

PORTUGAL TELECOM SGPS SA
Form 20-F
March 27, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2008

OR

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

OR

- **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 1-13758

PORTUGAL TELECOM, SGPS S.A.

(Exact name of Registrant as specified in its charter)

The Portuguese Republic

(Jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

**Nuno Vieira, Investor Relations Director, Tel. +351 21 500 1701, Fax +351 21 500 0800
Av. Fontes Pereira de Melo, 40, 1069-300 Lisboa Codex, Portugal**

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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing one ordinary share, nominal value €0.03 per share	New York Stock Exchange
Ordinary shares, nominal value €0.03 each	New York Stock Exchange*

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

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

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

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

Ordinary shares, nominal value €0.03 per share	896,512,000
Class A shares, nominal value €0.03 per share	500

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

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

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

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

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>
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Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing: U.S. GAAP International Financial Reporting Standards as issued by the International Accounting Standards Board Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

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

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CERTAIN DEFINED TERMS

Unless the context otherwise requires, the terms "*Portugal*" and the "*Portuguese State*" refer to the Republic of Portugal, including the Madeira Islands and the Azores Islands; the term "*EU*" refers to the European Union; the term "*EC Commission*" refers to the Commission of the European Communities; the terms "*United States*" and "*U.S.*" refer to the United States of America; the term "*Portugal Telecom*" refers to Portugal Telecom, SGPS S.A.; the term "*Vivo*" refers to Vivo Participações S.A. and its consolidated subsidiaries; and unless indicated otherwise, the terms "*we*," "*our*" or "*us*" refer to Portugal Telecom and its consolidated subsidiaries.

PRESENTATION OF FINANCIAL INFORMATION

Our consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as endorsed by the EU ("EU-IFRS"). EU-IFRS may differ from IFRS as issued by the International Accounting Standards Board ("IASB") if, at any point in time, new or amended reporting standards have not been endorsed by the EU. At December 31, 2008, 2007 and 2006, there were no unendorsed standards effective as of and for the years ended December 31, 2008, 2007 and 2006, respectively, that affected our consolidated financial statements, and there was no difference between EU-IFRS and IFRS as issued by the IASB as applied by Portugal Telecom. Accordingly, our financial statements as of and for the years ended December 31, 2008, 2007 and 2006 are prepared in accordance with IFRS as issued by the IASB. IFRS comprise the accounting standards issued by the IASB and its predecessor body and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and its predecessor body.

We publish our financial statements in Euro, the single European currency adopted by certain participating member countries of the European Union, including Portugal, as of January 1, 1999. Unless otherwise specified, references to "Euros," "EUR" or "€" are to the Euro. References herein to "U.S. dollars," "\$" or "US\$" are to United States dollars. References to "Escudos" or "PTE" are to Portuguese Escudos. References to "Real," "Reais" or "R\$" are to Brazilian Reais. The Federal Reserve Bank of New York's noon buying rate in the City of New York for Euros was €0.728= US\$1.00 on March 20, 2009, and the noon buying rate on that date for Reais was R\$2.250= US\$1.00. For convenience and comparability, figures previously stated in Escudos have been converted to figures in Euros based on the fixed Escudo/Euro exchange rate of PTE 200.482 = €1.00. We are not representing that the Euro, US\$ or R\$ amounts shown herein could have been or could be converted at any particular rate or at all. See "*Item 3 Key Information Exchange Rates*" for further information regarding the rates of exchange between Euros and U.S. dollars and between Reais and U.S. dollars.

We provide mobile telecommunications services in Brazil through Vivo Participações S.A. ("Vivo"). We hold our participation in Vivo through our 50% interest in Brasilcel N.V., a joint venture with Telefónica, S.A. Our consolidated financial statements as of and for the years ended December 31, 2004, 2005, 2006, 2007 and 2008 proportionally consolidate the financial results of Vivo.

FORWARD-LOOKING STATEMENTS

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

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(b) statements that are preceded by, followed by or include the words "believes," "expects," "anticipates," "intends," "is confident," "plans," "estimates," "may," "might," "could," "would," the negatives of such terms or similar expressions.

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

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

material adverse changes in economic conditions in Portugal or Brazil;

exchange rate fluctuations in the Brazilian Real and the U.S. dollar;

risks and uncertainties related to national and supranational regulation;

increased competition resulting from further liberalization of the telecommunications sector in Portugal and Brazil;

the development and marketing of new products and services and market acceptance of such products and services; and

the adverse determination of disputes under litigation.

