners, which contributes to making imports more expensive, especially food, 2009 was marked by inflationist pressures. This effect was augmented by constraints in terms of logistics and distribution capacity. Annual inflation rose from 12.5% to a value close to 14%. This increase justified the adoption of restrictive measures in terms of monetary policy and reinforced the priority of developing logistics infrastructures (warehousing, transportation and distribution), as well as the increase of internal productive facilities.

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02

Regulatory background

Portugal

Broadband markets. On 5 January the European Commission sent a letter to ANACOM, approving the deregulation of wholesale broadband access markets in the competitive areas. Those areas cover around 61% of all the Portuguese broadband lines and correspond to 184 main exchanges of Portugal Telecom.

On 14 January 2009, a final decision was issued, taking into consideration comments received from the European Commission, on the definition of the product and geographic markets, as well as SMP assessments and the imposition, maintenance, change or suppression of regulatory obligations with respect to the markets for wholesale (physical) network infrastructure access at a fixed location and wholesale broadband access.

Number Portability. On 4 February 2009, ANACOM approved Regulation 87/2009, which amends Regulation 58/2005 of 18 August - Portability Regulation, as well as the respective final consultation report. Regulation 87/2009 came partially into force on 4 March, 2009 and on 20 July, the rules concerning technical aspects and new deadline for number portability within mobile telephone services came into effect. On 8 July 2009, ANACOM approved Regulation 302/2009, implementing an additional amendement to the portabiliuty regulation, which clarified the method for calculating the terms applicable to the prior notice for submission of the electronic portability request and maximum response time to said request by the Donor Operator.

Next Generation Access Networks. On 18 February 2009, ANACOM granted an approval to the public consultation report on the regulatory approach to next generation access networks (NGAN). According to the principle of proportionality in the imposition of obligations, ANACOM considered a step by step approach:

- In competitive areas, only access to ducts is imposed, with improvements and equality of access, whereas other obligations are imposed (access to the actual fibre or dark fibre) only where there is a lack of space in ducts. As a last resort, where there is agreement between the parties, and as an alternative to access to own fibre or dark fibre, the option of virtual access to the network may be considered;

- In non-competitive areas, in addition to access to ducts, access to own fibre or dark fibre is also imposed, as well as virtual access to the network (advanced bitstream).

Between May and July, the Assistant Secretary of State for Public Works and Communications, approved the programmes and tender specifications of the public tenders for the installation, management, operation and maintenance of high-speed electronic communication networks in the Centre, North, Alentejo and Algarve Zones of Mainland Portugal, as well as Azores and Madeira.

On 6 February 2010, the Minister of Public Works and Communications announced the decision on the public tenders for the installation, management, operation and maintenance of high-speed electronic communication networks in the Centre, North, Alentejo and Algarve Zones of Mainland Portugal.

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Digital Terrestrial Television. On 9 June 2009, ANACOM announced that PT Comunicações would be granted the certificates that allocate rights of use of frequencies, pursuant to the provision of the digital terrestrial television service (DTT), to which Multiplexers B to F (MUX B to F) are associated.

DTT began to be broadcasted on 29 April 2009, in 29 Portuguese municipalities. In September and at year-end, 60% and about 80%, respectively, of Portuguese households were already covered.

In December 2009, the pay-TV platform was finally granted to PT Comunicações by decision of the Administrative Court, putting an end to a litigation involving PT Comunicações and Air Plus.

Following PT Comunicações request, ANACOM decided, on 29 January 2010, to approve the draft decision to repeal the act of granting of rights of use of frequencies associated with Multiplexers B to F and, as a consequence, the five titles which evidenced the rights allocated to PT Comunicações, without forfeiture of the guarantee bond. It was likewise determined that the decision to repeal shall be retroactive in effect from the date of this draft decision.

The Board of the Regulatory Authority for the Media (ERC) decided, on 23 March 2009, to exclude the two applications submitted under the public tender for the licensing of a generalist programme service on a national basis with free unrestricted access (the 5th Channel). The applications were excluded because they failed to meet the legal and regulatory requirements for admission to the tender.

The interested parties have appealed and, on October 2009, the Court decided in favour of the appeal presented by one of the parties. ERC informed to appeal from the Court Decision. Up to date the licence for the 5th Channel has not been granted.

Electronic communications networks and infrastructure: (Decree-Law No. 123/2009). On 26 February 2009, the Council of Ministers approved a draft legislation establishing the framework applicable to the construction, access and installation of electronic communication networks and infrastructure, with the aim of facilitating either the removal or the mitigation of barriers to the construction of next generation network infrastructure. This draft was subjected to a public consultation procedure.

According to the communication issued by the Council of Ministers, this proposal «*will respond to the clear need to define the framework governing development and investment by investors and/or operators of electronic communications in Next Generation Networks, as well as for the functioning of a competitive market. All are called upon to intervene in order to advance investment in the information society*».

Pursuant to the draft approved by the Council of Ministers and taking into account the several contributions addressed by the entities that took part in the consultation procedure, Decree-Law No. 123/2009, dated 21 May 2009, in the Official Gazette, no. 98, Series I, establishes a new framework that applies to the construction of infrastructure apt for the accommodation of electronic communications networks, to the set up of electronic communications networks and to the construction of infrastructures for telecommunications in housing developments. This decree-law has already been amended, by Decree-Law No. 258/2009, of 25 September 2009, the latter having corrected some failures and having also clarified some aspects of the installation of infrastructures of Telecommunications in buildings (ITED) and of Infrastructures of Telecommunications in housing developments, urban settlements and concentrations of buildings (ITUR).

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In particular, Decree-Law No 123/2009 sets forth several obligations in order to allow electronic communications operators to enjoy better conditions necessary to the installation and development of electronic communications networks.

For the above mentioned purpose, Decree-Law No. 123/2009 foresees the implementation of a Centralized Information System (SIC) to be managed and operated by ANACOM, whose main objective is to render available information on infrastructure apt for the installation of electronic communications networks, the basis of which is the information provided by the several entities subject to Decree-Law No. 123/2009, such as the State, Autonomous Regions, municipalities, publicly held companies or concessionaires, other entities owning or exploring infrastructure part of the public domain of the State, Autonomous Regions or municipalities and electronic communications undertakings.

On 16 December 2009 ANACOM approved the launch of a public consultation to render information available within the SIC. The deadline for submitting comments ends on 9 February 2010.

ITED manual (2nd edition) and ITUR manual (1st edition). On 25 November 2009, ANACOM approved the final version of the 2nd edition of the manual of Telecommunications infrastructures in buildings (ITED) and of the 1st edition of the manual of Infrastructures for Telecommunications in housing developments, urban settlements and concentrations of buildings (ITUR), which entered into force on 1 January 2010.

It was further decided to establish a transition period for the 2nd edition of the ITED Manual until 31 March 2010. During this period, ITED projects which are in accordance with the requirements and specifications of the previous version of the Manual (ITED Manual - 1st edition) will continue to be considered valid. For such purpose, the date considered shall be the date of submission of the project to the Municipalities in what concerns the referred to in article 71 of Decree-Law No. 123/2009 of 21 May, or the project s conclusion date, referenced expressly in the Statement of Liability for the cases set out in article 72 of said Decree-Law.

The changes implemented in the ITED Manual and the ITUR Manual have the objective of standardising the procedures related to the installation of optical fibre in housing developments, urban settlements and concentrations of buildings.

Quality of service of wholesale offers. On 11 March 2009, ANACOM issued a final decision regarding the publication of levels of performance in the quality of service (QoS) in the RUO (Reference Unbundling Offer), LLRO (leased lines reference offer), RDAO (reference ducts access offer), Rede ADSL PT and SLRO (subscriber line resale offer) wholesale offers.

Wholesale market for voice call termination on individual mobile networks. On 7 May 2009, the European Commission (EC) adopted a recommendation on the regulatory treatment of fixed and mobile termination rates in the European Union. The Recommendation sets out that national regulatory authorities (NRAs) should determine the national termination rates (both in fixed and in mobile networks) based on the costs incurred by an efficient operator for terminating calls on its network. A specific cost methodology is established (a bottom-up LRIC model) for calculating the rate, with the purpose of allowing operators to recover just what are considered to be relevant costs incurred in the provision of call termination services to third parties. NRAs must take the utmost account of the Recommendation, ensuring that termination rates are applied at a symmetric and cost-efficient level by the end of 2012. However, there is also a provision, in exceptional circumstances, for national regulators to be able to use alternative approaches up to 1 July 2014,

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if these methods lead to a result which is consistent with the Recommendation and with a competitive market. The EC expectation is that by the end of 2012 MTRs will lie in the range between 1.5 and 3 eurocents.

On 14 January 2010, ANACOM approved the draft decisions on the definition of relevant wholesale markets for voice call termination on individual mobile networks, the assessment of SMP in these markets and the imposition, maintenance, amendment or withdrawal of regulatory obligations, as well as the details of the implementation of the obligation to control prices.

Spectrum. On 20 May 2009, ANACOM approved the draft of the auction Regulation for the granting of frequencies rights of use for broadband wireless access (BWA).

On 17 June 2009, ANACOM approved the report on the public consultation on the allocation of usage rights in the 2500-2690 MHz frequency range (also known as the 2.6 GHz band).

On 29 July 2009, ANACOM approved the report of the public consultation on the digital dividend.

New European rules were published in the Official Journal of the European Union on 20 October 2009, opening up the GSM radio spectrum band to new services, including 3G and 4G devices as well as mobile broadband. The new rules make it possible for GSM systems (2G mobile equipment) and UMTS (3G phones that add high-speed mobile internet to regular phone services) to co-exist on the 900 MHz and 1800 MHz GSM frequency bands. These measures are due to be implemented by Europe s 27 Member States within six months, in the case of the Directive, so that GSM spectrum bands are effectively made available for 3G services.

On 23 December 2009, ANACOM approved the draft revision of the National Frequency Allocation Plan (NFAP), 2009/2010 edition, for submission to the general consultation, under the terms of article 8 of the Law of Electronic Communications.

Regulation on the settlement and collection of fees. On 1 July 2009, ANACOM approved a final decision on the Regulation on the adoption, settlement and collection of fees due to this Authority.

Universal Service. On 11 March 2009 ANACOM decided not to oppose the proposal for the public payphones tariffs, as presented by PT Comunicações on 11 February 2009 and that came into force on 1 April 2009.

On 3 November 2009, ANACOM decided not to oppose the proposal for the fixed telephone service residential tariffs, within the scope of the universal service, as presented by PT Comunicações on October 27, 2009, subject to the obligations of transparency.

Regarding the Universal Service financing, ANACOM continued in 2009 the preparation of a public consultation by which ANACOM intends to define a methodology to calculate the net costs of Universal Service and the concept of excessive burden, and to define the compensation for NCUS over the period 2001-2003. Throughout the year, PT Comunicações and ANACOM exchanged views and information and held various meetings over this matter.

Reanalysis of the leased lines retail market and the wholesale markets of terminating and trunk segments of leased lines. On 16 December 2009, ANACOM approved the draft decision on the definition of product markets and geographic markets, the evaluation of SMP and the imposition, maintenance, amendment or

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withdrawal of regulatory obligations in relation to the market for the retail provision of leased lines and the wholesale markets for the provision of terminating and trunk segments of leased lines.

New Regulatory Framework. On 19 December 2009, the legislation comprising the new regulatory framework for telecommunications entered into force, with its publication in the Official Journal of the European Union.

The package, consisting of two directives and one regulation, is due to be signed on 25 November by the presidents of the European Parliament and the Council, entering into force upon its publication in the Official Journal of the European Union, scheduled for 18 December 2009. Directives have to be transposed into national laws within 18 months from the date of their respective publication.

Call Centres. The Government approved Decree-Law No. 134/2009, imposing several obligations concerning the operation of call centres, such as maximum response time, follow up on requests and processing of calls according to their order of arrival.

Value Added Services based on messages. The Government approved Decree-Law No. 63/2009, published in March, imposing several obligations concerning value-added services based on message, such as the adoption of measures of tariff transparency, blocking mechanisms (by request of the consumer and at no cost to the consumer) and the inclusion of these services in the National Numbering Plan (with different access codes based on the nature and content of the service).

Brazil

The main regulatory events of 2009. ANATEL maintained its supervision, which was intensified with the effectiveness of number portability throughout the Brazilian and by ANATEL s oversight, together with that of consumer advocacy organizations, of compliance by Vivo of its Customer Care Services with Decree 6523/2008 (General Rules on Customer Care Services Provided by Telephone), which entered into effect on 1 December 2008. Published Public Consultations and Resolutions regarding changes to the regulatory framework focused on increasing competition and consumer rights.

Consultations undertaken by ANATEL. Public Consultation 31/2009 regarding a new 2.5 GHz frequency band, including, among other issues, the primary allocation of the 120 MHz frequency band in 2013 and of the 140 MHz frequency band in 2016 to Personal Mobile Services. The period for comment ended on 16 October 2009.

In December 2009, ANATEL launched Public Consultation 51/2009 regarding the Bidding Terms for the H band radiofrequency, the remainders of frequencies A, D, E, and M bands, the TDD band and band extensions in 900 MHz and 1800 MHz.

Also in December, pursuant to Resolution 516/2008 (General Plan to Revise Telecommunications Regulations in Brazil PGR), ANATEL launched Public Consultation 50/2009 regarding two new types of virtual operations: Certified and Authorized Virtual Networks.

Resolutions issued by ANATEL. Resolution 535/2009 by which it established a calculation methodology for the Weighted Average Cost of Capital - WACC.

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On 6 May 2009, Law 11,934/2009 was enacted, setting limits for the human exposure to electrical, magnetic and electromagnetic fields generated by radio transmitter stations, by user terminals, and by electrical systems that operate in a band of up to 300 GHz. Pursuant to this new law, the limits on human exposure proposed by the International Commission on Non-Ionising Radiation Protection (ICNIRP) are mandatory and must be implemented in all of Brazil. Those limits have been announced by the World Health Organization and have already been adopted by ANATEL Resolution 303/2002.

ANATEL Publication 002/2007/SPV ANATEL (3G Auction) of December 2007 established mobile coverage goals for Brazilian municipalities with no coverage, as well as benchmarks for 3G services in the frequencies subject to bid. Immediately after the extension of mobile coverage to the abovementioned municipalities, we expect the redemption (on a proportional basis depending on the amount of municipalities that have been covered) of the guarantees offered by the company in April 2008 of compliance with ANATEL s goals. Pursuant to Order 5,954/2009, ANATEL confirmed that the first-year goals regarding the extension of the coverage and 3G services have been met.

Notwithstanding the agreement reached by fixed and mobile operators, ANATEL refused the request of operators for the readjustment of maximum prices for calls involving the SMP network under STFC Basic Plans (including both Local and Long Distance Services). Consequently, there was no adjustment to VU-M prices for 2008-2009.

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03

Strategic profile

Business context

Global telecommunications sector

Development of new access technologies. The development of new access technologies and networks continued to accelerate, with operators announcing plans, trials and investments in Next Generation Access Networks (NGAN), namely Fibre-To-The-Home (FTTH) and DOCSIS 3.0 cable networks in the fixed business, and Long Term Evolution (LTE) in the mobile business. Examples include KPN s announcement to provide FTTH to 1.3 million Dutch homes by the end of 2012 and Verizon s plans to provide LTE service in 25 US cities by the end of 2010.

Enhanced convergence trend. The availability of new access technologies and the proliferation of IP-enabled equipment has been driving an increasing convergence of contents and services across platforms. Consumption patterns are changing, with final interface and customer experience emerging as key decision criteria. For instance, mobile operator selection is increasingly based on available handsets and less on the network itself (smartphone sales increased by 22% in 2009, already accounting for 16% of global handset sales) and social networking is complementary to voice as a communication vehicle. This trend has led to the appearance of new business models and players in the broad communications and entertainment markets, embracing not only telecommunications operators, but also IS/IT companies, ISPs and content providers.

Emerging markets as a growth engine. In 2009, emerging markets continued to be a major source of growth for the telecommunications industry. Telecom value-added in BRIC countries grew by 9.2% in 2009, as compared to 1.7% in North America and Western Europe. Within these markets, it is important to highlight the phenomenon of fixed-to-mobile migration, which continued to accelerate, namely in countries with relatively limited scope and breadth of fixed network infrastructure. Additionally, the debate whether companies should reinvest in developed countries or reallocate capital to emerging markets continued throughout 2009. Examples of these movements include the bid that Vivendi successfully launched over the fixed telecom Brazilian operator GVT, the fourth investment of Telefonica in China, increasing its stake in China Unicom from 5% to 8%, and continued investment interest expressed by France Telecom and Vodafone in Africa.

Telecommunications context in Portugal

Consolidation of bundled offers. 2009 was marked by a proliferation of bundled packages among the various market participants, with triple-play offers (bundling TV, voice and broadband), becoming increasingly more popular and attractive. The major transformation initiated in 2008 continued, with the consolidation of the presence of cable operators in the voice segment and commercial aggressiveness of alternative fixed operators.

Increased competitiveness in urban areas. In 2009, there was a significant change in the landscape of the Portuguese telecommunications market, with operators investing in fibre, namely PT, having announced the investment to cover one million households with FTTH, but also cable and alternative fixed operators. This

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trend benefited from increased regulatory visibility, with a new regulation concept that followed a geographical segmentation approach, removing some restrictions on PT s broadband offer.

PT s positioning

In the domestic market, PT plans to: (1) consolidate the inflection of the historical trend in the wireline business, leveraging its successful TV strategy (having already achieved a market share of 23% in the Portuguese pay-TV market); (2) develop innovative data and internet access products in the mobile business, and (3) launch leading edge convergent products and services for the enterprise segments.

At an international level, the focus of PT is on the operational performance of its assets and on the sharing of best practices across the various businesses. The expansion of international operations to multiple geographies is one of the most important catalysts of value creation in the telecommunications sector and PT is no exception. PT has been building a relevant portfolio of international operations which, in 2009, already represents 51.5% of revenues, up by 1.8pp y.o.y, and 44.0% of EBITDA, up by 5.0pp y.o.y.

Domestic operations

Reversal of the historic trend in the wireline business. During 2009, the wireline business consolidated the turnaround of its historical downward trend, which was initiated at the end of 2008. Retail revenue generated units (RGUs) increased by 289 thousand underpinned by pay-TV and ADSL retail net adds of 269 thousand and 152 thousand respectively. This success has more than compensated the net loss of 96 thousand fixed lines, which compares to 173 thousand lines lost in 2008 and 313 thousand in 2007. The growth in retail accesses underpinned growth in retail revenues, which increased by 1.8% y.o.y, and operating revenue growth (+0.8% y.o.y). During 2009, the pay-TV business continued to gain scale reaching 581 thousand customers (still below critical mass), leading to a significant improvement in the evolution of gross profit, which declined by 0.4% y.o.y and already increased by 0.4% in 4Q09. This sustained recovery of the wireline business is based on the development of the pay-TV offer and of triple-play packages, including TV, broadband and voice services. PT has become a true European case-study by reaching a 23% market share in only 21 months after having launched its pay-TV offering, with an implied monthly market share gain of 1.1pp (the closest performance by a European operator only reaches 7.6% market share in 21 months, a 0.4pp monthly share gain).

Development of innovative data and internet wireless access products and services. Against the backdrop of a challenging environment, PT continued to develop an ambitious data growth strategy focused on the rollout of mobile broadband offers, competitive smartphone offering, promotion of value added services and development of innovative convergent offers to all market segments. PT continued to invest in the quality and coverage of its 3G and 3.5G networks, reaching more than 90% of the population and gaining the recognition of the national regulator and consumers as the best network. During 2009, PT continued to consolidate its leadership position in the mobile market, with mobile customers growing 4.6% y.o.y, underpinned by the increased popularity of the wireless broadband offers.

Leading-hedge convergent products. In 2009, PT strategically captured the potential of fixed-mobile convergence opportunities. Targeting the SoHo and SME segment, PT continued to market Office Box, a national and European reference in the provision of integrated telecommunications services of fixed and mobile voice and data. PT also maintained its offering of software and hardware productivity tools and

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advanced solutions for the corporate segment. Additionally, PT continued to market mobile broadband packaged with residential bundled offers for TV and ADSL customers, with the objective of further differentiating its offers by giving mobility to its customers.

International operations

Leadership in the Brazilian mobile market. During 2009, Vivo continued to focus its efforts on maintaining a clear leadership position in the Brazilian mobile market, with the development of new and competitive voice offers and rollout of mobile broadband offers. The quality and coverage of its 3G and 3.5G networks continued to be core to Vivo, with the objective of delivering high quality services and outstanding customer experience both in voice and data while consolidating its GSM switch strategy. Simultaneously, Vivo continued to engage in several projects to increase its productivity levels and consolidate all the previous operating companies.

Sharing of best practices. The continuous focus on efficiency in international operations and sharing of best practices has allowed for a significant revenue growth and profitability increase of these operations in 2009. An additional effort is being made by having top management travel frequently to PT s operations around the world to better follow-up the developments in each geography.

New operational and organisational structure

Functional merger of the wireless business (TMN) with the wireline business (PTC), with stronger focus on the specific needs of the different client segments in the domestic market. The functional merger of TMN with the wireline business represents a milestone for the organisation, as well as a turning point in what regards efficiency and effectiveness in the way business areas operate. The new organisation is based on two principles:

- Stronger customer focus: PT abandoned a structure organised around fixed and mobile platforms, and changed to a structure centred on the specific needs of each segment, implementing a new organisation around five customer segments: Residential, Personal, SMEs/SoHo, Corporate and Wholesale.

- Superior operational efficiency: PT eliminated several decision processes and layers, and reduced the number of directors, enabling a leaner and more agile company to effectively compete in an increasingly challenging environment.

Strategy

Consolidate competitiveness at domestic level, while developing an international growth agenda. PT remains committed to a cost, operational, financial and strategic discipline, aiming at focusing the development of its resources in its core businesses and in its core regions, Portugal, Brazil and sub-Saharan Africa. PT has established five key ambitious objectives for the 2009-11 triennium: (1) grow the customer base to 100 million customers; (2) increase its exposure to international businesses up to two thirds of revenues; (3) reinforce leadership in all domestic market segments; (4) achieve a top-quartile performance in shareholder return and results, and (5) become a reference in terms of sustainability.

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Domestic leadership in all segments

Reinforce leadership in all market segments where PT operates. With the entrance in the pay-TV business, PT is turning around its domestic residential business, starting from an attacker position and, simultaneously, leveraging its position as a major integrated operator, aiming at offering broad and convergent products and services. In a converging world where individuals increasingly need to contact, communicate and consume seamless data services through all types of devices everywhere at their workplace, at home or on the move , PT s unique skills and ability to offer integrated services are proving to be a true competitive advantage in Portugal.

To make the difference in customer service. In a context of major market transformation and economic uncertainty, understanding customers needs throughout their life cycle and addressing these needs by ensuring world-class execution is a distinctive factor. This trust-based relationship makes it possible to successfully encourage customers to adhere to increasingly complete product and service packages for longer periods, allowing PT to increase its share-of-wallet.

International expansion

Maximise the strategic value of PT s international assets, reinforcing the focus on Brazil and sub-Saharian Africa. Given PT s size, growth prospects and starting position, the Brazilian market remains a priority. Africa will continue to be an important source of growth, where PT will reinforce partnerships and explore value-creating investment opportunities.

Focus on operational and commercial excellence of all assets, ensuring sharing of best-practices. By reinforcing operational and commercial excellence in all operations, promoting the sharing of best-practices amongst all businesses, PT will be able to fully tap the potential of each operation, taking into account the market development status in all segments as well as its competitive positioning.

Innovation

PT as a specialist innovator. PT aims to be a competitive operator in the innovation arena, thus ensuring its own space in the global sector. As such, PT is concentrating its operation around distinctive skills, eliminating activities and operations where the organization does not have this differentiating factor. This way, PT believes that it can build a structural competitive advantage if it can bring to bear its investments in leading-edge technology to provide more and better quality services to customers in reduced time-to-market a key driver for growth in a continuously changing and evolving market.

With that positioning in mind, PT is establishing open and strategic partnerships with key suppliers and also leveraging its innovation program - OPEN to build an innovation culture and a time-balanced portfolio of investments (long-term structural projects, medium-term business development, and short-term business optimization).

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Regarding strategic partnerships, as a global innovation leader with a proven track record, PT has been able to attract leading global and local suppliers to create partnerships that aim at accelerating the development of new technologies, services, and products to our customers. Throughout 2009, PT signed collaboration agreements with six global companies, all leaders in their own fields, and we expect this to be a win-win collaborative process whereby PT secures access to state-of-the-art technological solutions and provides feedback and input to the innovation process of our partners.

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04

Research and development

Innovation drivers

2009 was a reference year for Portugal Telecom as regards the development of sustained innovation in Research and Development.

The launch of the OPEN program and the implementation of systematic research and information processing practices, the involvement of internal and external experts, and the implementation of projects, have not only enriched the portfolio of the various business areas, but also created an innovation mindset oriented towards achieving differentiated results.

The competitive environment we are experiencing, combined with the impact of the economic downturn, mobilized the search for innovative solutions at all levels within the Company. This was a particularly interesting year, with the various companies in the Company significantly contributing to an increase in competitiveness vis-à-vis the competition.

In 2009, Portugal Telecom invested around Euro 213 million on Applied Research and Development, representing an increase of about 42% over the amount recorded in 2008.

On a broader perspective, the organization fostered innovation on several fronts, in addition to the traditional business components (products, services and technologies). For this reason other components were also addressed such as operational efficiency, customer relations, the development of new business models and the creation of a more efficient organizational culture.

Domestic operations

In the domestic operations, PT has been implementing various activities and projects.

Product and Service Development

During 2009 the emphasis was clear regarding the development of new products and services. The investments made were fundamentally aimed at ensuring greater differentiation from the competition, the development of services which added value and thus promote the retention of the current client base, enhance the features offered to the customer and improve the quality of the service provided.

In this context, PT s commitment to the massive implementation of FTTH should be underlined. This investment positioned the company as a leader in the number of households with fibre access in Portugal, paving the way for the launch of new features on the client s home access. As a result, and according to the European FTTH Council, Portugal entered the world ranking of countries with the highest penetration of fiber access.

In addition, the company invested in new services and features for its IPTV platform, such as Meo Kids, Cross-Platform Access (TV, Mobile and Online), multi-access remote recording, and the implementation of Multi-Room and Overlay services on RF, eliminating the need for set top boxes at the customer s home. This

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commitment has earned the trust of the Portuguese population, and MEO s customer data base grew in an overwhelmingly positive way over 2009, surpassing the 550,000 customer mark.

In the mobile market, throughout the year, PT was a pioneer in Portugal, creating specific business offers, regarding new equipment, such as its own brand Bluebelt and Silverbelt terminals on the Windows Phone platform. Thus PT revolutionised the national scene in the smartphone market, leveraging and enabling mass adoption of in mobile Internet and meo mobile services, the latter an innovative mobile TV service.

In addition, PT was the first Portuguese operator to launch a mobile terminal based on the Android platform, besides the world premiere of the Microsoft Phone.

The development of Mobile Apps on the Android, Symbian, Windows Phone and iPhone platforms is an area requiring considerable R&D investment, and PT has been managing all its resources to keep up with the latest trends in the mobile market and provide innovative services to its current customer base.

Finally, the ongoing commitment to new segmented business offers, supported on technology- and application-enabled converging solutions, has allowed the company to meet the needs of different market sectors in an innovative way.

Instances of this are the services launched in the business segment, application-enabled services over Framework Office box, on a SaaS logic, as well as Telepresence and Web conferencing services, supporting remote work solutions and solutions that increase professional productivity.

Development of Web Solutions

The growing trend towards a blend between the real world and virtual world led Portugal Telecom to take this on as a strategic area of enormous technological and functional evolution.

Throughout the year, several projects took shape and were differentiation tools for conquering new areas of opportunity.

We highlight the development of the Pond , a new service that allows users to manage and aggregate multiple online profiles in a single application, integrating multiple web2.0 platforms (such as access to blogging, social networks and user-generated content YouTube, Flickr, Sapo videos or Picasa), with access via PC, TV or Mobile Handset.

In order to fill another market need, Sapo developed an Online Advertising multi-platform, named Sapo Ads an online advertising solution, contextualized and segmented by behavior, which is very favourably positioned against the international benchmarks of the Web market.

In IPTV sector, the Sapo portal was also released on Meo, allowing customers to access videos, up-to-date news, newspapers and weather services seamlessly on their television.

Technological and Network Infrastructures

Technological and network infrastructures are a key component of PT s business strategy and thus a highly differentiating factor when approaching markets and sustaining its competitive position, it was given particular relevance in terms of:

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Convergence Solutions:

- The evolution of the network control architecture for a solution based on the standard IP Multimedia Subsystem (IMS) enhancing a more efficient provision of fixed-mobile convergence services;

- The implementation of a pilot and the evaluation of Femtocell-based solutions, enabling mobile coverage expansion to shadow areas (home or business), using a fixed infrastructure.

As regards improving the quality and characteristics of services:

- The evolution of radio technology with highest spectral efficiency in mobile networks allowed the implementation of HSPA+ solutions to 21 Mbps in the network;

- The implementation of major charges in the transmission network system enabled by the evolution of the mobile backhaul component for an IP-based architecture;

- The offer of fiber-based solutions (GPON) during the year 2009, allowed greater flexibility with regard to the existing supply, improving the service characteristics in addition to promoting higher service quality. Within this project, PT studied and developed mass deployment techniques of this technology including optimized RF and Home Networking components.

Operational Efficiency

Throughout 2009, Portugal Telecom has committed strongly to areas that have direct impact on operational efficiency.

In this context, and with a view to increasing the productivity of operation and maintenance teams, several projects were implemented:

Operation Route Optimization a platform oriented to the wireline business, through which a solution is guaranteed to optimize the routes of the Field Force intervention teams. The solution correlates at each moment the geographic locations of the teams on the ground with the location of customer requests, allowing the identification of the team best positioned for each intervention, thus minimizing consumption and intervention times.

Mobile Field Force Tools a reference in terms of digitalizing Field Force teams, the project aimed to provide installation and maintenance teams with Hand Held Devices associated with a Field Force Management application. Intervention orders were then sent directly to the various teams mobile equipment, thus increasing productivity, reducing paper use and minimizing error rates.

WorkForce Management Tools for Contact Centers - internally known as the TEFRA project, it uses a software tool that manages physical and human resources (space and people) as well as associated costs, ensuring the optimization of available resources and improving the team s performance rates.

Fiber Operations Center - in the context of fiber optic mass deployment in access network, a single integrated call center for fiber-acess customers was created, with direct impact on the increased efficiency of the teams involved, speeding up their learning curve resulting in a lower average volume of incidents.

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Customer Relations

Customer relation is one of the strategic pillars of PT. Some of the exemplary projects were developed, which had a positive impact on improving customer relations:

ONE project implementation of a single application for managing customer relations, in a horizontal approach to the entire service portfolio, aggregating the client s entire information. Adopting this innovative solution had an impact on the productivity levels of front office teams, improving the whole process of interaction and customer experience, in moments of contact with the company.

Heka project development of a knowledge-oriented customer service base, where all relevant and transversal information of the various businesses is gathered (operating procedures, pricing plans, instructions for client activation, equipment features, and product portfolio, among others).

Creation of the Tactical Operations Center - This operation center is aims at expediting the resolution of problems identified through client-contact channels, through systematic analysis of discontinuities in operational indicators. Thus, the resolution of customer constraints has become more effective and definite.

Society and Environment

One of the company s strategic desiderata relates to Sustainability, which become a reference for the telecommunications sector.

Portugal Telecom s position has always been grounded on fundamental principles of growth, contribution and innovation, with a view to better integration in and prosperity of the social context in which it operates.

At this point, several initiatives competitively contributed to continuous improvement. One of the transversal projects adopted by the organization was the replacement of traditional lighting systems with high energetic efficiency lamp systems (LEEE), with a direct impact on reducing costs and decreases the carbon footprint.

In its daily operations, some steps were also taken to reduce the costs associated with printing, by implementing measures to minimize paper and ink cartridge consumption by changing the printers and print-servers parameters.

The implementation of Free Cooling solutions in small and medium-sized PABX should also be mentioned. These reshaped the traditional temperature control process in technical rooms, and significantly reduced energy consumption and the subsequent environmental impact.

Finally, reflecting this business sustainability mindset, new policies were also adopted for procurement procedures as regards the selection and evaluation of the different tenders submitted by suppliers. Thus, the process of analyzing proposals considers, among its various evaluation criteria, such factors as the lower energy dependence of the equipment to be purchased.

From a different perspective and in accordance with a market approach, specific projects and solutions were developed for the Central Administration, Education and Health, of which the following should be highlighted:

- Solutions for the Central Administration Portal da Segurança (the security portal): a solution developed for the Ministry of Internal Affairs where any citizen can access data that allows them to

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get in touch faster with the Security Forces, the Border and Foreign Citizen Service, and the National Authority for Civil Protection;

- Solutions for the Education sector the e-Escolas and e-Escolinhas projects are a reference with a view to providing students with laptop computers connected to the Internet via mobile broadband (from the first cycle of Basic Education to Higher Education); a project to develop schools with educational content, which carries technologies into the classroom in an integrated manner; the Scratch project, in partnership with MIT, focused on the development of new human-machine interfaces;

- Solutions for the Health sector in particular concerning a service management platform for healthcare providers units, with an impact on the optimization of resources and processes, which is reflected in reduced assistance time. Also at the level of information sharing, PT has aimed to create a Digital Health Network which uses fibre to connect all entities providing health-related services (hospitals, health centers, and pharmacies, among others).

Research and Development Ecosystem

The structured and continuous investment in Research and Development is fundamental to the growth and improvement of innovative products and technologies.

Portugal Telecom has been investing in intellectual capital and methodologies with the aim of creating a culture of innovation, therefore ensuring new technological achievements.

In terms of intellectual property, regarding issues related to optical communication and optimization of electronic communication processes, PT Inovação submitted two provisional patent applications and converted two other provisional requests to definitive applications requests. One of these is an international patent application.

In this area, PT Inovação has played a key role in the development of prototypes and business support solutions for PT. In 2009, it explored the following areas of knowledge:

- Context Awareness services and applications to support future IP multimedia environments;

- Participation in the Future Internet Platform and its areas of architecture, new business models and virtualization systems;

- Identity management architecture at transport, network and service level;
- Promotion of technological solutions to support communities with health care needs;
- Cloud computing;
- Development of Content Delivery and interactivity solutions for TV platforms;
- Multifunctional systems to manage vehicles and road infrastructures;
- Creation of training solutions in virtual 3D environments, in an e-learning services framework;

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• Trial of optical communications evolution solutions, in particular of wireless optical access and high bandwidth;

• Development of authentication, security and privacy solutions for new generation telecommunications networks.

Within the investment in projects which, by their characteristics, may contribute significantly to innovation, PT maintains its INESC participation, aimed at promoting academic projects with potential impact on PT s business, as well as at furthering the Sapo Labs (a partnership between Sapo and the University of Aveiro). The latter led to the development of Sapo Campus, a tool to support students and teachers in the classroom context (blogs, videos and photos in the classroom environment).

In this context, SAPO has also played an important role in enhancing the company-university relationship, establishing protocols with several Portuguese universities, including the University of Aveiro, the University of Porto School of Engineering, the University of Coimbra, the University of Minho and the University of Lisbon School of Sciences.

There are numerous initiatives, including several areas areas of knowledge, of which the following stand out:

• WEB technologies applied to educational contexts embodied in the SAPO CAMPUS project a tool that brings the services of the new Web 2.0 (blogs, videos, photos, wiki, Messenger and widgets) closer to PLE Personal Learning Environment concepts;

• WEONTV project Social Networking for IPTV environment this seeks to explore emerging social contexts in the daily use of television, taking advantage of various dynamics of recommendation and content sharing;

• VERBATIM P project dedicated to natural language processing, through the development of advanced artificial intelligence systems in the textual recognition of patterns;

• SYLVESTER project - development of a social trend parser, using social tools (such as Twitter and Facebook) automatically analyzing feelings and fostering a more accurate modeling of content recommendation systems and social network analysis;

• MIR project - Dedicated to the advanced graphics processing, through the development of advanced artificial intelligence systems in pattern recognition in images and video;

- REACTION project - oriented to computational journalism with technologies involving information recovery, extraction and aggregation for news integration and organization;

In addition, in the context of its active involvement in the Carnegie Mellon University Program, Portugal Telecom not only supported the participation of several students in the Professional Masters and PhD programs, but also received students who completed the program s 1st edition, reinforcing the commitment to capture young talent in Technological and Research and Development areas.

In this Program, PT assumed the position of main Industrial partner, involving training and applied research projects associated to masters thesis. In this context, the following should be noted:

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- The creation of the PT - Security Lab project, aimed at supporting the reinforcement of offers in security solutions for networks and cyberspace;

- The NetOptima project - which involves PT researchers and academics, as well as Master s degree students, to create a modeling tool for corporate networks that supports interactive and graphical validation of QoS policies and security;

- A conceptual usability and interaction study of a portal for children (SAPO kids) as part of a MHCI thesis;

- Proof of Concept of a content recommendation engine as part of a MSE thesis.

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05

Financial review

Consolidated income statement

Consolidated income statement (1) **Euro million**

	2009	2008	y.o.y
Operating revenues	**6,784.7**	**6,720.9**	**0.9%**
Wireline (2)	1,947.8	1,931.4	0.8%
Domestic mobile • TMN (2)	1,517.8	1,593.6	(4.8)%
Brazilian mobile • Vivo (1)	3,138.1	3,034.3	3.4%
Other and eliminations	181.0	161.6	12.0%
Operating costs, excluding PRB s and D&A	**4,282.4**	**4,240.6**	**1.0%**
Wages and salaries	693.2	616.6	12.4%
Direct costs	1,135.1	1,086.9	4.4%
Commercial costs	1,113.5	1,232.9	(9.7)%
Other operating costs	1,340.6	1,304.2	2.8%
EBITDA (3)	**2,502.3**	**2,480.3**	**0.9%**
Post retirement benefits	89.6	44.8	100.3%
Depreciation and amortisation	1,437.9	1,268.3	13.4%
Inco me from operations (4)	**974.7**	**1,167.2**	**(16.5)%**
Other expenses (income)	**64.0**	**110.5**	**(42.0)%**
Curtailment costs, net	14.8	100.0	(85.2)%
Net losses (gains) on disposal of fixed assets	(0.4)	(19.5)	(97.9)%
Net other costs (gains)	49.7	30.0	65.6%
Income before financial results and income taxes	**910.7**	**1,056.7**	**(13.8)%**
Financial expenses (income)	**(109.1)**	**129.5**	**n.m.**
Net interest expenses	302.3	272.4	11.0%
Equity in earnings of affiliates, net	(456.0)	(171.0)	166.7%
Net other financial losses (gains)	44.7	28.1	59.1%
Income before income taxes	**1,019.7**	**927.2**	**10.0%**
Provision for income taxes	(233.2)	(231.4)	0.8%
Income from continued operations	**786.5**	**695.8**	**13.0%**
Losses (income) attributable to minority interests	(102.6)	(119.7)	(14.3)%
Consolidated net income	**683.9**	**576.1**	**18.7%**

(1) Considering a Euro/Real average exchange rate of 2.7674 in 2009 and 2.6737 in 2008. **(2)** Wireline and domestic mobile operating revenues include the impact of the decline in regulated mobile termination rates (MTRs). At TMN, this impact amounted to Euro 62.1 million in 2009 and Euro 4.8 million in 4Q09. **(3)** EBITDA = income from operations + post retirement benefits + depreciation and amortisation. **(4)** Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + other costs (gains).

Consolidated operating revenues

In 2009, **consolidated operating revenues** increased by 0.9% y.o.y to Euro 6,785 million, as a result of revenue growth in wireline and Vivo, which more than offset the decline in revenues of TMN due to the negative impact of the 41% decline in MTRs from 30 June 2008 to 31 December 2009, and the negative impact of the Real devaluation. Adjusting for the effects of the consolidation of Telemig, lower MTRs and using constant exchange rate, consolidated operating revenues would have increased by 2.3% y.o.y.

In 2009, revenues from domestic operations decreased by 1.9% y.o.y. The financial performance of the domestic operations was negatively impacted by lower equipment sales, which declined by Euro 26 million in

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2009, and lower MTRs. Excluding the adverse impact of MTRs, revenues from domestic operations would have remained broadly flat despite lower equipment sales.

In 2009, wireline operating revenues increased by 0.8% y.o.y, from Euro 1,931 million to Euro 1,948 million, underpinned by the inflection of retail revenues, which posted a 1.8% y.o.y increase, from Euro 953 million to Euro 971 million. The growth in retail revenues was achieved on the back of the continued strong performance of the Meo triple-play offer (voice, data and video), which in turn mitigated significantly fixed line disconnections, which stood at 96 thousand in 2009 compared to 173 thousand in 2008 and 313 thousand in 2007. Moreover, net disconnections of traffic generating lines stood at 56 thousand in 2009, compared to 110 thousand in 2008, an improvement in performance of almost 50% y.o.y.

Retail net additions reached 325 thousand in 2009, driven by the success of PT s Meo triple-play offer, decelerating fixed line disconnections and gain in broadband market share. ADSL retail customers increased 21.5% y.o.y in 2009, reaching 862 thousand customers. Broadband retail net additions reached 152 thousand in 2009 compared to 73 thousand in 2008, reflecting a clear and steady improvement over the last five quarters. PT s Meo offer continues to see strong demand in the market. Pay-TV net additions reached 269 thousand in 2009 and total pay-TV customers stood at 581 thousand, equivalent to 67.4% penetration of the ADSL retail customer base. Retail RGU per access increased by 12.2% y.o.y in 2009 from 1.36 to 1.53.

In 2009, TMN s operating revenues decreased by 4.8% y.o.y to Euro 1,518 million, mainly due to the negative impact of lower MTRs (Euro 62 million) and lower equipment sales (Euro 15 million), which more than offset growth in customer revenues (+0.5% y.o.y in 2009) underpinned by growth in post paid customers and data revenues. Non-SMS data revenues continued to be an important source of growth, on the back of increasing penetration of smartphones and wireless data cards. Excluding the impact of lower MTRs, TMN s operating revenues would have decreased by 0.9% y.o.y in 2009, as a result of declining equipment sales, whilst service revenues would have remained flat.

Vivo s operating revenues increased by 3.4% y.o.y in Euros and 7.0% y.o.y in Reais, on the back of continued customer growth (15.1% increase y.o.y in the customer base). Excluding the impact of the consolidation of Telemig and using constant exchange rate, Vivo s operating revenues would have increased by 4.4% y.o.y, driven by growth in service revenues (7.2% y.o.y).

Other revenues, including intra-group eliminations, increased by 12.0% y.o.y in 2009, mainly due to the improved revenue performance of Dedic, PT s contact centre business in Brazil, MTC, in Namibia, and Timor Telecom, which more than offset the loss of fees resulting from the termination of Vivo s management contract in August 2008 and the revenue contraction at CVT in Cape Verde, primarily due to adverse regulatory and economic conditions.

Revenues by region **Euro million**

	2009	2008	y.o.y
Domestic operations (1)	3,320.9	3,386.6	(1.9)%
Brazil (2)	3,240.1	3,111.5	4.1%
Other and eliminations (3)	223.7	222.8	0.4%
Total operating revenues	**6,784.7**	**6,720.9**	**0.9%**

(1) Domestic operations include the wireline segment, domestic mobile, PT Inovação, PT SI, PT Pro, PT Contact and PT Sales. **(2)** Considering a Euro/Real average exchange rate of 2.7674 in 2009 and 2.6737 in 2008. Includes primarily Vivo and Dedic, PT s contact centre business. **(3)** Includes fully consolidated international assets, namely MTC, CVT, CST and Timor Telecom, and also the holding companies.

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In 2009, the contribution from fully and proportionally consolidated international assets to operating revenues stood at 51.5% and Brazil accounted for 47.8% of consolidated operating revenues, an increase of 1.5pp y.o.y, despite the depreciation of the Real against the Euro in the period.

Consolidated operating costs, excluding PRBs and depreciation and amortization

Consolidated operating costs excluding post retirement benefits (PRBs) and depreciation and amortization (D&A), increased by 1.0% y.o.y to Euro 4,282 million in 2009, as compared to Euro 4,241 million in the same period of last year, primarily explained by higher contributions from (1) the wireline business (Euro 104 million), due to increased commercial activity, in line with the roll-out of its pay-TV service which led to higher programming costs, and (2) PT s call centre business in Brasil (Euro 29 million). These effects were partially offset by decreases (1) at Vivo (Euro 11 million), reflecting the net effect of the impacts of depreciation of the Real (Euro 75 million) and consolidation of Telemig (Euro 58 million), and (2) at TMN, mainly due to the reduction in MTRs. Adjusting for the effects of the consolidation of Telemig and lower MTRs and using a constant exchange rate, operating costs would have increased by 2.5% y.o.y.