PART I

ITEM 1 IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

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

ITEM 2 OFFER STATISTICS AND EXPECTED TIMETABLE

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

ITEM 3 KEY INFORMATION

Selected Consolidated Financial Data

The selected consolidated balance sheet data as of December 31, 2007 and 2008 and the selected consolidated statement of income and cash flow data for each of the years ended December 31, 2006, 2007 and 2008 have been derived from our audited consolidated financial statements included herein prepared in accordance with IFRS. The selected consolidated balance sheet data as of December 31, 2004, 2005 and 2006 and the selected consolidated statements of income and cash flow for the year ended December 31, 2005 have been derived from our consolidated financial statements prepared in accordance with IFRS included in our Annual Report for the year ended December 31, 2007 (the "2007 20-F"). The selected consolidated statements of income and cash flow data for the year ended December 31, 2004 have been derived from the 2007 20-F and were restated from those presented in the 2006 20-F in order to present PT Multimédia Serviços de Telecomunicações e Multimédia,

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SGPS, S.A. ("PT Multimedia") as a discontinued operation. The spin-off of PT Multimedia was completed on November 7, 2007.

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

The following selected consolidated financial data as of and for the years ended December 31, 2004, 2005, 2006, 2007 and 2008 proportionally consolidate 50% of the balance sheet, income statement and cash flow data of Vivo. In addition, following the spin-off of PT Multimedia on November 7, 2007, the selected consolidated statement of income for PT Multimedia was presented under the caption "Discontinued Operation" for all periods through the completion of the spin-off, and the selected consolidated balance sheet as of December 31, 2007 and 2008 no longer includes the assets and liabilities related to PT Multimedia, following the completion of its spin-off on November 7, 2007.

	Year Ended December 31,				
	2004	2005	2006	2007	2008
	(EUR Millions)				
Statement of Income Data:					
Continuing operations					
Revenues:					
Services rendered	5,010.4	5,320.4	5,245.9	5,625.5	6,115.5
Sales	325.0	413.8	426.2	442.5	508.7
Other revenues	75.8	89.8	93.2	80.4	110.1
Total revenues	5,411.2	5,824.0	5,765.3	6,148.4	6,734.3
Costs, expenses losses and income:					
Wages and salaries	588.1	623.4	633.5	638.1	616.6
Post retirement benefits	58.8	(21.6)	(72.1)	(65.1)	44.8
Direct costs	692.9	716.3	724.9	907.3	1,086.9
Costs of products sold	577.8	639.5	580.6	656.1	778.5
Marketing and publicity	136.1	164.7	138.3	147.2	176.3
Supplies and external services	891.3	1,074.6	1,130.6	1,179.2	1,229.9
Indirect taxes	118.9	165.2	175.9	201.8	233.6
Provisions and adjustments	163.2	161.6	216.6	127.0	124.8
Depreciation and amortization	883.5	1,058.7	1,130.7	1,123.1	1,268.3
Curtailement costs, net	165.6	314.3	19.0	275.6	100.0
Losses (gains) on disposals of fixed assets, net	7.8	(1.7)	(5.1)	(2.8)	(19.5)
Other costs, net	35.7	22.2	115.4	45.1	30.0
Income before financial results and taxes	1,091.5	906.8	977.1	915.7	1,064.1
Minus: Financial costs (gains), net	230.0	50.5	118.4	(116.8)	129.5
Income before taxes	861.5	856.3	858.6	1,032.5	934.6
Minus: Income taxes	285.5	288.1	(21.4)	243.3	233.3
Net income from continuing operations	576.0	568.2	880.0	789.2	701.2
Discontinued operations					
Net income from discontinued operations	149.2	120.7	74.1	45.5	
Net income	725.2	689.0	954.1	834.7	701.2
Attributable to minority interests	102.0	35.0	87.4	92.8	119.7
Attributable to equity holders of the parent	623.2	654.0	866.8	741.9	581.5
Income before financial results and taxes per ordinary share, A share and ADS(1)	0.94	0.80	0.87	0.89	1.19
Earnings per share, A share and ADS:					
Basic(2)	0.53	0.57	0.78	0.71	0.64
Diluted(3)	0.50	0.53	0.73	0.67	0.63

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	Year Ended December 31,				
	2004	2005	2006	2007	2008
	(EUR Millions)				
Earnings per share, A share and ADS from continuing operations, net of minority interests:					
Basic(2)	0.45	0.50	0.74	0.69	0.64
Diluted(3)	0.42	0.47	0.69	0.66	0.63
Cash dividends per ordinary share, A share and ADS(4)					
Share capital	1,166.5	1,128.9	395.1	30.8	26.9