Wages and salaries increased by 12.4% y.o.y in 2009 to Euro 693 million, primarily explained by higher contributions from Vivo and from our call centre operation in Brazil. Wages and salaries accounted for 10.2% of consolidated operating revenues.

Direct costs increased by 4.4% y.o.y to Euro 1,135 million in 2009 and accounted for 16.7% of consolidated operating revenues. This growth is primarily explained by higher contributions from: (1) the wireline business (Euro 18 million), with the increase in programming costs (Euro 50 million), related to the roll-out of the pay-TV service, being partially offset by the impact of the decline in MTRs; and (2) Vivo (Euro 47 million), reflecting increases in interconnection costs and lease costs 3G related and also the impact of the consolidation of Telemig (Euro 20 million), which more than offset the effect of the depreciation of the Real (Euro 21 million). These effects were partially offset by a reduction in direct costs from the domestic mobile business (Euro 20 million), primarily explained by the impact of the decline in MTRs (Euro 32 million).

Commercial costs decreased by 9.7% y.o.y. to Euro 1,113 million in 2009 and accounted for 16.4% of consolidated operating revenues. The decreases at TMN (Euro 47 million) and Vivo (Euro 74 million) are primarily explained by lower equipment sales, while Vivo s commercial costs were also impacted by the net effects of the depreciation of the Real (Euro 25 million) and consolidation of Telemig (Euro 16 million).

Other operating costs, which mainly include support services, supplies and external services, indirect taxes and provisions, increased by 2.8% y.o.y to Euro 1,341 million in 2009, as compared to Euro 1,304 million in the same period of last year. Adjusting for the effect of the consolidation of Telemig (Euro 16 million) and on a constant currency basis (Euro 23 million), other operating costs would have increased by 3.3% y.o.y in 2009 to Euro 1,347 million, primarily explained by a higher contribution from the wireline business, due to increased commercial activity and higher support service and customer care costs related to the strong take up of the pay-tv service. Regarding Vivo and also adjusting for the effects mentioned above, other operating costs would have increased by 0.9% y.o.y in 2009, with the reduction in provisions for trade receivables and the impact of the termination of the management fee contract in August 2008 being more than offset by increases in electricity, commercial support and billing expenses, primarily explained by increased commercial activity and the take-up of the GSM and 3G services.

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EBITDA

EBITDA increased by 0.9% y.o.y in 2009 to Euro 2,502 million, equivalent to a margin of 36.9% . Excluding the impact of the consolidation of Telemig, lower MTRs and using constant exchange rate, consolidated EBITDA would have increased by 2.0% y.o.y. EBITDA performance in the period was supported by growth at Vivo and other international assets, which was partially offset by the decrease in the domestic businesses, as a result of lower MTRs, investments in the roll-out of triple-play offers and the termination of Vivo s management contract.

Wireline EBITDA amounted to Euro 800 million in 2009, equivalent to a 41.1% margin. EBITDA margin continued to be impacted primarily by higher programming, customer care and support service costs in connection with the roll-out of the triple play offers. EBITDA decline has been improving during the course of the year. In 2009, wages and salaries in the wireline segment increased by 2.9% y.o.y as a result of:
(1) headcount migration from the domestic mobile due to the reorganisation of the domestic fixed and mobile business along customer segments, and (2) the decision to halt the redundancy programme and focus efforts in the insourcing of certain core functions. As a result of the halting of the redundancy programme, the projected benefit obligations related to salaries payable to pre-retired and suspended employees fell by Euro 116 million, and the corresponding cash outflow was as a result also Euro 12 million lower in the period.

In 2009, TMN s EBITDA decreased by 1.1% y.o.y to Euro 674 million as a result of the decrease in MTRs. Excluding the negative impact of Euro 30 million due to lower MTRs, TMN s EBITDA would have increased by 3.2% y.o.y in 2009. EBITDA margin reached 44.4%, an increase of 1.6pp compared to 2008 as a result of continued growth in post paid customers, data revenues and cost reductions.

In 2009, Vivo s EBITDA increased by 13.8% y.o.y, underpinned by customer growth. Excluding the consolidation of Telemig and using constant exchange rate, Vivo s EBITDA would have increased by 15.3% y.o.y. Vivo s EBITDA margin reached 30.2% in 2009, an improvement of 2.7pp compared to 2008.

Other EBITDA increased by 3.2% y.o.y to Euro 81 million in 2009, mainly as a result of the improved performance of Dedic, PT s contact centre business in Brazil, MTC, in Namibia, and Timor Telecom, notwithstanding the loss of fees due to the termination of Vivo s management contract as from August 2008 and weaker performance of CVT due to adverse economic and regulatory conditions.

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

	2009	2008	y.o.y
Wireline	799.6	887.1	(9.9)%
Domestic mobile • TMN	674.1	681.9	(1.1)%
Brazilian mobile • Vivo (1)	947.2	832.5	13.8%
Other and eliminations	81.3	78.8	3.2%
EBITDA (2)	**2,502.3**	**2,480.3**	**0.9%**
EBITDA margin (%)	36.9	36.9	(0.0)pp
Domestic operations (3)	1,467.5	1,563.1	(6.1)%
Brazil (1)(4)	958.4	844.0	13.6%

Other (5)	76.4	73.2	4.4%

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(1) Considering a Euro/Real average exchange rate of 2.7674 in 2009 and 2.6737 in 2008. **(2)** EBITDA = income from operations + post retirement benefits + depreciation and amortisation. **(3)** Domestic operations includes the wireline segment, domestic mobile, PT Inovação, PT SI, PT Pro, PT Contact and PT Sales. **(4)** Includes mainly Vivo and Dedic. **(5)** Includes only fully consolidated international assets, namely MTC, CVT, CST and Timor Telecom, and also the holding companies.

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Fully and proportionally consolidated international assets contributed to 44.0% of PT s consolidated EBITDA in 2009. Brazilian businesses accounted for 38.3% of EBITDA in 2009. Fully consolidated African businesses accounted for 4.6% of EBITDA in 2009.

Net income

Post retirement benefit costs amounted to Euro 90 million in 2009, compared to Euro 45 million in 2008, as a result of lower return on assets in 2008 compared to the actuarial assumption of 6% (Euro 40 million), following the decline in the value of assets under management in 2008.

Depreciation and amortisation costs increased by 13.4% y.o.y to Euro 1,438 million, reflecting higher contributions from: (1) Vivo, which accounted for approximately 60% of the increase in D&A, as a result the consolidation of Telemig, the amortisation of 3G licenses and higher depreciation rates for the CDMA network following the GSM network rollout, and (2) wireline in Portugal, as a result of the investments in the rollout of pay-TV service and the revaluation of ducts and certain real estate assets undertaken during 2008.

Curtailment costs decreased to Euro 15 million in 2009 from Euro 100 million in 2008, due to the halting of the redundancy programme.

Net gains on disposal of fixed assets amounted to Euro 0.4 million in 2009 compared to Euro 19 million in 2008. Gains recorded in 2008 were mainly related to real estate disposals.

Net interest expenses rose by Euro 30 million to Euro 302 million in 2009 as a result of the increase in PT s average net debt in the period due to the post completion of the share buyback programme in 2008 and the acquisitions of Telemig and 3G licences in Brazil. In 2009, consolidated average cost of debt has remained flat at 5.0% compared to 2008. Excluding Brazil, the average cost of debt stood at 4.3% .

Equity in earnings of affiliates includes primarily PT s share in the earnings of Unitel, CTM, Médi Télécom and UOL and amounted to Euro 456 million in 2009 compared to Euro 171 million in 2008. In 2009, this caption includes the capital gain related to the disposal of the stake in Médi Télécom (Euro 267 million) while in 2008 includes gains related to the disposal of PT s interest in Banco Best (Euro 9 million).

Net other financial losses, which include foreign currency gains, net gains on financial assets and other financial expenses, amounted to Euro 45 million in 2009, compared to Euro 28 million in 2008. Net foreign currency gains amounted to Euro 20 million in 2009 compared to net losses of Euro 9 million in 2008 as a result of positive foreign currency adjustments related to investments in Brazil. Net gains on financial assets amounted to Euro 8 million in 2009 compared to Euro 19 million in 2008, and were related to the change in the fair value of free-standing cross-currency derivative instruments. The change in the fair value is explained by the appreciation of the US Dollar against the Euro until April 2009, when these derivatives were settled. In 2008, net gains on financial assets included primarily: (1) the change in fair value of free-standing cross currency derivatives, which resulted in a gain of Euro 10 million due to the appreciation of the US Dollar against the Euro and the Real, and (2) the gain obtained from the disposal of a 3% stake in Africatel in 3Q08 amounting to Euro 9 million. Other financial expenses, which include banking services, financial discounts and other financing costs, increased to Euro 73 million in 2009, compared to Euro 39 million in 2008. The increase in this caption in 2009 is largely explained by the debt restructuring undertaken in 2009 in connection with the acquisition of 3G licenses in Brazil, which consisted of the early repayment of certain loans.

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Provision for income taxes increased from Euro 231 million in 2008 to Euro 233 million in 2009, corresponding to an effective tax rate of 25.0% in 2008 and 22.9% in 2009.

Income attributable to minority interests decreased to Euro 103 million in 2009 from Euro 120 million in 2008. The reduction in this caption is primarily explained by the decrease in minority interests from Vivo, which amounted to Euro 43 million in 2009 compared to Euro 52 million in 2008, and Africatel which amounted to Euro 52 million in 2009 compared to Euro 62 million in 2008.

Net income increased by 18.7% y.o.y in 2009 to Euro 684 million, compared to Euro 576 million in 2008, with the capital gain related to the disposal of Médi Télécom being partially offset by higher costs related to post retirement benefits, depreciation and amortisation and net interest. In 2008, net income also included Euro 37 million of extraordinary gains.

Earnings per Share

In 2009, **basic earnings per share** increased by 22.9% y.o.y to Euro 78 cents from Euro 64 cents in 2008. The average number of shares outstanding decreased by 3.4% y.o.y to 876 million in 2009, whilst the diluted average number of shares outstanding over the same period declined by 3.2% y.o.y to 941 million.

Earnings per share **Million (shares outstanding); Euro (per share data)**

	2009	2008	y.o.y
Average number of shares oustanding			
Basic (1)	875,9	907,1	(3,4)%
Diluted (2)	940,5	971,8	(3,2)%
Earnings per share			
Basic	0,78	0,64	22,9%
Diluted (2)(3)	0,76	0,62	21,8%

(1) Adjusted for the 20.6 million own shares held through equity swaps. **(2)** Diluted shares are calculated assuming the full exercise of convertible bonds. **(3)** Diluted earnings are computed adjusting for the costs of convertible bonds.

Capex

Capex increased by 2.1% y.o.y (Euro 26 million) in 2009 to Euro 1,268 million, equivalent to 18.7% of revenues, as a result of increase in wireline capex, which more than offset capex reductions at TMN and Vivo.

Wireline capex increased from Euro 403 million in 2008 to Euro 565 million in 2009, primarily as a result of the FTTH rollout, which allows for increased bandwidth for both residential and corporate customers, and investment in IPTV services namely in relation to growth in customers. At the end of 2009, PT had 965 thousand homes under construction or available with fibre to the home.

TMN s capex decreased by 26.4% y.o.y to Euro 180 million in 2009. The decrease in TMN s capex is explained by the investments in the deployment of 3G/3.5G networks, both in terms of capacity and coverage, carried out in 2008, which resulted in improved quality of mobile voice and data services in Portugal. As a result, in a recent study undertaken by the Portuguese telecoms regulator, TMN was considered as having the most reliable and stable network performance in Portugal.

Capex at Vivo decreased by 17.5% y.o.y to Euro 421 million in 2009. Excluding the consolidation of Telemig (Euro 8 million) and the depreciation of the Real against the Euro (Euro 14 million), capex at Vivo would have

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decreased by 16.2% y.o.y. Capex at Vivo was directed towards: (1) increasing network capacity to support the accelerated growth in voice traffic in the 2G network; (2) expanding coverage of 3G and 3.5G networks, and (3) improving network quality to continue to be the most reliable and best quality network in Brazil.

In 2009, other capex increased to Euro 102 million, compared to Euro 85 million in 2008, mainly a result of higher investments in Africa, namely CVT and MTC, and in Timor Telecom due to substantial customer growth.

Capex by business segment (**1**) **Euro million**

	2009	**2008**	**y.o.y**
Wireline	565.4	402.8	40.4%
Domestic mobile • TMN (2)	180.1	244.6	(26.4)%
Brazilian mobile • Vivo (1)(3)	420.9	510.3	(17.5)%
Other	101.9	84.6	20.5%
Total capex	1,268.3	1,242.3	2.1%
Capex as % of revenues (%)	18.7	18.5	0.2pp

(1) Considering a Euro/Real average exchange rate of 2.7674 in 2009 and 2.6737 in 2008. **(2)** Excludes additional commitments under the terms of the UMTS licence (Euro 11.5 million in 1Q09). **(3)** Excludes the acquisition of 3G licences in Brazil (Euro 227 million in 2Q08).

Cash flow

Operating cash flow amounted to Euro 1,162 million in 2009, compared to Euro 1,374 million in 2008, as a result of an increase in working capital investment (Euro 190 million) due to: (1) one-off cash receipts from Zon in 2008; (2) settlement with the Portuguese State in connection with discounts on services rendered to retirees in 2008; (3) higher management fees received from Vivo in 2008, and (4) higher level of capex in 4Q08 compared to 4Q09, at Vivo and TMN, thus leading to increased payments to fixed asset suppliers in 1Q09.

Free cash flow amounted to Euro 869 million in 2009, which compares to Euro 217 million in 2008. This improved performance is primarily explained by: (1) the investment in the acquisition of Telemig undertaken in 2008; (2) the disposal of the stake in Médi Télécom in 2009; (3) the decrease in income taxes paid (Euro 83 million), which resulted from payments on account made during 2008 higher than the tax payable and lower taxable income in 2009; (4) the increase in dividends received from non consolidated subsidiaries (Euro 41 million), and (5) the decrease in the payment of salaries to pre-retired and suspended employees (Euro 12 million), which resulted from the halting of the redundancy programme. These effects more than offset: (1) the Euro 211 million reduction in operating cash flow mainly due to the investment in working capital due to payments to fixed assets suppliers; (2) the Euro 66 million increase related to a required extraordinary cash contribution to the pension funds due to its underperformance in 2008; (3) the increase in interest paid amounting to Euro 55 million, due to higher average net debt, an increase in the average cost of debt in Brazil and a debt restructuring in connection with the acquisition of 3G licenses in Brazil which consisted of the early repayment of certain loans, and (4) the disposals in 2008 of the investment in Banco Best (Euro 16 million) and a 3% stake in Africatel (Euro 13 million).

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Free cash flow **Euro million**

	2009	2008	y.o.y
EBITDA minus Capex	1,234.0	1,238.0	(0.3)%
Non-cash items	101.8	118.8	(14.3)%
Change in working capital	(173.4)	17.0	n.m.
Operating cash flow	**1,162.4**	**1,373.7**	**(15.4)%**
Acquisition of Telemig	0.0	(517.0)	n.m.
Disposal of stake in Médi Télécom	400.0	0.0	n.m.
Interests	(355.1)	(299.9)	18.4%
Contributions related to PRBs	(75.2)	(8.9)	n.m.
Payments to pre-retired, suspended employees and other	(175.9)	(187.9)	(6.4)%
Income taxes	(162.9)	(246.0)	(33.8)%
Dividends received	121.1	80.1	51.2%
Other cash movements (1)	(44.8)	22.3	n.m.
Free cash flow	**869.5**	**216.5**	**n.m.**

(1) In 2008, this caption included Euro 13 million related to the disposal of a 3% stake in Africatel, Euro 16 million related to the disposal of the investment in Banco Best and Euro 23 million of cash proceeds from real estate asset disposals.

Consolidated net debt

Consolidated net debt amounted to Euro 5,528 million as at 31 December 2009, compared to Euro 5,571 million as at 31 December 2008, a decrease of Euro 43 million mainly due to the free cash flow generated in the period amounting to Euro 869 million, which more than offset the dividends paid by PT (Euro 504 million) and the negative impact of translation of the debt denominated in Brazilian Real against the Euro (Euro 190 million).

As at 31 December 2009, total consolidated gross debt amounted to Euro 7,046 million, of which 93.0% was medium/long-term and 79.8% was set at fixed rates. As at 31 December 2009, 85.7% of total debt was denominated in Euros and 14.3% in Brazilian Reais. Vivo s debt is either Real-denominated or has been hedged into Reais. In April 2009, PT repaid Euro 880 million of an existing bond. During 2009, PT issued Euro 2,450 million, which includes: (1) a tap of the 2012 Eurobond amounting to Euro 300 million; (2) a 4-year bond amounting to Euro 1 billion; (3) a 10 year bond amounting to Euro 750 million, and (4) new bilateral lines and private placements amounting to Euro 400 million.

Change in net debt **Euro million**

	2009	2008
Net debt (initial balance)	5,571.3	4,381.8
Less: free cash flow	869.5	216.5
Dividends paid by PT	503.6	533.2
Acquisition of own shares (1)	0.0	904.6
Impact of Telemig consolidation	0.0	(128.9)
Commitments related to fixed assets (2)	11.5	227.2

Other (3)	121.0	68.0
Net debt (final balance ex. translations effect)	5,337.9	5,769.5
Translation effect on foreign currency debt	190.1	(198.2)
Net debt (final balance)	5,528.0	5,571.3
Change in net debt	(43.2)	1,189.4
Change in net debt (%)	(0.8)%	27.1%

(1) In 2008, PT contracted equity swaps over 114.7 million own shares under the share buyback programme concluded in December 2008.
(2) This caption includes: (i) the Euro 227 million impact of the acquisition of Vivo s 3G licenses in 2008, and (ii) the commitments under the terms of TMN s UMTS licenses, amounting to Euro 12 million, in 2009. **(3)** This caption includes mainly: (i) Euro 85 million related to dividends paid by PT s fully consolidated subsidiaries to minority shareholders (Euro 41 million in 2008), net of Euro 13 million related to the cash contribution of minority shareholders to a share capital increase at Vivo Participações, and (ii) the settlement of an Euro-Dollar derivative, on 7 April 2009, which resulted in a payment of Euro 38 million and, as such, PT no longer holds any free standing foreign exchange derivatives on its domestic businesses.

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The amount of cash available in the domestic operations plus the undrawn amount of committed commercial paper lines and standby facilities totalled Euro 2,864 million at the end of December 2009, of which Euro 1,840 million was undrawn committed commercial paper and standby facilities. In the domestic operations, the amount of cash available plus the undrawn amount of committed commercial paper lines and standby facilities covers 9.0 times the maturities scheduled for 2010. On a consolidated basis the maturities scheduled for 2010 are covered 6.8 times.

PT s average cost of debt was 5.0% in 2009, with a maturity of 6.6 years as at 31 December 2009. Excluding Brazil, PT s average cost of debt was 4.3% in 2009, with a maturity of 6.7 years as at 31 December 2009. In 2009, the net debt to EBITDA ratio was 2.2x and EBITDA cover stood at 8.3x.

Post retirement benefits

As at 31 December 2009, the **projected post retirement benefits obligations (PBO)** related to pensions and healthcare amounted to Euro 3,045 million and the market value of assets under management amounted to Euro 2,370 million. In addition, PT had liabilities in the form of salaries due to suspended and pre-retired employees amounting to Euro 791 million and these are not subject to any legal funding requirement. These monthly salaries are paid directly by PT to the beneficiaries until retirement age. As a result, gross unfunded total obligations amounted to Euro 1,467 million, including an overfunded position of Euro 79 million in the healthcare plan. After-tax unfunded obligations amounted to Euro 1,079 million. PT s post retirement benefits plans for pensions and healthcare are closed to new participants.

Post retirement benefits obligations **Euro million**

	31 December 2009	31 December 2008
Pensions obligations	2,710.2	2,607.5
Healthcare obligations	335.3	426.3
PBO of pension and healthcare obligations	**3,045.5**	**3,033.8**
Market value of funds (1)	(2,369.5)	(2,131.6)
Unfunded pensions and healthcare obligations (**2**)	**675.9**	**902.1**
Salaries to suspended and pre-retired employees	791.4	907.7
Total gross unfunded obligation	1,467.4	1,809.9
After-tax unfunded obligations	**1,078.5**	**1,330.2**
Unrecognised prior years service gains	23.4	25.4
Accrued post retirement benefits	1,490.8	1,835.3

(1) The change in the market value of funds resulted from the positive performance of assets under management amounting to Euro 310.3 million (equivalent to 15% in 2009) and the contributions made by beneficiaries and PT totalling Euro 120.1 million, which were partially offset by the payments of pensions and supplements of Euro 166.2 million and healthcare benefits of Euro 26.2 million. **(2)** As at 31 December 2009, unfunded pensions and healthcare obligations are net of an asset of Euro 84 million mainly related with the overfund of healthcare plan.

The PBO was computed based on actuarial assumptions consistent with the demographic and financial information of our plans and in line with IAS 19 requirements. Following the changes in financial markets and economic trends that occurred in 2009, the discount rate was adjusted from 5.75% at the end of 2008 to 5.50% at the end of 2009, in line with the decrease in corporate bond spreads. The inflation assumption was adjusted from 1.75% to 2.00%. Based on the demographic information of beneficiaries as of 31 December 2009, demographic assumptions on healthcare plan were also adjusted. The net impact of the aforementioned changes to the actuarial assumptions was a gain of Euro 2 million.

Total gross unfunded obligations decreased by Euro 342 million to Euro 1,467 million as at 31 December 2009 as a result of lower liabilities related to salaries payable to suspended and pre-retired employees, mainly

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due to the halting of the redundancy programme and lower liabilities in the form of pension and healthcare benefits following the positive performance of assets under management (15% returns in 2009), which more than offset the time value effect on the unfunded balance.

Change in gross unfunded obligations **Euro million**

	2009	2008
Gross unfunded obligations (initial balance)	1,809.9	1,304.0
Post retirement benefits costs (PRB)	91.6	46.7
Prior years service gains related to unvested rights	0.0	(2.1)
Curtailment cost	14.9	100.5
Contributions to pension funds (1)	(108.3)	(46.2)
Payments to pre-retired, suspended employees and other	(175.9)	(187.9)
Net actuarial (gains) losses (2)	(164.8)	594.8
Gross unfunded obligations (final balance)	1,467.4	1,809.9
After-tax unfunded obligations	1,078.5	1,330.2

(1) In 2009, this caption includes: (i) termination payments amounting to Euro 2.7 million; (ii) net reimbursement of healthcare expenses made by PT amounting to Euro 3.2 million, and (iii) contributions to the pension funds of Euro 108.8 million, of which Euro 33 million were made through the transfer of real estate properties. **(2)** In 2009, this caption relates primarily to the difference between the actual return on assets (Euro 310.3 million, or 15% in 2009) and the expected return on assets (6% on an annual basis).

Post retirement benefits costs **Euro million**

	2009	2008
Service cost	6.8	10.0
Interest cost	216.4	208.7
Expected return on assets (1)	(131.6)	(172.0)
Sub-total	91.6	46.7
Amortisation of prior year service gains	(2.0)	(2.0)
Post retirement benefits costs	**89.6**	**44.8**

(1) The decrease in the expected return on assets is explained by the devaluation of plan assets occurred in 2008.

Equity (excluding minority interests)

Equity excluding minority interests amounted to Euro 1,318 million as at 31 December 2009. The increase of Euro 1,085 million in 2009 is explained by: (1) the net income generated in the period of Euro 684 million; (2) actuarial gains, net of taxes, related to post retirement benefits amounting to Euro 121 million, and (3) positive currency translation adjustments amounting to Euro 673 million, mainly related to the appreciation of the Real against the Euro. These effects more than offset the payment of Euro 504 million in dividends in April 2009 by PT to its shareholders.

Change in shareholders equity (excluding minority interests) **Euro million**

	2009
Equity before minority interests (initial balance)	**232.0**
Net income	683.9
Currency translation adjustments	673.0
Dividends (1)	(503.6)
Net actuarial gains (losses), net of taxes	121.1
Other (2)	111.1
Equity before minority interests (final balance)	**1,317.5**
Change in equity before minority interests	**1,085.5**
Change in equity before minority interests (%)	**467.8%**

(1) Dividends paid on 24 April 2009. **(2)** Includes Euro 104 million related to a equity gain obtained in relation to the exchange of Vivo shares for Telemig shares as part of the corporate restructuring undertaken by Vivo in 3Q09.

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Pursuant to Portuguese legislation, the amount of **distributable reserves** is determined according to the standalone financial statements of the Company prepared in accordance with Portuguese GAAP. Distributable reserves increased by Euro 77 million to Euro 845 million as at 31 December 2009, as the dividends paid to shareholders (Euro 504 million) were more than offset by the Euro 530 million net income generated in 2009, under Portuguese GAAP.

Change in distributable reserves **Euro million**

	2009
Distributable reserves (initial balance)	**768.0**
Dividends attributed	(503.6)
Net income under Portuguese GAAP (1)	529.8
Other (2)	50.6
Distributable reserves (final balance)	**844.7**
Change in distributable reserves in the period	**76.7**
Change in distributable reserves in the period (%)	**10.0%**

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(1) The main differences between net income under Portuguese GAAP and IFRS are related to the recognition of post retirement benefits, the goodwill amortisation and the recognition of fair value of financial instruments and derivatives. **(2)** This caption includes again of Euro 56.4 million related to a corporate restructuring of certain subsidiaries.

Consolidated statement of financial position

Consolidated statement of financial position (1) **Euro million**

	31December 2009	31December 2008
Cash and equivalents(2)	1,518.0	1,124.6
Accounts receivable, net	1,538.4	1,393.7
Inventories, net	239.9	297.4
Financial investments	614.1	634.3
Intangible assets, net	4,046.7	3,463.0
Tangible assets, net	4,862.2	4,637.8
Accrued post retirement asset	67.6	1.6
Other assets	783.7	973.1
Deferred tax assets and prepaid expenses	1,160.7	1,188.8
Total assets	14,831.2	13,714.4
Accounts payable	1,338.6	1,373.6
Gross debt	7,046.0	6,695.9
Accrued post retirement liability	1,558.3	1,836.9
Other liabilities	1,597.2	1,777.4
Deferred tax liabilities and deferred income	906.3	834.5
Total liabilities	12,446.4	12,518.2
Equity before minority interests	1,317.5	232.0
Minority interests	1,067.3	964.2

Total shareholders equity	2,384.8	1,196.2
Total liabilities and shareholders equity	14,831.2	13,714.4

(1) Considering a Euro/Real exchange rate of 2.5113 at year-end 2009 and 3.2436 at year-end 2008. **(2)** This caption includes Euro 42 million related to dividends paid by Unitel to Portugal Telecom, which in the consolidated financial statements were included under the caption Accounts receivable - other .

As at 31 December 2009, the net exposure (assets minus liabilities) to Brazil amounted to Euro 3,136 million. The assets denominated in Brazilian Reais in the consolidated statement of PT s financial position, as at 31 December 2009, amounted to Euro 6,432 million, equivalent to 43.4% of total assets.

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The increase in total assets in 2009 is mainly explained by the impact of the appreciation of the Real against the Euro, whilst the increase in total liabilities is primarily explained by the increase in gross debt, which was partially offset by the decrease in post retirement benefit obligations.

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Business performance

Domestic Operations

Revenues from domestic operations, which include wireline and TMN, decreased by 1.9% y.o.y in 2009 as a result of lower equipment sales at TMN (Euro 15 million) and lower MTRs, which negatively impacted in the amount of Euro 62.1 million, notwithstanding the solid performance of: (1) wireline retail revenues, which increased by 1.8% y.o.y; (2) data & corporate revenues, which increased by 5.0% y.o.y, and (3) customer revenues at TMN, up by 0.5% y.o.y.

Wireline revenues increased by 0.8% y.o.y in 2009, as a result of the robust performance in retail revenues (+1.8% y.o.y). The improvement in retail revenues is explained by the strong take-up of the Meo pay-TV service, postpaid broadband, decelerating line loss, despite continued pricing pressure in the corporate and SME / SOHO segments and decline in directories, due to the challenging economic conditions. Accordingly, retail revenue generating units (RGUs) increased by 325 thousand in 2009, compared to 191 thousand in 2008. The continued success of the Meo pay-TV offer is underpinning the performance of the wireline segment even though it was only launched on a nationwide basis in April 2008 and is yet to reach critical mass.

As for wireless, service revenues fell by 4.6% y.o.y in 2009, as a result of adverse economic conditions, notwithstanding post paid customer growth and higher contribution from data services. As a result of the impact of lower customer revenues, MTRs cuts, roaming revenues and lower equipment sales, TMN s operating revenues declined by 4.8% y.o.y in 2009.

Domestic operations income statement (1) **Euro million**

	2009	2008	y.o.y
Operating revenues	**3,320.9**	**3,386.6**	**(1.9)%**
Wireline	1,947.8	1,931.4	0.8%
Domestic mobile • TMN	1,517.8	1,593.6	(4.8)%
Other and eliminations	(144.7)	(138.4)	4.6%
EBITDA (2)	**1,467.5**	**1,563.1**	**(6.1)%**
Post retirement benefits	89.6	44.8	100.3%
Depreciation and amortisation	675.0	611.4	10.4%
Income from operations (3)	**702.9**	**907.0**	**(22.5)%**
EBITDA margin	44.2%	46.2%	(2.0)pp
Capex (4)	770.8	661.2	16.6%
Capex as % of revenues	23.2%	19.5%	3.7pp
EBITDA minus Capex	696.7	901.9	(22.8)%

(1) Domestic operations includes the wireline segment, domestic mobile, PT Inovação, PT SI, PT Pro and PT Contact. **(2)** EBITDA = income from operations + post retirement benefits + depreciation and amortisation. **(3)** Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs. **(4)** Excludes additional commitments under the terms of the UMTS licence (Euro 11.5 million in 1Q09).

EBITDA declined by 6.1% y.o.y in 2009 to Euro 1,467 million, equivalent to a margin of 44.2%. This performance was achieved against a backdrop of: (1) strong growth in pay-TV, which resulted in higher programming and commercial costs; (2) increased customer care and support costs, due to the growth in pay-TV and wireless broadband; (3) lower MTRs, and (4) the halting of the redundancy programme in favour of

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insourcing. The rate of EBITDA decline, notwithstanding the halting of the redundancy programme, in the wireline business has been improving, throughout the quarters. TMN s EBITDA margin stood at 44.4% in 2009, increasing 1.6pp y.o.y, due the strict cost control.

Wireline

In 2009 retail net additions reached 325 thousand, as a result of the significant growth of the pay-TV service, which accounted for 269 thousand net additions, bringing the total pay-TV customers to 581 thousand and showing a sequential acceleration in net additions. ADSL net additions in 2009 reached 152 thousand, while traffic generating lines declined by 56 thousand. In 2009, net disconnections of voice lines were 96 thousand, including the 40 thousand net disconnections of carrier pre-selection lines. This performance marks a clear improvement in relation to the same period last year, which saw 173 thousand net disconnections, thus consolidating the improvement in key operational performance indicators seen during 2009. Pay-TV customer penetration stands at 22.2% of traffic-generating lines and 67.4% of the ADSL customer base, a solid performance considering that the pay-TV service was launched, on a nationwide basis only in April 2008.

The number of retail RGU per access, measured by the number of retail accesses per PSTN/ISDN line, continued to increase with the rollout of the pay-TV offer and stood at 1.53 in 2009, as compared to 1.36 in 2008.

Competitors accesses, which include wholesale accesses and carrier pre-selection, fell by 76 thousand in 2009, reflecting a decrease in carrier pre-selection (-40 thousand), unbundled local loop lines (-25 thousand), and wholesale line rental (-12 thousand).

In 2009 ARPU increased by 3.1% y.o.y to Euro 30.1, as a result of higher penetration of both TV and ADSL and gross profit was broadly flat despite strong growth in retail net additions.

Meo has further reinforced its position as the most innovative pay-TV offer in the Portuguese market by launching various features to differentiate its offer, including: (1) real video-on-demand (VoD) with DVD-like features and a catalogue of more than 2,000 movies including high definition (HD); (2) catch-up TV; (3) electronic programming guide accessible remotely through the internet and the mobile phone; (4) TV channel recording, which can be remotely programmed through the internet or through the mobile phone; (5) gaming, karaoke and several interactive content and service areas; (6) access to personal photo folders, and (7) customised offers for kids, continuously enhanced with new contents. In addition, PT has also launched Meo@PC, allowing customers to have online access to Meo s pay-TV service through the PC, strengthening the mobility and convergence attributes of Meo and further enhancing its differentiation in the pay-TV market.

Meo provides access to a comprehensive content offering, with more than 120 TV channels and over 2,000 VoD titles. The VoD offer, which includes blockbusters from five Hollywood studios is a key differentiating feature of the service as more than 50% of Meo s IPTV customers have already used VOD on a paid basis (+8.0pp, as compared to 2008), consuming on average 2.7 movies per month. In 4Q09, as part of the Christmas campaign and focusing on increasing VoD usage, PT launched a Gift Voucher with a cover pricing of Euro 20 to use in VoD at a Euro 15 price.

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Wireline operating data

	2009	2008	y.o.y
Main accesses (000)	4,587	4,298	6.7%
Retail accesses	4,189	3,864	8.4%
PSTN/ISDN	2,746	2,843	(3.4)%
Traffic-generating lines	2,612	2,668	(2.1)%
Carrier pre-selection	134	174	(23.2)%
ADSL retail	862	710	21.5%
TV customers	581	312	86.2%
Wholesale accesses	398	434	(8.3)%
Unbundled local loops	281	305	(8.1)%
Wholesale line rental	63	76	(16.2)%
ADSL wholesale	54	53	2.0%
Net additions (000)	289	132	118.9%
Retail accesses	325	191	70.2%
PSTN/ISDN	(96)	(173)	(44.4)%
Traffic-generating lines	(56)	(110)	(49.1)%
Carrier pre-selection	(40)	(63)	(36.2)%
ADSL retail	152	73	108.9%
TV customers	269	291	(7.7)%
Wholesale accesses	(36)	(59)	(39.0)%
Unbundled local loops	(25)	14	n.m.
Wholesale line rental	(12)	(65)	(81.0)%
ADSL wholesale	1	(8)	n.m.
Retail RGU per access (1)	1.53	1.36	12.2%
ARPU (Euro)	30.1	29.2	3.1%
Total traffic (million minutes)	11,225	11,888	(5.6)%
Retail traffic	4,713	4,990	(5.5)%
Wholesale traffic	6,512	6,898	(5.6)%
Employees	6,450	6,183	4.3%

(1) Retail accesses per PSTN/ISDN line.

PT has been continuously strengthening its Meo offer with new features and content, namely through the development of partnerships with key content producers and suppliers. On 2 April 2009, PT launched Meo Kids, a new children s interactive service with unique content, karaoke, videos and news. Meo Kids is available for all PT s pay-TV customers with an interface designed for two distinctive groups: children between four and seven years and children between seven and ten, providing them an improved and targeted experience of next generation television. On 6 April 2009, PT launched the AXN channel in HD, available through IPTV and Satellite. On 24 July, PT announced a partnership with free-to-air channel SIC, which enhances its competive position in pay-TV as well as internet. On 31 July 2009, PT launched the FOX channel in HD, available through IPTV. Portugal was the third market launching FOX HD worldwide. On 15 October, PT announced the launch of FOX Life channel, available through IPTV as from 1 January 2010. On 18 December 2009, PT also reinforced its offer to the youth segment, launching an exclusive new channel dedicated to teenagers, SIC K, in a partnership with free-to-air channel SIC. Additionally, in December 2009, PT also reinforced its VoD offer with exclusive Portuguese musical theatre content.

Meo marketing campaigns continue to enjoy the highest notoriety in the Portuguese pay-TV market. In effect, in 2009, proved ad recall stood above 60% and spontaneous ad recall was above 40%, well ahead of any other competing brands in the sector. In May 2009, Meo was elected Brand of 2008 by the specialised

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magazine Meios & Publicidade , which undertakes an annual initiative aimed at rewarding companies, projects, personalities and advertising agencies for their achievements. In September 2009, in a study undertaken by the telecoms regulator, Meo was considered to be the operator having the best customer satisfaction in the Portuguese telecoms sector, with the highest score related to the best image, the best customer care support and the best price-quality relation. In October 2009, Meo was considered by Marketeer, a specialised marketing magazine, as the 2009 top brand for telecommunications. In 2009, the Meo brand was top of mind of all brands in Portugal.

Following the announcement of PT s investment in fibre optic FTTH network, PT announced a partnership with Corning, a worldwide leader in provision of fibre optics. The FTTH network (fibre-to-the-home) should allow PT to provide high-speed and high quality services, and meet consumers needs and requirements. This strategic investment positions PT well in order to achieve its goal of leadership in all areas of its activity in the domestic market and of profitable future growth. Additionally, the new network will support innovative services, which will further differentiate PT s offers and play an important role in the consolidation of the wireline growth trends and in the reduction of costs associated to maintenance and customer support. At this initial stage, PT covered 965 thousand households (under contruction and available) with FTTH. PT also announced a partnership with Cisco aimed at developing value added solutions for the residential and corporate market segments, which should allow PT to maintain an edge in advanced telecommunication solutions for the residential and corporate market. As part of this alliance, PT launched the TelePresence service, making it available in Lisbon, Porto, Madeira and Azores.

In 2009, wireline operating revenues increased by 0.8% y.o.y to Euro 1,948 million, notwithstanding increased pricing pressure in the corporate and SME / SOHO segments and the decline in directories (-11.2% y.o.y), in equipment sales in 2009 (-15.2% y.o.y) and in MTRs. Notwithstanding continued pressure on the traditional voice business, revenues of pay-TV and ADSL retail have been increasing (+55.1% y.o.y) in line with the stated strategy of addressing the residential market by offering triple-play and double-play services.

Retail revenues increased by 1.8% y.o.y in 2009, to Euro 971 million, underpinned by growth in retail RGUs of 325 thousand, namely pay-TV customers (+269 thousand net additions in 2009), high quality broadband customers(+162 thousand post paid net adds) and resilience of traffic generating lines which decreased by 56 thousand in the period. The growth in number of RGUs per customer contributed to the increase in retail ARPU of 3.1% y.o.y, which stood at Euro 30.1. The performance of retail revenues, which increased for the fourth consecutive quarter in 4Q09, shows a continued sequential acceleration, notwithstanding strong competition from other fixed and cable operators as well as from mobile operators, both in voice and broadband, and against a backdrop of challenging economic conditions.

Wholesale revenues increased by 1.4% y.o.y in 2009 to Euro 495 million, as a result of the increase in leased lines (+15.5% y.o.y) which more than offset the decline in traffic revenues (-6.0% y.o.y) which were negatively impacted by lower MTRs.

Revenues from data and corporate services increased by 5.0% y.o.y in 2009 as a result of the strong increase in revenues from network management, outsourcing and IT (29.5% y.o.y) which more than offset the decrease in revenues from VPN and leased lines (-2.4% y.o.y). This performance was achieved notwithstanding some lumpiness in relation to the execution of certain large contracts and pricing pressure.

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Other revenues decreased by 11.0% y.o.y in 2009, as a result of the decline in directories, which decreased by 11.2% y.o.y, and equipment sales, which decreased by 15.2% y.o.y, as commercial activities in 2009 continued to focus on the marketing of triple-play and pay-TV services, based on rented set-top boxes.

Wireline income statement (1) **Euro million**

	2009	2008	y.o.y
Operating revenues	1,947.8	1,931.4	0.8%
Retail	971.0	953.5	1.8%
Wholesale	495.4	488.5	1.4%
Data & corporate	300.7	286.5	5.0%
Other wireline revenues	180.6	203.0	(11.0)%
Operating costs, excluding D&A	1,148.2	1,044.3	9.9%
Wages and salaries	233.3	226.7	2.9%
Direct costs	409.0	390.9	4.6%
Commercial costs	118.0	112.5	4.8%
Other operating costs	387.9	314.1	23.5%
EBITDA (2)	**799.6**	**887.1**	**(9.9)%**
Post retirement benefits	89.6	44.7	100.5%
Depreciation and amortisation	434.7	365.7	18.9%
Income from operations (3)	**275.4**	**476.7**	**(42.2)%**
EBITDA margin	**41.1%**	**45.9%**	**(4.9)pp**
Capex	565.4	402.8	40.4%
Capex as % of revenues	29.0%	20.9%	8.2pp
EBITDA minus Capex	234.2	484.3	(51.6)%

(1) Includes intragroup transactions. **(2)** EBITDA = income from operations + post retirement benefits + depreciation and amortisation.
(3) Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs.

EBITDA declined by 9.9% y.o.y in 2009, showing sequential improvement in the trend seen throughout the year: 1Q09 (-11.0% y.o.y), 2Q09 (-11.2% y.o.y), 3Q09 (-9.9% y.o.y) and 4Q09 (-7.2% y.o.y). Operating expenses increased by 9.9% y.o.y primarily driven by the increase in other operating expenses (+23.5% y.o.y), namely customer care and support costs in connection with the continued growth of pay-TV customers. Direct costs increased by 4.6% y.o.y to Euro 409 million, reflecting higher programming costs of approximately Euro 77 million, notwithstanding a decline in traffic costs (-15.0% y.o.y). Wages and salaries increased by 2.9% y.o.y to Euro 233 million as a result of: (1) headcount migration from the domestic mobile due to the reorganisation of the domestic fixed and mobile business along customer segments, and (2) the decision to halt the redundancy programme and focus on insourcing of certain activities that were previously being outsourced, thus reducing cash costs. Commercial costs, which increased by 4.8% y.o.y to Euro 118 million, reflect the increase in cost of goods sold (+11.3% y.o.y).

In 2009, gross profit declined by 0.4% y.o.y, showing a significant improvement when compared with the 4.5% y.o.y decline in 2008. It is worth highlight that in 4Q09, gross profit increased by +0.4% y.o.y, the best performance in the last nineteen quarters, accelerating the trend seen in 3Q09 (-0.1% y.o.y) and thus confirming the success of Meo as the key driver for an effective turnaround in the wireline business. EBITDA margin stood at 41.1% in 2009.

Capex increased from Euro 403 million in 2008 to Euro 565 million in 2009. Capex was directed mainly towards investments in: (1) the build out of FTTH network, which allows for increased bandwidth for both residential and corporate customers, and (2) roll out of IPTV services, as a result of the growth in pay-TV

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customers, which account for approximately one third of total wireline capex. At the end of 2009, PT had 965 thousand homes, under construction or available, with fibre to the home.

Domestic Mobile

In 2009, TMN`s total customers increased by 4.6% y.o.y to 7,252 thousand and net additions reached 319 thousand. Customer growth at TMN continued to be underpinned by wireless broadand net additions. At the end of 2009, post paid customers accounted for 30.8% of total customer base, up by 2.9pp y.o.y.

In 2009, TMN continued to invest significantly in the differentiation of its handset portfolio and services offered. TMN makes available to its customers data and value added services such as: (1) internetnotelemóvel , an internet access service and an innovative portal, developed exclusively for TMN, enabling internet access on mobile phones in any place and at any; (2) musicbox , the first unlimited music download service for both mobile handsets and PC s; (3) meo mobile , a mobile TV service, made available through the Meo brand, available everywhere with access to 38 channels including live; (4) App Store , a mobile application store with hundreds of applications, both free and paid, and with a wide range of areas of interest, namely sports, news, travel, etc, and (5) pond , an online aggregator of media and social networking applications with three main areas: user generated content like photos and videos in a partnership with PT s Sapo web portal, Flickr, Picasa, Youtube; social networking, namely Facebook, and blogging, through Twitter, Sapo Blogs and Blogger , and (6) MMS Face Fun, an exclusive and innovative service that allows customers to transform their pictures by merging it with another picture.

Domestic mobile operating data (1)

	2009	2008	y.o.y
Customers (000)	7,252	6,933	4.6%
Net additions (000)	319	680	(53.1)%
Total traffic (million minutes)	9,848	9,047	8.9%
MOU (minutes)	117	115	1.8%
ARPU (Euro)	16.2	18.1	(10.6)%
Customer	14.0	14.9	(5.8)%
Interconnection	1.9	2.9	(34.7)%
Data as % of service revenues (%)	23.1	20.4	2.6pp
SARC (Euro)	36.0	38.0	(5.3)%
Employees	1,004	1,082	(7.2)%

(1) Includes MVNO subscribers.