- (1) Based on 1,166,485,050 ordinary and A shares issued as of December 31, 2004, 1,128,856,500 ordinary and A shares issued as of December 31, 2005 and 2006, 1,025,800,000 ordinary and A shares issued as of December 31, 2007 and 896,512,500 ordinary and A shares issued as of December 31, 2008.
- (2) The weighted average number of shares for purposes of calculating basic earnings per share is computed based on the average ordinary and A shares issued and the average number of shares held by Portugal Telecom.
- (3) The weighted average number of shares for purposes of calculating diluted earnings per share is computed based on the average ordinary and A shares issued and the average number of shares held by Portugal Telecom and takes into account the number of shares from the exchangeable bonds issued on August 28, 2007 and from the exchangeable bonds issued on December 6, 2001 to December 6, 2006 when those bonds were repaid, in each case assuming the conversion of the bonds into ordinary shares.
- (4) Cash dividends per ordinary share, A share and ADS for the years ended December 31, 2004, 2005, 2006, 2007 and 2008 were €0.35, €0.475, €0.475, € 0.575 and €0.575, respectively. Cash dividends per ordinary share, A share and ADS for the years ended December 31, 2004, 2005, 2006, 2007 and 2008 were US\$0.43, US\$0.60, US\$0.64, US\$0.90 and US\$0.78, respectively.

	For the Year Ended December 31,				
	2004	2005	2006	2007	2008
	(EUR Millions)				
Cash Flow Data:					
Cash flows from operating activities	1,958.9	1,392.3	1,821.7	1,859.2	1,828.9
Cash flows from investing activities	185.5	(1,910.7)	1,136.7	235.9	80.1
Cash flows from financing activities	(1,958.2)	590.2	(3,015.4)	(1,953.6)	(1,472.6)

	As of December 31,				
	2004	2005	2006	2007	2008
	(EUR Millions)				
Balance Sheet Data:					
Current assets	3,972.9	6,153.7	3,998.7	3,816.3	3,317.0
Investments in group companies	318.3	425.6	499.1	538.1	613.2
Other investments	114.7	96.1	132.4	27.2	21.1
Tangible assets	3,936.3	4,062.0	3,942.0	3,585.4	4,637.8
Intangible assets	3,244.9	3,601.6	3,490.9	3,383.1	3,463.0
Post retirement benefits			134.1	134.1	1.6
Deferred tax assets	1,423.0	1,387.2	1,167.0	992.9	1,031.4
Other non current assets	918.6	902.6	807.1	645.1	628.0
Total assets	13,928.7	16,628.8	14,171.2	13,122.2	13,713.1

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	As of December 31,				
	2004	2005	2006	2007	2008
	(EUR Millions)				
Current liabilities	4,077.2	4,947.5	3,888.4	3,864.7	5,148.7
Medium and long term debt	3,899.3	5,168.6	4,467.5	4,960.7	4,441.2
Accrued post retirement liability	2,321.6	2,635.9	1,807.6	1,463.9	1,836.9
Deferred tax liabilities	327.9	334.9	90.4	84.9	462.2
Other non current liabilities	1,048.6	959.8	811.3	666.2	624.3
Total liabilities	11,674.5	14,046.7	11,065.2	11,040.4	12,513.3
Equity excluding minority interests	1,686.5	1,828.4	2,255.2	1,338.2	235.6
Minority interests	567.6	753.7	850.8	743.6	964.2
Total equity	2,254.2	2,582.1	3,106.0	2,081.8	1,199.8
Total liabilities and shareholders' equity	13,928.7	16,628.8	14,171.2	13,122.2	13,713.1
Number of ordinary shares	1,166.5	1,128.9	1,128.9	1,025.8	896.5
Share capital(1)	1,166.5	1,128.9	395.1	30.8	26.9

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

Exchange Rates**Euro**

The majority of our revenues, assets and expenses are denominated in Euros, although a significant portion of our assets and liabilities are denominated in Brazilian Reais. We have published our audited consolidated financial statements in Euros, and our shares trade in Euros on the regulated market Euronext Lisbon. Our financial results could be affected by exchange rate fluctuations in the Brazilian Real. See "*Item 5 Operating and Financial Review and Prospects Exchange Rate Exposure to the Brazilian Real.*"

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

The following tables show, for the period and dates indicated, certain information regarding the U.S. dollar/Euro exchange rate. The information is based on the noon buying rate in the City of New York for cable transfers in Euro. On March 20, 2009, the Euro/U.S. dollar exchange rate was €0.728 per US\$1.00.