In addition, TMN also has a wide portfolio of handsets, which is continuously updated in order to support its innovative service offering and underpin TMN s differentiation in the market. In 2Q09, TMN launched Bluebelt, the first smartphone using TMN s brand, a high-end equipment with 3.5G technology for mobile broadband with speeds up to 7.2 Mbps, e-mail in real time, camera with 3.2 Mpx and auto focus, flash and zoom, video camera, MP3 player, Windows Live Messenger, Meo Mobile application and a direct access to content. In 3Q09, TMN launched HTC Magic, the first smartphone in Portugal operating on the open source Android platform, allowing a unique experience in mobile broadband and interactive services and content. TMN has continued to lead the development of the smartphone market in Portugal, through the world premier of Microsoft s Windows Phone, based on the Windows Mobile 6.5 platform, which allows a new and integrated management of applications, tasks, mails and messages and GPS navigation. This operating system was made available in various phones: tmn bluebelt, tmn silverbelt, Samsung Omnia II i8000 and Samsung Lite

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B7300. In 4Q09, TMN, maintaining a strong innovation pace, launched, in association with SonyEricsson, the AINO model, which allows remote access to the PlayStation 3, which can be acquired alone or in a package including one PlayStation 3 and a game.

TMN is focused on increasing the penetration as well as the usage of smartphones, not only by launching own-brand terminals at lower prices but also making smartphones available with pre paid tariff plans. As part of this effort, in October 2009, TMN started to market the BlackBerry Curve 8520 with a pre paid tariff plan and its Christmas campaign was focused on the promotion of smartphones and touch-screen phones.

In 2009, wireless broadband remained a key priority, with TMN launching, following the first pilot project worldwide, a new mobile broadband service based on HSPA+ that makes available speeds of up to 21Mbps. TMN has also launched a new prepaid wireless broadband offer with download speed of 1Mbps, which allows surfing time of ten non-consecutive hours, in a range of 180 days, with unlimited downloads for a charge of Euro 10. In February 2009, in a study undertaken by the telecom regulator, TMN was considered to be the operator having the best 3G coverage and best 3G service throughout the country. TMN already covers all district capitals also with 3.5G. In addition, in April 2009, also in a study undertaken by the telecoms regulator, TMN was considered the operator having the best wireless broadband performance and reliability. TMN was also elected by the readers of PC Guia , a specialised magazine, the best wireless broadband provider in Portugal for the second consecutive year.

TMN also continued to invest in the differentiation and awareness of its brand in 2009. In October 2009, TMN launched an innovative marketing campaign to celebrate the achievement of the important milestone of seven million customers. Also in October, in order to address the youth market, TMN sponsored the ninth round of the surf championship, the ASP World Tour 2009, which took place for the first time in Portugal. As a result of a continued investment, TMN is the best well known mobile brand and the second in terms of top of mind of all brands in Portugal, only behind PT`s Meo brand.

In 2009, non-SMS and valued added data services continued to contribute to top line growth, increasing by 27.3% y.o.y and accounting for 59.0% of total data revenues, up by 9.0pp y.o.y. This growth in non-SMS data continued to be driven by the steady performance of wireless broadband and increasing data usage, particularly of smartphones and other data-enabled phones. In the period, total data revenues accounted for 23.1% of service revenues, increasing by 2.6pp over the same period last year.

TMN s ARPU decreased by 10.6% y.o.y in 2009 to Euro 16.2, as a result of: (1) strong subscriber growth; (2) increased penetration of services in lower segments of the market, and (3) declining MTRs. In effect, interconnection ARPU declined by 34.7% y.o.y. In 2009, total traffic increased by 8.9% y.o.y to 9,848 million minutes, driven mainly by outgoing traffic, which increased by 11.5%. Growth in customer base (+4.6%, EoP) coupled with an increased penetration of on-net flat-fee tariff plans underpinned traffic growth in the period.

In 2009, TMN s operating revenues amounted to Euro 1,518 million, a decrease of 4.8% y.o.y (- Euro 76 million), mainly due to the negative impact of Euro 62.1 million as a result of lower MTRs and the 9.6% y.o.y decline in equipment sale (- Euro 15 million). Service revenues decreased by 4.6% y.o.y (- Euro 65 million), as the increase in customer revenues, which were up by 0.5% y.o.y, was insufficient to offset the decrease in interconnection revenues (-30.3% y.o.y) due to the regulated cuts in MTRs and the decline in roamers revenues of 3.5%. Excluding lower MTRs, operating and service revenues would have decreased by 0.9% y.o.y and 0.2% y.o.y, respectively.

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Domestic mobile income statement (1) **Euro million**

	2009	2008	y.o.y
Operating revenues	**1,517.8**	**1,593.6**	**(4.8)%**
Services rendered	1,360.0	1,424.9	(4.6)%
Customer	1,173.4	1,167.3	0.5%
Interconnection	161.0	231.2	(30.3)%
Roamers	25.5	26.4	(3.5)%
Sales	144.1	159.4	(9.6)%
Other operating revenues	13.7	9.3	47.3%
Operating costs, excluding D&A	**843.7**	**911.7**	**(7.5)%**
Wages and salaries	48.3	51.9	(6.8)%
Direct costs	259.4	279.3	(7.1)%
Commercial costs	276.6	323.9	(14.6)%
Other operating costs	259.3	256.6	1.0%
EBITDA (2)	**674.1**	**681.9**	**(1.1)%**
Depreciation and amortisation	220.9	231.7	(4.6)%
Income from operations (3)	**453.2**	**450.2**	**0.7%**
EBITDA margin	44.4%	42.8%	1.6pp
Capex	180.1	244.6	(26.4)%
Capex as % of revenues	11.9%	15.3%	(3.5)pp
EBITDA minus Capex	494.1	437.3	13.0%

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(1) Includes intragroup transactions. **(2)** EBITDA = income from operations + depreciation and amortisation. **(3)** Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs. **(4)** Excludes additional commitments under the terms of the UMTS licence (Euro 11.5 million in 1Q09).

Customer revenues increased by 0.5% y.o.y to Euro 1,173 million (Euro 6 million) on the back of customer growth, namely in wireless broadband despite adverse economic conditions affecting the corporate and SME/SOHO segments. Interconnection revenues declined by 30.3% y.o.y (- Euro 70 million) in 2009 to Euro 161 million, as a result of the decline in MTRs from Euro 11 cents per minute in the beginning of 2008 to Euro 6.5 cents as from 1 April 2009. TMN has fully implemented the glide path imposed by the Regulator. Equipment sales declined by 9.6% y.o.y (-Euro 15 milion) primarily due to lower handset prices.

EBITDA decreased by 1.1% y.o.y to Euro 674 million in 2009, as a result of the decline in MTRs, which had a negative impact of Euro 29.8 million. Adjusting for this negative effect, EBITDA would have increased by 3.2% . Operating expenses, excluding D&A, decreased by 7.5% y.o.y in 2009 to Euro 844 million, on the back of strict cost discipline: (1) wages and salaries decreased by 6.8% y.o.y in 2009, reflecting efficiency gains as a result of the reorganisation of PT s domestic businesses along customer segments and fixed-mobile integration, (2) commercial costs declined by 14.6% y.o.y to Euro 277 million, as a result of the continued focus on reducing the breadth of TMN s handset portfolio and increasing the number of exclusive handsets and lower SARC, and (3) direct costs, which mainly include costs of telecommunications, decreased by 7.1% y.o.y to Euro 259 million in 2009 due to the positive impact of lower MTRs. Unitary SARC, which includes marketing, handset subsidies and commissions, declined 5.3% y.o.y in 2009. EBITDA margin stood at 44.4% in 2009, increasing by 1.6pp when compared to 42.8% in 2008.

Capex decreased by 26.4% y.o.y in 2009 to Euro 180 million. The decrease in TMN s capex in 2009 is explained primarily by the investments in the continued deployment of 3G/3.5G networks, both in terms of capacity and coverage, carried out in 2008 which resulted in an improved quality of TMN s voice and data networks and services. Capex continued to be directed primarily towards expanding network capacity and coverage, as a result of increased voice and data usage, and improving mobile voice and data services to customers. Approximately 70% of network capex is being directed towards 3G and 3.5G networks. As a result

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of the strict cost and capex control, EBITDA minus capex at TMN increased by 13.0% to Euro 494 million in 2009.

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International Businesses

Brazilian Mobile - Vivo

In 2009, Vivo s customer base increased by 15.1% y.o.y to 51,744 thousand, surpassing the 50 million customer mark during December. GSM and 3G accounted for 43,504 thousand customers at the end of December 2009, equivalent to 84.1% of total customers (+14.9pp y.o.y). In 2009 net additions reached 6,799 thousand, decreasing by 9.0%, which is explained by the decelerating trend seen in the market in 2009 as compared to 2008, the intense proliferation of SIM Cards and Vivo s focus on retaining and maintaining its customer base, namely high-value customers, notwithstanding the fact that in 4Q09 net additions increased by 8.6% y.o.y, reaching 2,897 thousand driven by: (1) the most comprehensive and differentiated offer, namely related to post paid plans and handsets; (2) strong marketing campaigns, namely during Christmas, aimed at increasing usage and on retaining and maintaining Vivo s customer base, and (3) the leadership in quality and 3G coverage. The increase in net additions in 4Q09, allowed Vivo to post a 37.0% market share of net additions, well ahead of any competitor, thus reinforcing its leadership, for the second consecutive quarter. In November 2009, to enhance the pospaid offer Vivo launched a new pricing plan, Vivo Você, which includes more services and has been very successful in terms of take up rates. As a result of its quality and balanced offer, Vivo is the operator that has gained more customers from number portability since it was implemented in Brazil.

Total minutes carried by Vivo in 2009 increased by 27.6% y.o.y, on the back of on-net traffic growth, as a result of the success of recent marketing campaigns focused on promoting usage, against a backdrop of strong usage growth, namely in 2H09, incoming traffic has slightly increased (+0.9% y.oy) as a result of accelerated fixed to mobile migration. Vivo s blended MOU has increased by 6.3% y.o.y in 2009 reaching 92 minutes, underpinned by outgoing MOU (+18.5% y.o.y).

Brazilian mobile operating data (1)

	2009	2008	y.o.y
Customers (000)	51,744	44,945	15.1%
Market share (%)	29.7	29.8	(0.1)pp
Net additions (000)	6,799	7,475	(9.0)%
Total traffic (million minutes)	52,106	40,843	27.6%
MOU (minutes)	92	86	6.3%
ARPU (R$)	26.4	29.2	(9.5)%
Customer	15.9	16.8	(5.8)%
Interconnection	10.3	12.1	(14.8)%
Data as % of service revenues (%)	13.6	10.2	3.4pp
SARC (R$)	75.6	82.5	(8.4)%
Employees	10,598	8,386	26.4%

(1) Operating data calculated using Brazilian GAAP.

Vivo s blended ARPU reached R$ 26.4 in 2009, a decrease of 9.5% y.o.y as a result of customer growth, higher penetration of mobile services in the lower income segments and campaigns aimed at stimulating usage. Customer ARPU declined by 5.8% y.o.y to R$ 15.9 due to promotions and bonuses offered against a backdrop of competitive environment and multiple SIM card penetration. Interconnection ARPU declined by

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14.8% y.o.y as a result of fixed to mobile migration. ARPU was positively impacted by data ARPU growth, which was driven by connectivity and data applications.

Vivo s operating revenues, as stated in Brazilian Reais and in accordance with IFRS, increased by 7.0% y.o.y in 2009 to R$ 17,369 million, as a result of growth in service revenues (+9.8% y.o.y) underpinned by strong growth in customers and in data services, driven primarily by wireless broadband. Data revenues increased by 44.0% y.o.y in 2009 and already account for 13.6% (+3.4pp y.o.y) of service revenues. The growth drivers of data services were: (1) wireless broadband connectivity, due to strong customer growth, (2) the increase in the usage of person-to-person SMS / MMS, as a result of higher recharges with services and activations of post paid plans with data benefits; (3) promotions for the usage of SMS Content (interactivity actions on the TV and other media), and (4) the launch of new services, namely Vivo Avisa and Vivo Informa . To increase smartphones penetration and data usage, Vivo has launched several marketing initiatives in 2009, such as: (1) Motocubo , a smartphone addressed to the youth segment with simplified access to social networking sites, and (2) My first Smartphone campaign that offers the smartphone after a post paid contract with wireless broadband embedded. Service revenues were negatively impacted by the deceleration in interconnection revenues, due to promotions focusing on on-net traffic campaigns, which in turn led to a reduction in incoming traffic and substitution of fixed-to-mobile traffic. Equipment sales declined by 17.2% y.o.y in 2009 to R$ 1,299 million as a result of an increased focus on SIM Card only offers.

Brazilian mobile income statement (1) **R$ million**

	2009	2008	y.o.y
Operating revenues	**17,368.6**	**16,225.6**	**7.0%**
Services rendered	15,680.6	14,280.5	9.8%
Sales	1,299.2	1,568.5	(17.2)%
Other operating revenues	388.8	376.6	3.3%
Operating costs, excluding D&A	**12,125.9**	**11,774.0**	**3.0%**
Wages and salaries	890.9	770.6	15.6%
Direct costs	3,395.3	3,028.1	12.1%
Commercial costs	3,994.3	4,252.4	(6.1)%
Other operating costs	3,845.4	3,722.9	3.3%
EBITDA (2)	**5,242.7**	**4,451.6**	**17.8%**
Depreciation and amortisation	3,981.4	3,320.1	19.9%
Income from operations (3)	**1,261.4**	**1,131.5**	**11.5%**
EBITDA margin	30.2%	27.4%	2.7pp
Capex (4)	2,329.5	2,728.8	(14.6)%
Capex as % of revenues	13.4%	16.8%	(3.4)pp
EBITDA minus Capex	2,913.2	1,722.9	69.1%

(1) Information prepared in accordance with IFRS. **(2)** EBITDA = income from operations + depreciation and amortisation. **(3)** Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs. **(4)** Excludes the acquisition of 3G licences in Brazil (Euro 227 million in 2Q08).

EBITDA increased by 17.8% y.o.y to R$ 5,243 million in 2009, on the back of revenue growth and cost control. Commercial costs decreased by 6.1% y.o.y while unitary SARC, which includes marketing, handset subsidies and commissions, decreased by 8.4% y.o.y in 2009. This performance of commercial costs is explained by: (1) the decline in subsidisation due to a higher take-up on GSM handsets and SIM Card only offers, (2) the decline in cost of products sold, impacted by the appreciation of the Real, and (3) the focus on retaining Vivo s best customers and up-selling of services aimed at increasing the share of wallet. Against a backdrop of intensive competition and aggressive campaigns, EBITDA margin increased in 2009 by 2.7pp to 30.2%.

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Capex decreased by 14.6% y.o.y to R$ 2,329 million in 2009 and was primarily directed towards: (1) increasing network capacity to support the accelerated customer growth experienced by Vivo, namely in 2G; (2) expanding coverage of 3G and 3.5G networks; (3) continued expansion of coverage in the Northeast states following the launch of the service in October 2008 and the pre paid in September 2009, (4) improving network quality to continue to be the most reliable and best quality network in Brazil, and (5) investments in customer care and informations systems. At the end of December, the 3G network covered 579 municipalities, reaching more than 60% of total Brazilian population.

Other International Assets

In 2009, international assets excluding Vivo, on a pro-forma basis, increased their proportional revenues and EBITDA contribution by 23.0% to Euro 513 million and by 31.2% to Euro 221 million respectively. This performance was achieved on the back of strong customer growth and profitability underpinned by cost control.

Proportional income statement of other international assets (1) **Euro million**

	2009	2008	y.o.y
Operating revenues	**512.9**	**416.9**	**23.0%**
EBITDA (2)	**221.5**	**168.8**	**31.2%**
Depreciation and amortisation	43.3	32.3	34.3%
Income from operations (3)	**178.2**	**136.5**	**30.5%**
EBITDA margin	43.2%	40.5%	2.7pp

(1) Proforma consolidation of international assets using the percentage of ownership held by PT. Excludes investments in Vivo and Médi Telecom, which has been disposal of. **(2)** EBITDA = income from operations + depreciation and amortisation. **(3)** Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs.

Highlights of main assets in Africa and Asia (2009) (1) **thousand (customers), million (financials)**

	Stake	Customers	Rev. local	y.o.y	EBITDA local	y.o.y	Margin	Rev. Eur	EBITDA Eur
Unitel (2) (4)	25.00%	5,700	1,562	23.0%	1,030	33.7%	65.9%	1,120	738
MTC (3) (4)	34.00%	1,363	1,444	10.8%	772	21.1%	53.5%	124	66
CVT (3) (4)	40.00%	374	7,775	(3.5)%	4,561	(6.8)%	58.7%	71	41
CTM (2)	28.00%	833	2,439	(0.1)%	1,133	4.2%	46.5%	219	102
CST (3) (4)	51.00%	89	269,216	36.9%	75,119	14.3%	27.9%	12	3
Timor Telecom (3)	41.12%	355	49	26.3%	25	21.2%	51.4%	35	18

(1) Figures account for 100% of the company. PT has management contracts in CVT, CST and Timor Telecom. **(2)** Equity consolidation method. **(3)** Full consolidation method. **(4)** These stakes are held by Africatel, which is 75% controlled by PT.

In 2009, Unitel s revenues and EBITDA increased by 23.0% and 33.7% y.o.y, to USD 1,562 million and USD 1,030 million respectively, underpinned by strong and steady customer growth, notwithstanding the devaluation of Kwanza, which was more pronounced in 4Q09. Net additions totalled 1,128 thousand in 2009, with total customer base reaching 5,700 thousand at the end of December 2009, an increase of 24.7% over the same period of last year. In 2009, ARPU totalled USD 25.0, a decrease of 5.7% over the same period of last year, mainly due to the kwanza devaluation.

In 2009, MTC s revenues and EBITDA increased by 10.8% and 21.1% y.o.y respectively. EBITDA margin increased to 53.5% in 2009. The customer base reached 1,363 thousand at the end of December 2009, an increase of 26.5% over the same period of last year, with net additions reaching 285 thousand. Post paid

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customers increased by 13.3% y.o.y, equivalent to 7.0% of total customer base. ARPU totalled NAD 95.3, a decrease of 16.9% y.o.y, as a result of customer growth in the period.

CVT s revenues decreased by 3.5% y.o.y to CVE 7,775 million, while EBITDA decreased by 6.8% y.o.y to CVE 4,561 million in 2009. EBITDA margin stood at 58.7% in 2009. Mobile customers increased by 15.2% to 291 thousand. ARPU totalled CVE 1.369 decreasing 32.2% y.o.y, as a result of customer growth and lower roaming revenues.

CTM s revenues decreased by 0.1% y.o.y to MOP 2,439 million in 2009, benefiting from an improved trend against a backdrop of economic recovery in 4Q09. EBITDA increased by 4.2% to MOP 1,133 million, with strong cost control more than offsetting economic pressure over revenues. EBITDA margin increased to 46.5% in 2009. In the mobile division, customers increased by 19.5% y.o.y reaching 525 thousand at the end of December 2009. In 2009, CTM s mobile ARPU decreased by 26.0% to MOP 104.3, as a result of customer growth in the period.

In 2009, CST s revenues and EBITDA increased by 36.9% y.o.y to STD 269,2 million and by 14.3% y.o.y to STD 75,1 million respectively. EBITDA margin stood at 27.9% . In the mobile division, CST had 81 thousand customers at the end of December 2009, an increase of 59.9% y.o.y. Mobile ARPU totalled STD 208 thousand in 2009, a decrease of 21.3% over the same period of last year.

In 2009, Timor Telecom s revenues and EBITDA increased by 26.3% and 21.2% y.o.y, to USD 49 million and USD 25 million respectively, mainly as a result of the strong increase in the number of mobile customers. EBITDA margin stood at 51.4% . Timor Telecom s mobile net additions reached 226 thousand, bringing the total customer base to 351 thousand at the end of December 2009, an increase of 180.7% y.o.y. This significant customer growth was achieved as a consequence of the launch of new commercial offers and investment in coverage. Mobile ARPU totalled USD 17.9 in 2009, a decrease of 31.2% over the same period of last year, as a result of the strong customer growth in the period.

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Employees

Number of employees and productivity ratios

	2009	2008	y.o.y	y.o.y %
Domestic operations	10,978	10,440	538	5.2%
Wireline	6,450	6,183	267	4.3%
Domestic mobile • TMN	1,004	1,082	(78)	(7.2)%
Other	3,524	3,175	349	11.0%
International businesses	26,043	21,530	4,513	21.0%
Brazilian mobile • Vivo(1)	5,299	4,193	1,106	26.4%
Other	20,744	17,337	3,407	19.7%
Total Group employees	37,021	31,970	5,051	15.8%
Fixed lines per employee	711	696	15	2.2%
Mobile cards per employee				
TMN	7,223	6,418	805	12.5%
Vivo	4,882	5,360	(478)	(8.9)%

(1) Proporcional 50%

At the end of 2009, PT s employees were 37,021, of which 29.7% were in the domestic operations. In the wireline business, the total number of employees increased by 4.3% y.o.y, as a result of the management of the domestic businesses along customer segments and of the integrated management of the wireline and mobile businesses, with the ratio of fixed lines per employee reaching 711. At TMN, the number of employees decreased by 7.2% y.o.y, to 1,004, while the ratio of mobile cards per employee increased by 12.5% to 7,223 cards. As at 31 December 2009, the total number of employees at Vivo increased by 26.4% y.o.y to 10,598 (100% of Vivo). The ratio of mobile cards per employee decreased by 8.9% y.o.y to 4,882 cards.

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Capital markets

Shareholder remuneration

In terms of shareholder remuneration, PT returned approximately Euro 504 million to shareholders in 2009, through a cash dividend of Euro 57.5 cents per share paid in April 2009, related to fiscal year 2008.

(1) Subject to Shareholders approval at the AGM.

On 14 May 2009, PT announced that the Board of Directors approved the intention to submit for shareholders approval at the next AGM the payment of a cash dividend of Euro 0.575 per share for the fiscal year ending 31 December 2009, subject to market conditions and PT s financial condition at the time. The payment of this dividend is expected to take place following its approval at the next AGM, to be held on 16 April 2010.

The Board also approved, on 14 May 2009, the intention to submit to the corresponding AGMs the same level of dividends per share (Euro 0.575) for the years ending 31 December 2010 and 2011, subject to market conditions, PT s financial condition and other factors considered relevant by the Board at the time. As such, PT reinforces its commitment to deliver compelling returns to its shareholders, whilst retaining the financial flexibility to continue investing in its core markets, new products and services, and maintaining its long-term competitive position.

As at 31 December 2009 and as at the date of this report, PT had equity swap contracts over 20,640,000 own shares, contracted under the share buyback programme. Adjusting for equity swaps on own shares, the total number of outstanding shares recognised in the balance sheet, is 875,872,500.

Shareholder structure

PT has a diversified shareholder base, with approximately two thirds of its share capital being held by foreign shareholders, mainly in United States, UK and Continental Europe. The Portuguese and the UK markets have

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been increasing their weight in PT s share capital, representing 36% and 21%, respectively of the total shareholder base. Continental Europe and the US markets represent approximately 19% and 23%, respectively, of PT s outstanding capital.

At the end of 2009, the holdings of the qualified shareholders represented more than 50% of PT s share capital, as follows:

Qualified holdings

Date of report	Institutions	No. of shares	% of capital	% of voting rights
17/Dec/08	Telefónica	89,651,250	10.00%	10.00%
31/Dec/08	Brandes Investments Partners	84,975,020	9.48%	7.52%
31/Dec/09	Espirito Santo Group	71,660,806	7.99%	7.99%
31/Dec/09	Caixa Geral de Depósitos Group	65,410,185	7.30%	7.30%
31/Dec/09	Ongoing Strategy Investments	60,404,969	6.74%	6.74%
15/Dec/08	Barclays Group (1)	23,924,243	2.54%	2.54%
05/Jun/07	Visabeira Group	22,667,473	2.01%	2.01%
07/Dec/09	BlackRock Inc.	21,025,118	2.35%	2.35%
04/Apr/08	Controlinveste Comunicações (2)	20,421,247	2.17%	2.17%
09/Jun/09	Norges Bank	17,991,955	2.01%	2.01%

(1) PTfurther disclosed, on 19 January 2010, that the BarclaysPlc held less than 2%of the voting rights corresponding to the share capital of PT.
(2) PTfurther disclosed, on 3 February 2010, that (i) on 27 January 2010, Controlinveste Comunicações, SGPS, S.A., within a share capital increase through contributionsin kind, transferred the ownership of 20,419,325 PT shares corresponding to 2.28%of PT sshare capital to Controlinveste International S.À.R.L.; and (ii) on 28 January 2010, Controlinveste International S.À.R.L., sold, through a transaction executed over the counter, to Controlinveste Finance International S.A., 20,419,325 PT shares representing 2.28%of PT s share capital.

Share performance

In 2009, PT shares outperformed the European telecommunication sector. PT shares closed the year 2009 at Euro 8.52, representing an increase of 40.4% over the previous year. The DJ Stoxx Telecom Europe index increased 11.3% in 2009, the PSI-20 index registered an increase of 51.3% in the same period.

In terms of total shareholder return, PT posted a 54.9% increase during 2009, which compares to 18.8% posted by the DJ Stoxx Telecom Europe index over the same period, thus also outperforming the sector.

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European telecoms share price performance in 2009

Among the major financial markets, the Bovespa registered the best performance in 2009 (+82.7%), followed by the NASDAQ (+43.9%). The PSI-20 index also saw a postive performance in 2009, registered the second highest increase (+33.5%) among the European markets.

Performance of major stock market indexes in 2009

Around 800 million PT shares were traded in 2009, equivalent to a daily average of 3.0 million shares.

In 2009, the price of PT s ADRs increased by 41.5%, closing the year at US$ 12.14. An average of approximately 150 thousand PT ADRs was traded daily in 2009 on the New York Stock Exchange. The number of ADRs outstanding at the end of 2009 was 36.6 million, of which 78.8%

were owned by the top 5

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institutional shareholders. PT s ADR programme continues to be one of the most active among European telecom operators.

Bond performance

The key credit strength of PT in 2009 was again its ability to generate a strong operating free cash flow, as a result of leading market positions in both fixed and mobile businesses in Portugal and in mobile business in Brazil, as well as the implementation of continued cost cutting programmes. In 2009, PT maintained a solid liquidity position, given its significant level of cash, its debt profile (with an average maturity above 6 years as of the year-end) and the additional flexibility provided by its committed stand-by lines and underwritten commercial paper lines.

Rating

On 21 April 2009, Standard & Poor s announced its review of the credit rating attributed to Portugal Telecom, raising the long-term rating to BBB from BBB- and the short-term rating to A-2 from A-3, with stable outlook. According to S&P, the upgrade recognises improving dynamics in PT s domestic wireline business, strengthening performance in Brazil, allowing payment of dividends, and consistently sound domestic mobile operations.

Moody s has confirmed the Baa2 rating with stable outlook, while Fitch improved the outlook of its BBB rating from negative to stable on 6 February 2009.

Bonds

In 2009, Portugal Telecom has executed 3 public issues, including: on 5 February, a tap of the 2012 bond issued in 2005, amounting to 300 million; on 30 April, a 1 billion Eurobond maturing in 2013; and on 2 November, a 750 million Eurobond maturing in 2019. Additionally, in July, PT issued 250 million fixed rate notes maturing in 2017, through a private placement.

On 7 April 2009, PT repaid the 880 million 10-year Eurobond issued in 1999. On 23 December, PT called the 200 million floating rate notes 1 year earlier of the expected initial maturity of 2 years.

In 2009, the performance of PT s bonds was mainly driven by the persistence of the global credit crisis in the first quarter and the gradual stabilization of the financial markets until year-end. PT spreads have been relatively close to end of 2008 levels until April 2009 and have tightened substantially since then, also reflecting the credit rating upgrade announced by S&P in April. The decrease in spreads was particularly significant from April to August, as the main concerns on financial institutions have gradually eased and liquidity in credit market has increased considerably.

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PT Eurobonds Spreads Performance in 2009

(basis points)

The crisis in the financial markets in the first quarter and the gradual improvement in market conditions during the remaining of the year has also been the main driver for the market performance in 2009 of PT s exchangeable bonds issued in August 2007. Until March, market price of these bonds has decreased, having reached a minimum of 92.5% of par. After mid-March, price increased significantly, led by the raise of PT share price and also by the tightening of PT credit spreads, ending 2009 at 109.2% of par.

Investor relations activities

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

During 2009, the Company participated in several investor events, including investor roadshows, analyst and investor presentations, one-on-one meetings and conference calls, and investor conferences in Europe and in the US.

In 2009, PT held a total of over 235 meetings with analysts and investors. Additionally, PT held meetings in its offices, as well as conference-calls with investors and analysts on a regular basis.

During 2009, PT held two roadshows in Europe and two roadshows in the US. The most significant were held in June in Europe and in November in Europe and in the US, following the announcement of the first nine months results.

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Main events

Events of the year

Shareholder remuneration

27.Mar.09 | PT s shareholders approved at the Annual General Meeting (AGM) held on 27 March 2009 the application of the 2008 net income of Euro 488,717,970.00, increased by Euro 26,776,717.50 of free reserves, in the total amount of Euro 515,494,687.50, as dividends paid to shareholders, corresponding to Euro 0.575 per share. Dividends paid in April 2009, net of dividends attributed to own shares, amounted to Euro 503,626,688.

14.May.09 | PT announced that the Board of Directors has approved the intention to submit for shareholders approval at the next AGM the payment of a cash dividend of Euro 0.575 per share for the fiscal year ending 31 December 2009, subject to market conditions and PT s financial condition at the time. The Board has also approved the intention to submit to the corresponding AGMs the same level of dividends per share (Euro 0.575) for the years ending 31 December 2010 and 2011, subject to market conditions, PT s financial condition and other factors considered relevant by the Board at the time.

Vivo

23.Mar.09 | Vivo Participações S.A. (Vivo), Telemig Celular Participações S.A. (TCP) and Telemig Celular S.A. (TC) announced the approval, by their respective Boards of Directors, of the proposal, to be submitted to the shareholders of the three companies mentioned above, for the corporate restructuring that is intended to incorporate the shares of TC in TCP and the shares of TCP in Vivo, thus converting TC into a fully owned subsidiary of TCP and TCP into a fully owned subsidiary of Vivo. This corporate restructuring aims to simplify the current organisational structure of Vivo and its subsidiaries, reducing the number of companies listed in the Bolsa de Valores de São Paulo (BOVESPA) and in the New York Stock Exchange (NYSE), thus reducing the costs associated with their market listing. This restructuring should also translate into a higher liquidity of the shares of Vivo, the company that will remain listed, thus benefiting all shareholders of TCP, TC and Vivo, and in a higher integration and rationalisation of the management of the respective companies.

29.May.09 | Vivo Participações S.A. (Vivo), Telemig Celular Participações S.A. (TCP) and Telemig Celular S.A. (TC) announced the approval, by their respective Boards of Directors, of the terms and conditions for the corporate restructuring that is intended to incorporate the shares of TC in TCP and the shares of TCP in Vivo, thus converting TC into a fully owned subsidiary of TCP and TCP into a fully owned subsidiary of Vivo. Subject to shareholder approval of the incorporation of TC shares by TCP, the share capital of TCP will be increased in the amount of R$461,368,861.48, to R$1,084,719,438.71, as a result of the issuance of 17.40 preferred or ordinary shares of TCP for each preferred or ordinary share, respectively, of TC. Additionally, subject to shareholder approval of the incorporation of TCP shares by Vivo, the share capital of Vivo will be increased in the amount of R$1,879,727,592.70, to R$8,780,150,322.86, as a result of the issuance of 1.37 preferred or ordinary shares of Vivo for each preferred or ordinary share, respectively, of TCP.

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TMN

29.Sep.09 | TMN announced that surpassed 7 million customers, strengthening leadership in the mobile communications sector in Portugal.

Corporate structure

27.Mar.09 | PT announced the appointment of Zeinal Bava as Chief Executive Officer (CEO), for the 2009/2011 term of office, at the meeting of the Board of Directors, held following the Annual General Meeting of Shareholders and also the appointment of the Executive Committee.

Financing

21.Apr.09 | S&P announced its review of the credit rating attributed to Portugal Telecom, raising the long-term rating to BBB from BBB- and the short-term rating to A-2 from A-3. The outlook is stable.

23.Apr.09 | Portugal Telecom announces the successful issuance of a Euro 1,000 million Eurobond, with a maturity of 4 years, through its wholly-owned subsidiary PT International Finance BV with a spread of 345bp over the mid swaps of similar maturity. The coupon of this issue will be 6.0% .

26.Oct.09 | PT announced the successful issuance of a Euro 750 million Eurobond, with a maturity of 10 years, through its wholly-owned subsidiary PT International Finance BV with a spread of 145bp over the mid swaps of similar maturity. The coupon of this issue will be 5.0% .

Next generation access networks

14.May.09 | PT announced the investment in its fibre optic network, also known as Fibre to the Home (FTTH). This network will allow PT to provide high-speed and high quality services, and meet consumers needs and requirements, thus positioning PT to achieve its goals of leadership in all areas of activity in the domestic market and profitable future growth. PT aims to cover one million households with FTTH by the end of 2009.

Television strategy

21.Oct.09 | PT announced that Meo, its pay-TV service, surpassed 500 thousand customers, representing circa 64% of PT s ADSL customers and 19% of its traffic generating lines.

Sale of Méditel

01.Sep.09 | PT announced that it has entered into a definitive agreement, together with Telefónica, S.A. (Telefónica), for the joint sale of their equity stakes in Médi Telecom S.A. (Méditel), each representing 32.18%, together with its outstanding shareholder loans, to the local shareholders of Méditel, FinanceCom,

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S.A., RMA Watanya, S.A. and Fipar Holding. The sale amount was Euro 400 million. The sale was concluded by December after the approval of the local regulator.

Notification of a decision of the ADC

02.Sep.09 | PT announced that PT and PT Comunicações S.A. (PTC) were notified of the Portuguese Competition Authority s (ADC) decision in the misdemeanour proceedings no. 05/03 further to which the Authority imposes a fine of Euro 45,015,524 for an alleged abuse of dominant position relating to the application, between 22 May 2002 and 30 June 2003, of the versions 11 to 15.9 of the wholesale offer RedeADSL PT . The ADC considered that the retail prices for the broadband Internet access, appliedin said period of time by Telepac and by TV Cabo, which were then part of PT Group, did not allow the remaining competitors which were using the wholesale offer Rede ADSL PT of PTC, to generate a sufficient margin of profit. PT and PTC regret that this has been the outcome of the investigation conducted by the ADC for 6 years, disagree of the Decision taken, consider unfounded and unfair the censorship falling on them, and understand that, even if a sanction would be justified, which is not the case, the fine imposed exceeds in an absolutely incomprehensible manner the maximum limit allowed by the applicable legal framework.

Subsequent events

Corporate bodies

17.Feb.10 | PT announced that Rui Pedro Soares resigned from his office as non-executive member of the company s Board of Directors.

22.Feb.10 | PT announced that Fernando Soares Carneiro resigned from his office as non-executive member of the company s Board of Directors.

Digital Terrestrial Television

22.Jan.10 | PT confirmed that PT Comunicações S.A. required to the telecoms regulator, ICP-ANACOM, and to ERC the revocation of the licenses granted for the use of multiplexers B to F as it understands that the necessary conditions for the development of such project are no longer met.

Acquisition of GPTI

8.Feb.10 | PT announced the acquisition of a 100% equity stake in GPTI, SA (GPTI). The acquisition will be carried out through the issuance of shares of Dedic, a 100% owned PT subsidiary that operates in the contact centre business in Brazil. Following the acquisition, current shareholders of GPTI will hold a 12.5% stake in Dedic. Depending on the operational and financial performance of the acquired company in 2010 and 2011, this stake may range from 5% to 20%.

Notification of a decision of the AdC

2.Mar.10 | PT announced that the Lisbon Commerce Court has ruled entirely in favour of the appeal lodged by PT Comunicações against the Portuguese Competition Authority s decision of 1 August 2007, which had condemned PT Comunicações in the payment of a fine amounting to Euro 38 million for allegedly refusing, without an objective justification, to grant access to certain sections of its duct system by TV Tel and Cabovisão. Therefore, PT Comunicações has been cleared from the accusation, a decision that may be appealed, of an infringement of competition rules, notably of abusing a dominant position. The Lisbon Commerce Court concluded that there was no evidence that the ducts belonging to PT Comunicações were essential facilities insofar as without access thereof it would be impossible for competitors to supply pay-TV, Internet access and fixed line telephone services. The Court also ruled that, even if the ducts had been found to constitute essential facilities, there was no proof that the refusals to grant access thereto were unjustified or discriminatory. The Court further held that as a result it was not established that the refusal to grant access to those particular sections of ducts had illegitimately precluded other competitors, namely TV Tel and Cabovisão, from developing their own networks and from supplying telecommunications services.

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Main risks and uncertainties

Business risk management is acquiring increasing relevance, not only due to the current globalisation context, but also considering the dynamics that characterise the industry and business environment of PT. Therefore, risk management plays not only a critical role in mitigating risk factors that can have a negative impact both at company s and stakeholders levels, but also contributes to the identification of new business opportunities.

Based on such commitment, PT is extending the scope of the work, investing in a structured Risk Management Framework to enable the identification of strategic and operational risks, implement and adequate controls that reduce the level of risk to an acceptable level. Therefore, Portugal Telecom has set a corporate unit which mission is to carry out an ongoing assessment, using international standards and practices like the COSO framework to monitor and improve the risk management process.

Risk Management is sponsored by the Executive Committee and directly supported by the management teams of the various business units, both at national and international levels, in order to ensure a timely identification and prioritisation of critical risks, and the development of risk management strategies in order to implement appropriate controls and ensure that the risk is maintained at an acceptable level. It should also be mentioned that the whole process is monitored by the Audit Committee, an independent supervisory body composed by non-executive board members.

As an economic group that carries out its business in several business areas, PT is exposed to various risks, being the following the main risk factors:

Regulation: PT is subject to the risk of regulatory changes or actions from national, international or European Union regulatory authorities that may create growing competitive pressure and affect its capacity to conduct its business in an effective manner. For additional information on this matter please refer to notes to the consolidated financial statements as of 31 December 2009.

Competition: Potential decline of PT`s revenues resulting from increased competition from other operators or new players in the market, namely through (i) development of new products and services, (ii) aggressive marketing and sales policies, (iii) improvements in product and service quality, (iv) increase in productivity and cost reduction, and (v) reconfiguration of the value chain from the customer s point of view.

Technological evolution: Considering the history of quick technological changes, PT is subject to the risk of failing to leverage technological innovations and developments in its business model in order to gain or maintain competitive advantages. PT has created a company wide program, and developed specific methodologies and processes to identify future trends, anticipate business opportunities in a systematic way in all market segments of the company, involving internal experts in the innovation of new products and services, development of business concepts and operational efficiency.

Economic environment: The international financial crisis may lead to a prolonged recession in the Portuguese and world economies, which might have an impact at in the demand for products and services and, as a

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result, on PT s operational and financial performance. As such, management continuously monitors impacts on the operational and financial performance of the Company.

Financial markets: Recent events have increased uncertainty and volatility in financial markets. Risk premium in the markets have increased significantly. As such, current conditions of the financial markets may have an adverse effect on PT s ability to access the capital it needs to support its growth, its strategies, and to generate future financial returns. The management of the financial market risk is ensured by the Corporate Finance Department. PT establishes agreements regarding a set of derivative financial instruments in order to minimise the risk exposure to changes in interest rates. The acquisition of financial instruments is made after a careful analysis of risks and benefits inherent to this type of transactions and consulting with various entities operating in this market. These transactions are subject to prior approval by the Executive Committee and involve a permanent follow-up of the financial markets evolution and of the positions held by the Company.

Exchange rate exposure: Portugal Telecom holds strategic investments in foreign countries whose currency is not the Euro, namely Brazil and several African countries. Exchange rate fluctuations of those currencies against Euro can impact Portugal Telecom financial position and results. Portugal Telecom does not have a hedging policy regarding the value of these investments, however the Executive Committee analyses the execution of cash flow hedging of the dividends and other capital income.

Strategic partnerships: The growth strategy at international level is based on a combination of alliances, joint ventures and partnerships that enhance the Company s competitive capacity. The Executive Committee of PT and its subsidiary companies play a central role in the management of this risk, by leveraging existing opportunities.

For additional information on internal controls and risk management please refer to the Corporate Governance Report included in this Annual Report.

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Outlook

PT will continue to be growth-oriented company, aiming at exploring the full potential of its assets portfolio, by taking advantage of existing and future opportunities in the telecommunications, multimedia and IT services markets. PT aims to continue to take advantage of the convergence opportunities, by bundling traditional voice and data services with new and sophisticated multimedia and IT services.

Following the restructuring of its domestic business along customer segments, PT will continue to focus its efforts on the development of fixed-mobile convergent products and services and integrated offers aimed at acquiring new customers, increasing share-of-wallet, improving customer loyalty and decreasing customer retention costs. PT will continue to invest in innovation, research and development aiming at enhancing its services with new, distinctive and customised features, functionalities and content tailored to meet the customer needs. PT will continue to leverage on close partnerships with its suppliers in order to reduce time-to-market and further differentiate the value proposals to its customers. PT will continue to invest to further develop new and more effective access and core networks and platforms, in fixed-line as well as in mobile, aimed at offering increased bandwidth to its customers. Furthermore, PT will continue to rationalise its cost structure through productivity increases and business process reengineering.

PT aims to further explore the growth potential of Vivo, its Brazilian mobile asset, leveraging on Brazil s favourable demographics and penetration growth potential, fixed-mobile migration and mobile broadband. To further exploit the data segment, PT will continue to invest in the development of 3G and 3.5G services. Additionally, PT also intends to increase its exposure to high-growth markets in Africa by selectively consider value-creating opportunities and taking full advantage of its existing asset portfolio and partnerships. PT will continue to promote the sharing of best practices amongst all of its assets, aiming at ensuring a sustainable competitive position in all markets.

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

PT will continue to contribute to the development of the information society, to promote the info-inclusion of the citizens in all countries where it operates. PT also aims to be a reference in terms of sustainability and will continue to invest in the development of a sustainable business model, and to be embracing policies and developing practices aimed at respecting the society and the environment.

In line with its announced remuneration policy, PT will provide one of the most attractive shareholder remuneration packages of the sector, which aims to combine with above-average growth prospects, leveraging on its international portfolio.

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Statement by the persons responsible

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

- The management report, the financial statements, the auditor s opinion and the other financial statements and documents required by law or regulation concerning the financial year ended on 31 December 2009 were prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and profit or loss of Portugal Telecom, SGPS, SA and the undertakings included in the consolidation taken as a whole;

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

Lisbon, 3 March 2010

Henrique Granadeiro, Chairman of the Board of Directors

Zeinal Bava, Chief Executive Officer

Luís Pacheco de Melo, Director, Chief Financial Officer

Carlos Alves Duarte, Executive Director

Rui Pedro Soares, Executive Director

Manuel Rosa da Silva, Executive Director

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Fernando Soares Carneiro, Executive Director

Shakhaf Wine, Executive Director

José Maria Alvarez-Pallete Lopéz, Non-Executive Director

Francisco Manuel Marques Bandeira, Non-Executive Director

José Guilherme Xavier de Basto, Non-Executive Director

Santiago Fernández Valbuena, Non-Executive Director

João Manuel de Mello Franco, Non-Executive Director

Joaquim Anibal Brito Freixial de Goes, Non-Executive Director

Mário João de Matos Gomes, Non-Executive Director

Gerald Stephen McGowan, Non-Executive Director

Rafael Luís Mora Funes, Non-Executive Director

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Maria Helena Nazaré, Non-Executive Director

Amílcar Carlos Ferreira de Morais Pires, Non-Executive Director

António Manuel Palma Ramalho, Non-Executive Director

Francisco Teixeira Pereira Soares, Non-Executive Director

Jorge Humberto Correia Tomé, Non-Executive Director

Paulo José Lopes Varela, Non-Executive Director

Milton Almicar Silva Vargas, Non-Executive Director

Nuno Rocha dos Santos de Almeida e Vasconcellos, Non-Executive Director

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Activities of Non-Executive Directors

In accordance with Article Six of its Regulation, approved on October 3rd, 2008, PT s Board of Directors has restated its commitment to conferring to its non-executive members the ability to monitor, evaluate and supervise the executive management of the Company.

During the year of 2009, PT s non executive directors were able to effectively carry out their functions without any kind of constrains. In light of this, we highlight the following activities:

• In addition to the exercise of their non-delegated duties on the Executive Committee, PT s non-executive members have performed their supervisory functions over the executive management, under Article 407(8) of the Portuguese Companies Code and paragraph 1 of Article Six of the Board of Directors Internal Regulations. Indeed, pursuant to those rules, the delegation of powers in the Executive Committee does not exclude the mandatory duty of general surveillance impending over non-executive Directors.

• As set out in Articles Five and Six of the Board of Directors Internal Regulations, PT s non-executive directors have also performed their supervisory functions in the internal committees of this corporate body, i.e.:

• In the Corporate Governance Committee, exclusively made up of non-executive directors whose powers and activities in 2009 are described in chapter II.3, paragraph C) of the Company s Corporate Governance Report;

• In the Evaluation Committee, made up of a majority of non-executive directors whose powers and activities are described in chapter II.3, paragraph C) of the Company s Corporate Governance Report.