Year ended December 31,	Average Rate(1) (EUR per US\$1.00)
2004	0.8014
2005	0.8064
2006	0.7898
2007	0.7248
2008	0.6805

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

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Period	High	Low
	(EUR per US\$1.00)	
September 2008	0.7174	0.6786
October 2008	0.8035	0.7113
November 2008	0.7984	0.7669
December 2008	0.7915	0.6965
January 2009	0.7810	0.7290
February 2009	0.7970	0.7655
March 2009 (through March 20, 2009)	0.7969	0.7283

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

Brazilian Real

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

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

The following tables show, for the periods and date indicated, certain information regarding the Real/U.S. dollar exchange rate. On March 20, 2009, the Real/U.S. dollar exchange rate was R\$2.250 per US\$1.00. The information is based on the noon buying rate in the City of New York for cable transfers in Brazilian Reais as certified for United States customs purposes by the Federal Reserve Bank of New York.

Year ended December 31,	Average Rate(1)
	(R\$ per US\$1.00)
2004	2.915
2005	2.408
2006	2.164
2007	1.929
2008	1.831

(1)

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

Period	High	Low
	(R\$ per US\$1.00)	
September 2008	1.923	1.657
October 2008	2.406	1.935
November 2008	2.456	2.100
December 2008	2.619	2.291
January 2009	2.370	2.190
February 2009	2.390	2.238
March 2009 (through March 20, 2009)	2.442	2.250

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Risk Factors

General Risks Relating to Our Company

Unfunded post retirement benefit obligations may put us at a disadvantage to our competitors and could adversely affect our financial performance.

We have unfunded post retirement benefit obligations that may limit our future use and availability of capital and adversely affect our financial and operational results. As of December 31, 2008, our projected post retirement benefit obligations related to pensions and healthcare amounted to €3,033.8 million, while the market value of assets amounted to €2,131.6 million. In addition, we are responsible for salaries to suspended and pre-retired employees amounting to €907.7 million. Liabilities relating to salaries are not subject to any legal funding requirement, and therefore monthly salaries are paid directly by us to beneficiaries until the retirement age. As a result, gross unfunded obligations amounted to €1,809.9 million as of December 31, 2008, compared to €1,304.0 million as of December 31, 2007. The change from December 31, 2007 to December 31, 2008 was primarily a result of (1) net actuarial losses relating to differences between actual data and actuarial assumptions totaling €827.1 million, (2) curtailment costs of €100.5 million and (3) post-retirement benefit costs of €46.7 million, which were partially offset by (i) payments and contributions of €234.1 million, and (ii) net actuarial gains of €232.3 million primarily related to changes in actuarial assumptions, including increases in the discount rate used to calculate pension and healthcare liabilities from 5.25% to 5.75% and in the discount rate used to calculate responsibilities for salaries to suspended and pre-retired employees from 4.75% to 5.75%.

Any decrease in market value of our plan assets increases our unfunded obligations and could materially increase our unfunded position. In the current credit crisis, the market value of our plan assets, and hence the level of our unfunded obligations, is volatile and poses a significant risk. We could be required to increase our funding of our pension and healthcare liabilities in order to comply with Portuguese insurance regulations, which could immediately affect our costs and financial performance. In addition, an increase in our gross unfunded obligations could have an impact on our overall profitability.

We may be negatively affected by the current global economic financial crisis.

We believe that a prolonged global economic and financial crisis could lead to a long economic recession in Portugal, and this could have an impact on the demand for our products and services and therefore on our revenues and profitability.

We must also maintain liquidity to fund our working capital, service our outstanding indebtedness and finance investment opportunities. Without sufficient liquidity, we could be forced to curtail our investments, or we may not be able to pursue new business opportunities. The principal sources of our liquidity are cash generated from our operations and equity and debt financing. Cash generated from operations is driven by our revenues and net income, which could be adversely affected by the current crisis.

The current financial crisis could increase our counterparty risk to the extent that we hold deposits in banks and enter into financial transactions, domestically and internationally, with banks and other institutions.

Also, we may be unable to access the equity or debt markets to obtain additional financing or to refinance existing indebtedness. For example, we have material indebtedness that matures in the following 12 months, and the continuation of adverse conditions in the financial markets in 2009 could adversely affect our ability to refinance our indebtedness by, for example, affecting our ability to obtain favorable pricing in any such refinancing or by causing us to rely on available short-term standby or

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commercial paper facilities for such refinancing. We discuss our liquidity and sources of funding in "Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources."