• By its turn, during the year of 2009, as per the Anglo-Saxon model adopted by the Company, the members of the Audit Committee - the supervisory corporate body, exclusively made up of non-executive directors - have carried out their activities in accordance with the law, the by-laws and the relevant regulations, as better described in chapter II.3, paragraph B) of the Company s Corporate Governance Report.

The effective performance of their functions by PT s non-executive directors was also strengthened by the role of the Chairman of the Board of Directors, who, since March 28th, 2008 has exclusively carried out the functions of chairman, no longer performing executive functions.

This role performed by the chairman is, inclusively, set out in Article Four of the Board of Directors Internal Regulations and has been achieved by the following means:

- Monitoring of the Executive Committee activities in order to keep the Board of Directors informed about the performance of the duties delegated on such Committee;

- Assisting the effective performance of non executive directors functions and duties, assuring the necessary mechanisms in order to allow them to take informed and independent decisions, in particular, in their duty of coordinating the Board of Directors meetings;

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- Stimulating the activities of the Board of Directors internal committees.

During the year of 2009, PT s non executive directors were able to carry out the referred functions and activities, in particular, by the following practices:

- Executive Committee s brief presentations, in the Board of Directors meetings, on the relevant aspects of the performed activities, providing the non executive directors with the required information and clarifications;

- Sending by the Chief Executive Officer to the Chairman of the Board of Directors of the calls and minutes of the Executive Committee s meetings;

- Regular attendance of the non executive directors to the meetings of the Board of Directors (being them the majority of the members of this corporate body in functions);

- Obtaining by the non executive directors, jointly or separately, of the necessary or convenient information to the performance of their functions, upon request to the Chairman of the Board of Directors and/or to the Chief Executive Officer, thus allowing a timely and proper answer.

Lastly and without prejudice of recognised urgency, the call for the Board of Directors meetings is made at least 5 days in advance and the agenda as well as the documentation to support the resolutions are made available at least 3 days in advance.

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PORTUGAL TELECOM, SGPS, SA

CONSOLIDATED INCOME STATEMENT

FOR THE YEARS ENDED 31 DECEMBER 2009 AND 2008

Euro

	Notes	2009	2008 (restated)
REVENUES			
Services rendered	6	6,253,723,858	6,102,100,602
Sales	6	422,894,805	508,662,301
Other revenues	6	108,061,947	110,123,957
		6,784,680,610	**6,720,886,860**
COSTS, LOSSES AND (INCOME)			
Wages and salaries	8	693,234,578	616,597,308
Direct costs	10	1,135,108,895	1,086,931,322
Costs of products sold	11	648,784,657	778,460,559
Marketing and publicity		165,761,900	176,292,202
Supplies and external services	12	1,294,090,787	1,229,948,221
Indirect taxes	14	243,624,838	233,600,026
Provisions and adjustments	38	101,807,099	118,782,268
Depreciation and amortisation	32 and 33	1,437,928,144	1,268,342,092
Post retirement benefits	9.6	89,630,520	44,759,000
Curtailment costs, net	9.6	14,804,659	99,955,165
Gains on disposals of fixed assets, net		(408,534)	(19,466,353)
Other costs, net		49,653,374	29,986,839
		5,874,020,917	**5,664,188,649**
Income before financial results and taxes		**910,659,693**	**1,056,698,211**
FINANCIAL LOSSES AND (GAINS)			
Net interest expense	15	302,279,680	272,372,217
Net foreign currency exchange losses (gains)	16	(20,155,129)	8,505,581
Net gains on financial assets and other investments	17	(8,067,568)	(19,297,574)
Equity in earnings of associated companies, net	30	(456,043,545)	(170,975,397)
Net other financial expenses	18	72,928,007	38,891,868
		(109,058,555)	**129,496,695**
Income before taxes		**1,019,718,248**	**927,201,516**
Income taxes	19	233,209,153	231,379,762
NET INCOME		**786,509,095**	**695,821,754**
Attributable to minority interests	20	102,578,076	119,721,635
Attributable to equity holders of the parent	**22**	**683,931,019**	**576,100,119**

Earnings per share			
Basic	22	0.78	0.64
Diluted	22	0.76	0.62

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

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PORTUGAL TELECOM, SGPS, SA

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEARS ENDED 31 DECEMBER 2009 AND 2008

Euro

	Notes	2009 (Note 40.5)	2008 (restated)
Income and expenses recognised directly in shareholders equity			
Foreign currency translation adjustments (i)		920,584,173	(764,998,457)
Post retirement benefits			
Net actuarial gains (losses)	9.7	164,773,415	(594,809,172)
Tax effect	19	(43,664,955)	157,624,431
Financial instruments			
Hedge accounting			
Change in fair value		(2,407,036)	(1,238,300)
Transferred to profit and loss	41	1,633,364	(44,656)
Tax effect	19	205,023	339,983
Other expenses recognised directly in shareholders equity, net		(5,901,102)	(3,943,124)
		1,035,222,882	**(1,207,069,295)**
Reserves recognised directly in shareholders equity			
Revaluation reserve of tangible assets			
Revaluation of real estate and of the wireline s ducts infrastructure	33		1,075,033,022
Tax effect	19	12,116,738	(284,346,234)
		12,116,738	**790,686,788**
Total earnings and reserves recognised directly in shareholders equity		**1,047,339,620**	**(416,382,507)**
Income recognised in the income statement		**786,509,095**	**695,821,754**
Total income recognised		**1,833,848,715**	**279,439,247**
Attributable to minority interests		348,381,799	(50,376,301)
Attributable to equity holders of the parent		**1,485,466,916**	**329,815,548**

(i) The gain recorded in 2009 is mainly related to the appreciation of the Real against the Euro from 3.2436 as at 31 December 2008 to 2.5113 as at 31 December 2009, while the loss recorded in 2008 is basically explained by the depreciation of the Real against the Euro from 2.5963 as at 31 December 2007 to 3.2436 as at 31 December 2008.

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

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PORTUGAL TELECOM, SGPS, SA

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 DECEMBER 2009 AND 2008 AND 1 JANUARY 2008

Euro

	Notes	31 Dec 2009	31 Dec 2008 (restated)	1 Jan 2008 (restated)
ASSETS				
Current Assets				
Cash and cash equivalents		1,449,516,549	1,010,655,198	664,642,854
Short-term investments	23	26,867,252	52,933,160	1,170,293,202
Accounts receivable - trade	24	1,398,864,344	1,244,602,525	1,307,429,771
Accounts receivable - other	25	169,707,724	201,884,374	128,745,389
Inventories	26	239,877,325	297,382,098	160,592,407
Taxes receivable	27	254,765,524	317,865,624	239,111,584
Prepaid expenses	28	137,262,528	131,470,086	106,526,815
Other current assets	29	22,191,369	60,188,716	38,979,994
Total current assets		**3,699,052,615**	**3,316,981,781**	**3,816,322,016**
Non-Current Assets				
Accounts receivable - trade		2,594,779	3,384,632	1,289,741
Accounts receivable - other	25	8,845,235	4,856,624	4,352,233
Taxes receivable	27	196,429,460	140,771,497	148,340,234
Investments in group companies	30	597,210,048	613,179,099	538,080,641
Other investments	31	16,885,925	21,111,478	27,235,420
Intangible assets	32	4,046,670,219	3,463,038,116	3,383,123,427
Tangible assets	33	4,862,214,772	4,637,837,013	3,585,397,171
Post retirement benefits	9.4	67,588,596	1,557,026	134,060,599
Deferred taxes	19	1,019,511,128	1,032,723,979	992,221,139
Other non-current assets	29	314,203,554	478,954,057	491,089,047
Total non-current assets		**11,132,153,716**	**10,397,413,521**	**9,305,189,652**
Total assets		**14,831,206,331**	**13,714,395,302**	**13,121,511,668**
LIABILITIES				
Current Liabilities				
Short-term debt	34	494,531,900	2,254,666,256	1,256,085,485
Accounts payable	35	1,335,127,377	1,372,302,781	1,108,882,163
Accrued expenses	36	636,891,386	647,156,746	641,050,928
Deferred income	37	417,777,933	362,622,368	331,950,552
Taxes payable	27	293,891,365	337,641,837	381,956,714
Provisions	38	77,815,865	72,214,080	74,958,499
Other current liabilities	39	142,370,844	107,020,445	67,308,947
Total current liabilities		**3,398,406,670**	**5,153,624,513**	**3,862,193,288**
Non-Current Liabilities				
Medium and long-term debt	34	6,551,516,128	4,441,190,114	4,960,675,814

Taxes payable	27	59,217,420	38,730,319	31,172,618
Provisions	38	102,629,790	96,806,426	111,833,374
Post retirement benefits	9.4	1,558,341,521	1,836,850,906	1,463,932,239
Deferred taxes	19	482,219,973	462,192,770	84,880,140
Other non-current liabilities	39	294,105,452	488,763,432	523,185,609
Total non-current liabilities		**9,048,030,284**	**7,364,533,967**	**7,175,679,794**
Total liabilities		**12,446,436,954**	**12,518,158,480**	**11,037,873,082**
SHAREHOLDERS EQUITY				
Share capital	40	26,895,375	26,895,375	30,774,000
Treasury shares	40	(178,071,827)	(178,071,827)	(323,178,913)
Legal reserve	40	6,773,139	6,773,139	6,773,139
Reserve for treasury shares	40	6,970,320	6,970,320	3,091,695
Other reserves and accumulated earnings	40	1,454,941,115	369,459,420	1,622,590,374
Equity excluding minority interests		**1,317,508,122**	**232,026,427**	**1,340,050,295**
Minority interests	20	1,067,261,255	964,210,395	743,588,291
Total equity		**2,384,769,377**	**1,196,236,822**	**2,083,638,586**
Total liabilities and shareholders equity		**14,831,206,331**	**13,714,395,302**	**13,121,511,668**

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

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PORTUGAL TELECOM, SGPS, SA

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEARS ENDED 31 DECEMBER 2008 AND 2009

Euro

	Share capital	**Treasury shares**	**Legal reserve**	**Reserve for treasury shares**	**Other reserves and accumulated earnings**	**Equity excluding minority interests**	**Minority interests (Note 20)**	**Total equity**
Balance as at 31 December 2007	**30,774,000**	**(323,178,913)**	**6,773,139**	**3,091,695**	**1,620,761,976**	**1,338,221,897**	**743,588,291**	**2,081,810,188**
Change in accounting policy (Note 4)					1,828,398	1,828,398		1,828,398
Balance as at 1 January 2008, as restated	**30,774,000**	**(323,178,913)**	**6,773,139**	**3,091,695**	**1,622,590,374**	**1,340,050,295**	**743,588,291**	**2,083,638,586**
Acquisition of treasury shares through equity swaps		(904,638,532)				(904,638,532)		(904,638,532)
Reserve for treasury shares				1,049,745,618	(1,049,745,618)			
Cancellation of treasury shares in March (Note 40)	(2,496,145)	711,917,017		(709,420,872)				
Cancellation of treasury shares in December (Note 40)	(1,382,480)	337,828,601		(336,446,121)				
Dividends (Note 21)					(533,200,884)	(533,200,884)	(43,599,140)	(576,800,024)
Changes in consolidation perimeter							302,769,121	302,769,121
Acquisitions, disposals and share capital increases							11,828,424	11,828,424
Revaluation of certain tangible assets					790,686,788	790,686,788		790,686,788
Income recognized directly in equity					(1,036,971,359)	(1,036,971,359)	(170,097,936)	(1,207,069,295)
Income recognized in the income statement					576,100,119	576,100,119	119,721,635	695,821,754
Balance as at 31 December 2008, as restated	**26,895,375**	**(178,071,827)**	**6,773,139**	**6,970,320**	**369,459,420**	**232,026,427**	**964,210,395**	**1,196,236,822**
Dividends (Note 21)					(503,626,688)	(503,626,688)	(154,046,696)	(657,673,384)
Corporate reestructuring at Vivo (Note 2)					103,641,467	103,641,467	(103,641,467)	
Acquisitions, disposals and share capital increases							12,357,224	12,357,224
Reassessement of the deferred tax liability related to the revaluation of assets (Note 19)					12,116,738	12,116,738		12,116,738
Income recognized directly in equity					789,419,159	789,419,159	245,803,723	1,035,222,882
Income recognized in the income statement					683,931,019	683,931,019	102,578,076	786,509,095
Balance as at 31 December 2009	**26,895,375**	**(178,071,827)**	**6,773,139**	**6,970,320**	**1,454,941,115**	**1,317,508,122**	**1,067,261,255**	**2,384,769,377**

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

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PORTUGAL TELECOM, SGPS, SA

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEARS ENDED 31 DECEMBER 2009 AND 2008

Euro

	Notes	2009	2008
OPERATING ACTIVITIES			
Collections from clients		7,783,167,222	7,779,372,079
Payments to suppliers		(4,298,265,954)	(4,304,337,083)
Payments to employees		(736,268,577)	(654,930,966)
Payments relating to income taxes	43.a	(161,179,339)	(245,970,058)
Payments relating to post retirement benefits	9.5	(251,165,791)	(196,801,097)
Payments relating to indirect taxes and other	43.b	(408,674,451)	(548,446,669)
Cash flow from operating activities (1)		**1,927,613,110**	**1,828,886,206**
INVESTING ACTIVITIES			
Cash receipts resulting from:			
Short-term financial applications	43.c	27,827,287	3,780,376,156
Financial investments	43.d	401,660,387	32,380,948
Tangible and intangible assets		11,705,679	40,785,288
Interest and related income		59,205,383	281,228,219
Dividends	43.e	140,164,156	19,175,607
Other investing activities		876,528	2,177,393
		641,439,420	**4,156,123,611**
Payments resulting from:			
Short-term financial applications	43.c	(1,761,381)	(2,663,016,114)
Financial investments	43.f	(10,614,560)	(348,600,843)
Tangible and intangible assets		(1,296,585,044)	(1,056,927,189)
Other investing activities		(3,766,717)	(7,508,185)
		(1,312,727,702)	**(4,076,052,331)**
Cash flow from investing activities (2)		**(671,288,282)**	**80,071,280**
FINANCING ACTIVITIES			
Cash receipts resulting from:			
Loans obtained	43.g	28,152,064,374	37,882,851,516
Increases in share capital and paid-in surplus	43.h	13,455,882	685,193
Subsidies		949,426	1,044,517
Other financing activities	43.i	30,332,926	7,151,102
		28,196,802,608	**37,891,732,328**
Payments resulting from:			
Loans repaid	43.g	(28,055,009,263)	(37,092,659,729)
Lease rentals (principal)		(17,047,074)	(22,011,222)
Interest and related expenses		(421,635,937)	(580,044,224)
Dividends	43.j	(588,516,153)	(574,613,933)
Acquisition of treasury shares	40.2		(1,049,745,618)
Other financing activities	43.i	(38,584,894)	(45,270,637)

	(29,120,793,321)	**(39,364,345,363)**
Cash flow from financing activities (3)	**(923,990,713)**	**(1,472,613,035)**
Cash and cash equivalents at the beginning of the period	1,010,655,198	664,642,854
Change in cash and cash equivalents (4)=(1)+(2)+(3)	332,334,115	436,344,451
Effect of exchange differences	106,527,236	(90,332,107)
Cash and cash equivalents at the end of the period	**1,449,516,549**	**1,010,655,198**

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

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Portugal Telecom, SGPS, SA

Notes to the Consolidated Financial Statements

As at 31 December 2009

(Amounts stated in Euros, except where otherwise stated)

1. Introduction

a) Parent company

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

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

As a result of the privatization process, between 1 June 1995 and 4 December 2000, Portugal Telecom s share capital is mainly owned by private shareholders. As at 31 December 2009, the Portuguese State owned, directly or indirectly, 9.72% of the total ordinary shares and all of the Class A Shares of Portugal Telecom (Note 40.1).

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

b) Corporate purpose

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

In Portugal, fixed line services are rendered by PT Comunicações, SA (PT Comunicações), under the provisions of the Concession Agreement entered into with the Portuguese State on 20 March 1995 in accordance with Decree-Law 40/95, for an initial period of thirty years, subject to renewal for subsequent periods of fifteen years. On 11 December 2002, according to the terms of the Modifying Agreement to the Concession Contract, PT Comunicações acquired the property of the Basic Network of Telecommunications and Telex (Basic Network). In addition, PT Comunicações also renders ISP services to residential and small and medium companies, and launched in 2007 a television service branded MEO, through the IPTV and DTH platforms.

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

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

In Brazil, the Group renders mobile telecommunications services through Brasilcel NV (Brasilcel or Vivo), a joint venture incorporated in 2002 by Portugal Telecom (through PT Móveis, SGPS, SA PT Móveis) and Telefónica (through Telefónica Móviles, SA) to join the mobile operations in Brazil of each group. In April 2008, after ANATEL s authorization, Vivo completed the stock purchase agreement with Telepart Participações SA to acquire control of Telemig Celular

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Participações SA, which provides mobile services in the Brazilian state of Minas Gerais through Telemig Celular (Note 2). Currently, Brasilcel, through Vivo, SA and Telemig Celular, provides mobile services in the Brazilian states of São Paulo, Paraná, Santa Catarina, Rio de Janeiro, Espírito Santo, Bahia, Sergipe, Rio Grande do Sul, Minas Gerais and eleven states in the Midwestern and Northern regions of Brazil.

In Africa, the group renders fixed, mobile and other telecommunication related services through Africatel Holding BV (Africatel). Services are currently being provided in Angola, Namibia, Mozambique, Kenya, Cabo Verde and São Tomé, among other countries.

On 1 September 2009, Portugal Telecom entered into a definitive agreement, together with Telefónica, S.A., for the joint sale of their equity stakes in Médi Telecom S.A. (Médi Telecom), each representing 32.18%, together with its outstanding shareholder loans, to the local shareholders of Médi Telecom. Following the approval of Agence Nationale de Règlementation des Télécommunications, the Moroccan telecommunications regulator, this sale was concluded in December 2009 when Portugal Telecom received an amount of Euro 380 million, in addition to an advance of Euro 20 million received in September 2009, totaling Euro 400 million (Note 43.d).

The consolidated financial statements for the year ended 31 December 2009 were approved by the Board of Directors and authorized for issue on 3 March 2010.

2. Basis of presentation

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

The consolidated financial statements of Portugal Telecom have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), and include all interpretations of the International Financial Reporting Interpretation Committee (IFRIC) as at 31 December 2009, approved by the EU. For Portugal Telecom, no differences have been identified between IFRS as adopted by the EU and applied by Portugal Telecom, and IFRS as published by the International Accounting Standards Board.

Consolidated financial statements have been prepared assuming the continuity of operations.

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

a) Consolidation principles

Controlled entities

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

The interest of any third party in the equity and net income of fully consolidated companies is presented separately in the Consolidated Statement of Financial Position and in the Consolidated Income Statement, under the caption Minority interests (Note 20).

Losses applicable to the minorities in excess of the minority s interest in the subsidiary s equity are allocated against the interest of the Group, except to the extent that the minority shareholder has a binding obligation and is able to make an

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additional investment to cover the losses. Any future gains reported by the subsidiary are allocated against the interest of the Group, until the excess losses recognised by the Group are covered.

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

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

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

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

Interests in joint ventures

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

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

Jointly controlled entities are presented in Exhibit II.

Investments in associates

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

Financial investments in associated companies are accounted for under the equity method adjusted, when applicable, to comply with Portugal Telecom s accounting policies (Exhibit III). Under this method, investments in associated companies are carried in the Consolidated Statement of Financial Position at cost, adjusted periodically for the Group s share in the results of the associated company, recorded as part of financial results under the caption Equity in earnings of associated companies, net (Note 30). In addition, these financial investments are adjusted for any impairment losses that may occur.

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

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

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

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Goodwill

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

Goodwill related to foreign investments is carried at the reporting currency of the investment, being translated to Euros at the exchange rate prevailing at the statement of financial position date. Exchange gains or losses are recognised in the Consolidated Statement of Comprehensive Income under the caption Foreign currency translation adjustments .

Goodwill related to associated companies is recognised under the caption Investments in group companies (Note 30), and goodwill related to subsidiaries and jointly controlled entities is recognized under the caption Intangible assets (Note 32). Goodwill is not amortised, but tested, on an annual basis at least, for impairment losses, which are recognised in net income in the period they occur, and cannot be reversed in a subsequent period.

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

b) Changes in the consolidated Group

During 2009, there were no significant changes in the consolidated Group.

The main change in the consolidation Group during 2008 is related to the consolidation of Telemig Celular Participações and Telemig Celular (together Telemig) as from 1 April 2008, following the acquisition of control of Telemig Celular Participações (TCP) on 4 April 2008, which held a 83.25% stake on Telemig Celular (TC) as of that date. In addition to the acquisition of shareholder control completed on 4 April 2008, Vivo acquired additional shares of TCP and TC following the voluntary and mandatory tender offers concluded on 15 May 2008 and 15 August 2008, respectively. As a result of these transactions, Vivo had as at 31 December 2008 a stake of 58.8% of TCP and 56.3% of TC, corresponding to voting rights of 97.0% and 95.7%, respectively.

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The detail of the net assets of Telemig consolidated as at 1 April 2008, which were acquired by Portugal Telecom through Vivo, and the goodwill recorded following the above mentioned transactions is as follows (50% share of Portugal Telecom):

Euro

	Book value	**Fair value adjustments**	**Fair value**
NET ASSETS ACQUIRED			
Intangible assets (Note 32)	24,562,683	546,274,017	570,836,700
Tangible assets (Note 33)	127,428,217	56,808,920	184,237,137
Cash and cash equivalents (Note 43.f)	170,803,876		170,803,876
Accounts receivable	39,476,039		39,476,039
Deferred tax assets (Note 19)	30,530,408		30,530,408
Prepaid expenses	18,301,988		18,301,988
Taxes receivable	16,291,914		16,291,914
Inventories	9,827,699	879,001	10,706,700
Other non-current assets	24,263,331		24,263,331
Deferred tax liabilities (Note 19)		(105,139,836)	(105,139,836)
Short-term debt	(35,357,298)	(628,039)	(35,985,337)
Accounts payable	(33,995,607)		(33,995,607)
Accrued expenses	(30,606,302)		(30,606,302)
Medium and long-term debt	(8,228,972)	2,308,921	(5,920,051)
Non-current provisions (Note 38)	(7,120,477)		(7,120,477)
Other current liabilities	(53,020,675)		(53,020,675)
Other non-current liabilities	(3,012,736)		(3,012,736)
Total net assets acquired	**290,144,088**	**500,502,984**	**790,647,072**
Minority interests (Note 20)			(304,038,052)
Goodwill (Note 32)			30,397,905
Purchase price (Note 43.f) (including Euro 3 million of expenses directly attributable to the acquisition)			**517,006,925**

The fair value adjustments of assets and liabilities were valued by an independent entity. The fair value adjustments related to intangible assets consist primarily of operating licenses granted by Anatel (Brazilian regulator) to Telemig in order to provide mobile services. These licenses were valued through the income approach, based on a detailed forecast of cash flows derived from projected financial information provided by management. These licenses are being amortized over its period including a renovation period (30 years).

As a result of the acquisition of shareholders   control of Telemig on 3 April 2008, Portugal Telecom s consolidated income statements for the year ended 31 December 2009 includes the results of Telemig, while for the year ended 31 December 2008 it includes the results of Telemig as from 1 April. The contribution of Telemig for Portugal Telecom s results in the three months period ended 31 March 2009 was a net profit before minority interests amounting to Euro 0.3 million. The pro-forma of Portugal Telecom s consolidated operating revenues and net income before minority interests for the period ended 31 December 2008 as if Telemig had been consolidated as from 1 January 2008 are as follows (amounts in millions):

Euro

	Reported figures	Telemig s results for the 1Q08	Pro-forma information
Operating revenues	6,721	71	6,792
Net income (before minority interests)	696	38	734

Following the above mentioned transactions concluded in 2008, on 27 July 2009, the general shareholders meetings of Vivo Participações, TCP and TC approved a corporate restructuring which consisted of the merger of shares of TC into TCP and the merger of shares of TCP into Vivo Participações. Under these operations, the former shareholders of TC and TCP were entitled to receive shares issued by TCP and Vivo Participações, respectively, and TC and TCP became wholly-owned subsidiaries of TCP and Vivo Participações, respectively. This restructuring resulted in a reduction of minority interests in Vivo Participações amounting to Euro 103,641,467 (Note 20). This reduction resulted primarily from a higher fair value of

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Vivo Participações as comparing to its carrying value, while the carrying value of Telemig was similar to its fair value as a result of the purchase price allocation made in 2008.

The restructuring mentioned above did not involve the acquisition or the loss of control of any of the companies involved in the reestructuring, since Vivo Participações already had control of Telemig as at 31 December 2008 and Brasilcel maintained control of Vivo Participações, notwithstanding the dilution of its interest in this subsidiary from 63.6% to 59.4%. Accordingly, this transaction was accounted for as an equity transaction, with the reduction of minority interests amounting to Euro 103,641,467 being recorded as a gain directly in equity, since this transaction did not result in a loss of control and was a transaction between owners in their capacity as owners.

3. Accounting policies, judgments and estimates

a) Current classification

Assets to be realized and liabilities to be settled within one year from the date of the Consolidated Statement of Financial Position are classified as current.

b) Inventories

Inventories are stated at average acquisition cost. An adjustment to the carrying value of inventories is recognised based on technological obsolescence or lower rotation.

c) Tangible assets

In 2008, Portugal Telecom changed the accounting policy regarding the measurement of real estate properties and the ducts infra-structure from the cost model to the revaluation model, since the Company believes the latter better reflects the economic value of those asset classes, given the nature of the assets revalued, which are not subject to technological obsolescence. The increase in tangible assets resulting from the revaluation reserves, which are non-distributable, is being amortised in accordance with the criteria used to amortize the revalued assets.

The remaining tangible assets are stated at acquisition cost, net of accumulated depreciation, investment subsidies and accumulated impairment losses, if any. Acquisition cost includes: (1) the amount paid to acquire the asset; (2) direct expenses related to the acquisition process; and (3) the estimated cost of dismantling or removal of the assets (Notes 3.g and 38). Under the exception of IFRS 1, revaluation of tangible assets made in accordance with Portuguese legislation applying monetary indices, prior to 1 January 2004, was not adjusted and was included as the deemed cost of the asset for IFRS purposes.

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

	Years
Buildings and other constructions	3 - 50
Basic equipment:	
Network installations and equipment	7 - 20
Ducts infra-structure	40
Telephones, switchboards and other	5 - 10
Submarine cables	15 - 20
Satellite stations	5 - 7
Other telecommunications equipment	3 - 10
Other basic equipment	4 - 20
Transportation equipment	4 - 8
Tools and dies	4 - 10
Administrative equipment	3 - 10
Other tangible fixed assets	3 - 10

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

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the assets, and is recognised in the Consolidated Income Statement under the caption Gains on disposals of fixed assets, net when occurred.

d) Intangible assets

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

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

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

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Intangible assets, except goodwill, are amortised on a straight-line basis from the month they are available for use, during the economic useful lifes or contractual periods if lower (including additional renovation periods if applicable), as follows:

Telecommunications licenses:

- Telecommunications licenses held by Vivo	Period of the license with renovation period	
- Property of the Basic Network held by PT Comunicações	Period of the concession (until 2025)	
- UMTS license owned by TMN	Period of the license with renovation period (until 2030)	
Satellite capacity rights	Period of the contract (until 2015)	
Software licenses	3	6
Other intangible assets	3	8

e) Investment property

Investment property (or real estate investments - Note 31) includes primarily buildings and land held to earn rentals and/or capital appreciation, and not for use in the normal course of the business (exploration, service render or sale).

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

Investment property is depreciated on a straight-line basis, during its expected useful life. The depreciation rates correspond to the estimated average economic useful lives, as detailed in Note 3.c.

f) Impairment of tangible and intangible assets, excluding goodwill

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

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

If the recoverable amount of an asset is estimated to be less than its carrying amount, an impairment loss is recognised immediately in the Consolidated Income Statement.

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

Tangible assets recognized according to the revaluation model are subject to periodic remeasurement and Portugal Telecom intends to revalue these assets at least every three years. Any impairment loss of these assets is recorded as a reduction to the revaluation reserve initially recognized under shareholders equity. Impairment losses in excess of the initial revaluation reserve are recognized in the Consolidated Income Statement.

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g) Provisions and contingent liabilities

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

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

Provisions for dismantling and removal costs are recognised from the day the assets are in use and if a reliable estimate of the obligation is possible (Notes 3.c) and 38). The amount of the provision is discounted, being the corresponding effect of time recognised in net income, under the caption Net interest expense .

Provisions are updated on the date of the Consolidated Statement of Financial Position, considering the best estimate of the Group s management.

h) Pension benefits

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

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

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

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

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

i) Post retirement health care benefits

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

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

Plan amendments related to reduction of the benefits granted to employees are recorded as prior years service gains or losses. Prior years service gains or losses related to vested rights are recognised under the caption Post retirement benefits when they occur and those related to unvested rights are recognised on a straight-line basis until they become

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vested, which usually corresponds to the retirement date. Gains obtained with the settlement of any plan are recognized when incurred under the caption Curtailment costs, net .

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

j) Pre-retirement and suspended employees

In connection with the programs related to employees that are under a suspended contract agreement or that have been pre-retired, the Group recognizes a liability in the Consolidated Statement of Financial Position equivalent to the present value of salaries payable up to the retirement age. The correspondent cost is recorded in the Consolidated Income Statement under the caption Curtailment costs, net , added by pensions, pension supplements and health care liabilities up to the retirement age, when the employee became suspended or pre-retired, and is determined based on actuarial studies (Note 9.3).

k) Grants and subsidies

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

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

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

l) Financial assets and liabilities

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

(i) Receivables (Notes 24 and 25)

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

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

(ii) Available for sale investments

Available for sale investments are those related to listed or quoted shares held by the Group and in connection with which the Company does not have a strategic interest. Available for sale investments are classified under the caption Other investments .

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

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

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sale investment, accumulated changes in the fair value of the investment previously recognised in equity are transferred to net income.

(iii) Financial liabilities and equity instruments

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

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

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

(iv) Bank loans (Note 34)

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

(v) Accounts payable (Note 35)

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

(vi) Derivative financial instruments and hedge accounting (Note 41)

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

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

Hedge accounting

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

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

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

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

(vii) Treasury shares (Note 40)

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

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

(viii) Cash and cash equivalents and short term investments (Note 23)

Cash and cash equivalents comprise cash on hand and demand bank deposits, due within three months or less from the date of acquisition, that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value. Cash and cash equivalents also includes deposits from customers and other entities that have not yet been cleared.

In the consolidated Consolidated Statement of Cash Flows, cash and cash deposits also includes overdrafts recognised under the caption Short-term debt .

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

(ix) Qualified Technological Equipment transactions

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

These transactions correspond to a sale and lease-back transaction, and the equipment continued to be recorded on the Company s consolidated Consolidated Statement of Financial Position. The Company obtained the majority of the economic benefits of these entities and therefore is exposed to the risks resulting from the activities of these special purpose entities. Accordingly, those entities were fully consolidated in the Company s financial statements. Consolidated current and non-current assets include an amount equivalent to the proceeds of the sale of the equipment (Note 29), and current and non-current liabilities include the future payments under the leasing contract (Note 39).

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

m) Own work capitalized

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

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

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- development expenses can be reliably measured.

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

Expenses incurred during investigation are recognised in net income when incurred.

n) Leasings (the company as a lessee)

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

Assets acquired under finance leases and the corresponding liability to the lessor, are accounted for using the finance method, in accordance with the lease payment plan (Note 34). Interest included in the rents and the depreciation of the assets are recognised in net income in the period they occur.

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

o) Taxation

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

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

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

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

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

p) Revenue recognition

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

Revenues from international telecommunications services are divided with the operators of the transit countries and the operators in the country in which calls are terminated based on traffic records of the country of origin and rates established

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in agreements with the various telecommunications operators. The operator of the country of origin of the traffic is responsible for crediting the operator of the destination country and, if applicable, the operators of the transit countries.

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

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

Advertising revenues from telephone directories and related costs are recognised in the period in which the directories are effective. PT Comunicações has a contract with Páginas Amarelas whereby the latter is responsible for production, publishing and distribution of PT Comunicações s telephone directories, as well as for selling advertising space in the directories. The total cost to be paid by PT Comunicações for such services is set at a fixed 72% of its gross revenues from the sale of advertising space in telephone directories. The prices of advertising space are fixed, not contingent, and based on the expected volume of the distributed directories (approximately one to every telephone number). Revenues from the sale of advertising space are invoiced directly by PT Comunicações to its corporate clients during the one-year advertising period. These revenues are recognized in earnings on a monthly basis during the period for the respective directory.

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

Nature of the revenue	**Caption**	**Moment of recognition**
Use of the network	Services rendered	In the month the service is rendered
Interconnection fees	Services rendered	In the month the service is rendered
Roaming	Services rendered	In the month the service is rendered
Pre-paid cards	Services rendered	When the service is rendered
Wireless broadband	Services rendered	When the service is rendered
Terminal equipment and accessories	Sales	When the sale occurs
Penalties imposed to customers	Other revenues	When received

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

The Group operates loyalty programmes for some of its customers, under which, based on certain levels of mobile traffic, these customers receive loyalty points that can be exchanged for equipments, accessories and discounts on subsequent purchases of mobile services. Following the adoption of IFRIC 13 *Customer Loyalty Programmes*, as explained in more detail in Note 4, Portugal Telecom splits the consideration received in the initial transaction between the revenue related to traffic and the loyalty points earned by the customer, recognizing a deferred income measured at fair value for the award credits, taking into consideration the expected points to be redeemed. Deferred income is than recognized as revenue when award credits are redeemed or expire.

Revenues from IPTV and satellite television services result essentially from and are recognised as follows:

Nature of the revenue	Caption	Moment of recognition
Monthly subscription fees for the use of the service	Services rendered	When the service is rendered
Rental of equipment	Services rendered	The period of rental
Sale of equipment	Sales	When the sale occurs
Penalties imposed to customers	Other revenues	When received

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q) Foreign currency transactions and balances

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

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

- Assets and liabilities at exchange rates prevailing at the date of the Consolidated Statement of Financial Position;
- Profit and loss items at average exchange rates for the reported period;
- Cash flow items at average exchange rates for the reported period, where these rates approximate the effective exchange rates (and in the remaining cases, at the rate effective on the day the transaction occurred); and
- Share capital, reserves and retained earnings at historical exchange rates.

The effect of translation differences is recognised in shareholders equity under the caption Cumulative foreign currency translation adjustments and included in the Consolidated Statement of Comprehensive Income. In accordance with IAS 21, when occurs a reduction of Portugal Telecom s investment in a foreign entity, through the sale or reimbursement of share capital, the accumulated effect of translated differences is transferred to the Consolidated Income Statement, considering the proportion of the reduction occurred.

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

r) Borrowing costs

Borrowing costs related to loans are recognised in net income when incurred. The Group does not capitalise any borrowing costs related to loans to finance the acquisition, construction or production of any asset, as the construction period of its tangible and intangible assets is relatively short (Note 4).

s) Consolidated Statement of Cash Flows

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

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

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t) Subsequent events (Note 46)

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

Critical judgments and estimates

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

(a) Post retirement benefits The present value of post retirement obligations is computed based on actuarial methodologies, which use certain actuarial assumptions. Any changes in those assumptions will impact the carrying amount of post retirement obligations. The key assumptions for post retirement obligations are disclosed in Note 9. The Company has the policy to review key assumptions on a periodic basis, if the corresponding changes have a material impact on the financial statements.

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

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

(d) Recognition of provisions and adjustments Portugal Telecom is party to various legal claims for which, based on the opinion of its legal advisors, a judgment was made to determine whether a provision should be recorded for these contingencies (Note 45). Adjustments for accounts receivable are computed based primarily on the aging of the receivables, the risk profile of the customer and its financial condition. These estimates related to adjustments for accounts receivable differ from business to business.

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

(f) Assessment of the fair value of assets stated at revaluation model Portugal Telecom used the revaluation model to measure the carrying value of certain asset classes. In order to determine the revalued amount of those assets, Portugal Telecom used the replacement cost method for the ducts infra-structure and the market value for real estate assets, which require the use of certain assumptions related to the construction cost and the use of specific indicators for the real estate market, respectively, as explained in more detail in Note 33.

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

4. Changes in accounting policies and estimates

During the year ended 31 December 2009, the following standards, revised standards and interpretations, which are applicable to Portugal Telecom, became effective:

• IAS 1 *Presentation of Financial Statements* was revised in September 2007 and is effective for years started on or after 1 January 2009. Besides certain changes with which Portugal Telecom already complied in its 2008 annual report, as they were permitted under the previous version of IAS 1, the revision of this standard had the following requirements which Portugal Telecom adopted in these consolidated financial statements: (1) include an additional financial statement disclosing all changes in equity, which previously was included in the notes to the financial statements; and (2) change of certain headlines from financial statements, namely from Consolidated Balance Sheet to Consolidated Statement of Financial Position and from Consolidated Statement of Recognized Income and Expenses to Consolidated Statement of Comprehensive Income .

• IAS 23 *Borrowing Cost*s was revised in March 2007 and is effective for years started on or after 1 January 2009. The revision of this standard removed the option of immediately recognizing as an expense borrowing costs that relate to assets requiring significant time to be ready for use or sale. Portugal Telecom had no impact in its financial statements following the adoption of the revised standard, as the construction period of its tangible and intangible assets is relatively short.

• IFRS 8 *Segment Reporting* was issued in November 2006 and is effective for years started on or after 1 January 2009, replacing IAS 14. IFRS 8 requires identification of operating segments based on internal reports that are regularly reviewed by a company s chief operating decision maker in order to allocate resources to the segment and assess performance. Portugal Telecom s segment reporting in its 2008 annual report already complied with IFRS 8 and accordingly the adoption of this new standard had no impact on the segments reported results or financial position.

• IFRIC 13 *Customer Loyalty Programmes* was issued in September 2007 and is effective for years started on or after 1 July 2008. The Group operates loyalty programmes for some of its customers, under which, based on certain levels of mobile traffic, these customers receive loyalty points that can be exchanged for equipments, accessories and discounts on subsequent purchases of mobile services. Up to 31 December 2008, Portugal Telecom accounted for these transactions by recognizing the full consideration from the mobile traffic as revenue and a separate liability for the estimated cost resulting from the redemption of the loyalty points. IFRIC 13 requires that such transactions be accounted for as multiple element revenue transactions and that the consideration received in the initial transactions shall be allocated between the revenue related to traffic and the loyalty points earned by the customer. Accordingly, following the adoption of this interpretation as at 1 January 2009, Portugal Telecom recognized a deferred income measured at fair value, instead of a provision as previously. As required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, this interpretation was applied retrospectively and, as a result, the following changes were made to the previously reported Consolidated Statements of Financial Position as at 31 December 2008 and 2007 and Consolidated Income Statement for the year ended 31 December 2008:

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Consolidated Statement of Financial Position as at 1January 2008	Prior to IFRIC 13 adoption	Impacts of IFRIC 13 adoption	Restated statement
Assets			
Deferred tax assets	992,880,357	(659,218)	992,221,139
Other assets	12,129,290,529		12,129,290,529
Total assets	**13,122,170,886**	**(659,218)**	**13,121,511,668**
Liabilities			
Current deferred income	286,056,467	45,894,085	331,950,552
Current provisions	123,340,200	(48,381,701)	74,958,499
Other liabilities	10,630,964,031		10,630,964,031
Total liabilities	**11,040,360,698**	**(2,487,616)**	**11,037,873,082**
Equity excluding minority interests	**1,338,221,897**	**1,828,398**	**1,340,050,295**
Minority interests	743,588,291		743,588,291
Total shareholders equity	**2,081,810,188**	**1,828,398**	**2,083,638,586**
Total liabilities and shareholders equity	**13,122,170,886**	**(659,218)**	**13,121,511,668**

Euro

Consolidated Statement of Financial Position as at 31December 2008	Prior to IFRIC 13 adoption	Impacts of IFRIC 13 adoption	Restated statement
Assets			
Deferred tax assets	1,031,431,805	1,292,174	1,032,723,979
Other assets	12,681,671,323		12,681,671,323
Total assets	**13,713,103,128**	**1,292,174**	**13,714,395,302**
Liabilities			
Current deferred income	305,392,739	57,229,629	362,622,368
Current provisions	124,567,576	(52,353,496)	72,214,080
Other liabilities	12,083,322,032		12,083,322,032
Total liabilities	**12,513,282,347**	**4,876,133**	**12,518,158,480**
Equity excluding minority interests (i)	**235,610,386**	**(3,583,959)**	**232,026,427**
Minority interests	964,210,395		964,210,395
Total shareholders equity	**1,199,820,781**	**(3,583,959)**	**1,196,236,822**
Total liabilities and shareholders equity	**13,713,103,128**	**1,292,174**	**13,714,395,302**

(i) The effect on shareholders equity excluding minority interests as at 31 December 2008 includes a positive impact of Euro 1,828,398 as at 1 January 2008 and a negative impact on the net income for the year ended 31 December 2008 amounting to Euro 5,412,357.

Euro

Consolidated Income Statement for the year ended 31December 2008	Prior to IFRIC 13 adoption	Impacts of IFRIC 13 adoption	Restated statement

Revenues (reduction in services rendered)	6,734,307,435	(13,420,575)	6,720,886,860
Operating expenses (reduction in provisions and adjustments)	5,670,245,473	(6,056,824)	5,664,188,649
Income before financial results and taxes	**1,064,061,962**	**(7,363,751)**	**1,056,698,211**
Financial results	(129,496,695)		(129,496,695)
Income taxes	(233,331,156)	1,951,394	(231,379,762)
Net income	**701,234,111**	**(5,412,357)**	**695,821,754**
Attributable to minority interests	119,721,635		119,721,635
Attributable to equity holders of the parent	**581,512,476**	**(5,412,357)**	**576,100,119**
Earnings per share			
Basic	0.64	(0.01)	0.64
Diluted	0.63	(0.01)	0.62

Based on the guidance of IAS 1 Presentation of Financial Statements, and following the adoption of a new accounting policy retrospectively, Portugal Telecom disclosed an additional Consolidated Statement of Financial Position as at 1 January 2008, which was also restated to reflect the impacts of the adoption of this accounting policy. In addition, Portugal Telecom disclosed notes as of that date for the captions that were impacted by the adoption of this new accounting policy.

In addition to the standards referred to above, other standards and interpretations as well as some minor improvements to several standards became effective in the year ended 31 December 2009, but are not applicable to the Company or had no material impact in its financial statements.

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Additionally, when the Board of Directors approved these financial statements, the following standards, revised standards and interpretations had been issued by IASB and IFRIC (some of those not yet endorsed by the European Union), which were not yet adopted by Portugal Telecom, as their application is only being required in subsequent periods:

- IAS 27 (revised) *Consolidated and separate financial statements*, IAS 28 (revised) *Investments in associates*, IFRS 3 (revised) *Business combinations* and IAS 31 (revised) *Interests in joint ventures* were issued in January 2008 and are effective for years started on or after 1 July 2009. The impact of the adoption of these revised standards has not been fully assessed by Portugal Telecom but, in accordance with the related transition rules, there is no impact on asset and liabilities as at 31 December 2009 as a result of past transactions.

- IAS 39 (revised) *Financial instruments* was issued in July 2008 and is effective for years started on or after 1 January 2010. This standard was amended in relation to the recognition and measurement for eligible hedged items. The impact of the adoption of this revised standard has not been fully assessed by Portugal Telecom.

- IFRIC 17 *Distribution of non-cash assets to owners* was issued in November 2008 and is effective for years started on or after 1 July 2009. The Company does not expect any impact on its consolidated financial statements as a result of the adoption of this interpretation.

- IFRS 1 (revised) *First-time adoption of IFRS* was revised in November 2008 and in July 2009 and is effective for years started on or after 1 January 2010. There will be no impact on the Company s consolidated financial statements as a result of the adoption of this revised standard.

- IFRIC 9 (revised) *Reassessment of embedded derivatives* and IAS 39 (revised) *Financial instruments* were issued in March 2009 and are effective for years started on or after 30 June 2009. This interpretation and this standard were amended in relation to the accounting treatment for embedded derivatives when reclassifying financial instruments. The impact of the adoption of these revised standard and interpretation has not been fully assessed by Portugal Telecom.

- IFRS 2 (revised) *Share-based payments* was issued in June 2009 and is effective for years started on or after 1 January 2010. The Company does not expect any impact on its consolidated financial statements as a result of the adoption of this revised standard.

During the year ended 31 December 2009 and based on the best information available, the Company revised certain accounting estimates related to the economic useful lives of certain terminal equipments and infra-structure assets, the adjustments to bad debts and the dismantling costs of infra-structure assets. The impact of this reassessment in accounting estimates was recognized prospectively and net income for the year ended 31 December 2009 was positively impacted by Euro 20.2 million.

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5. Exchange rates used to translate foreign currency financial statements