In these and other ways, the global economic and financial crisis and its effect on the European and Portuguese economies could significantly affect our business, liquidity and financial performance.

Financial market conditions may adversely affect our ability to obtain financing, significantly increase our cost of debt and negatively impact the fair value of our assets and liabilities.

Recent events have increased the uncertainty and volatility of the financial markets, leading to a significant increase in execution and price risk in financing activities. Risk premiums in general, and for Portugal Telecom in particular, have risen considerably. Current financial market conditions could adversely affect our ability to obtain future financing to fund our operations and capital needs and adversely impact the pricing terms we are able to obtain in any new bank financing or issuance of debt securities. In addition, any further deterioration could have even more significant effects on our ability to obtain financing and therefore on our liquidity. Changes in interest rates and exchange rates may also impact negatively the fair value of our assets and liabilities. If there is a negative impact on the fair value of our assets and liabilities, we could be required to record impairment charges.

Any future ratings downgrades may impair our ability to obtain financing and may significantly increase our cost of debt

Immediately after the announcement by Sonaecom on February 6, 2006 of the tender offer for Portugal Telecom, Standard & Poor's placed our credit rating on CreditWatch with negative implications, while Moody's placed our credit rating on review for possible downgrade, due to the possible increased leverage that might have resulted from the transaction. Following the presentation by our Board of Directors of an alternative shareholders' remuneration plan, increasing our indebtedness, Standard & Poor's and Moody's further downgraded our ratings to BBB+ and Baa1, respectively, on March 8, 2006. On August 3, 2006, Standard & Poor's and Moody's further downgraded our ratings to BBB- and Baa2, respectively, following the announcement of a step-up in the shareholder remuneration plan. After the failure of the Sonaecom tender offer, the rating agencies confirmed our credit ratings as BBB- (Standard & Poor's) and Baa2 (Moody's), both with stable outlook.

We have certain loans from the European Investment Bank ("EIB") totaling €291 million as of December 31, 2008 that contain a provision under which the EIB has the right to require us to provide a guarantee acceptable to the EIB in the event the long-term credit rating assigned to us by the rating agencies is reduced from the current rating (BBB- by S&P, Baa2 by Moody's and BBB by Fitch). In that circumstance, and after notice from the EIB, we would have 60 days to present an acceptable guarantee. If we were to fail to provide the EIB the required guarantee, the EIB would have the right to accelerate the repayment of the loans.

Our ratings downgrades could adversely affect our ability to obtain future financing to fund our operations and capital needs. Any further downgrade of our ratings could have even more significant effects on our ability to obtain financing and therefore on our liquidity. In addition, the pricing conditions applicable to our commercial paper programs could be revised in the event our credit rating is changed.

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The Portuguese State holds all of our A shares, which afford it special approval rights

All of our 500 A shares are held by the Portuguese State. Under our articles of association, the holders of our A shares, voting as a class, may veto a number of actions of our shareholders, including the following:

election of the chairman of the audit committee and the statutory auditor (See "*Item 10 Additional Information Corporate Governance New Corporate Governance Model*"), as well as the members of the board of the General Meeting of Shareholders;

authorization of a dividend exceeding 40% of our distributable net income per year;

capital increases and other amendments to our articles of association, as well as the limitation or suppression of pre-emptive rights;

issuance of bonds and other securities;

authorization of a shareholder that performs an activity competing with us to hold more than 10% of our ordinary shares;

approval of the general goals and fundamental principles of our policies; and

definition of our investment policies, including the authorization for acquisitions and transfers of shareholdings.

Additionally, the election of one-third of the directors, including the Chairman of the Board of Directors, must be approved by the Portuguese State, as the holder of all the A shares.

Risks Relating to Our Wireline and Domestic Mobile Businesses

Intense competition has significantly affected, and is expected to continue to significantly affect, our revenues and our results of operations

Competition from mobile telephony and from other wireline operators has reduced our wireline revenues and is likely to continue to adversely affect our revenues. During 2008, approximately 26.8% of our consolidated revenues were derived from services provided by our wireline business in Portugal, as compared to 30.0% in 2007. As a result of the trend toward the use of mobile services instead of fixed telephone services, combined with the increase in competition from other wireline operators, we have experienced, and may continue to experience, erosion of market share of both access lines and of outgoing domestic and international traffic. The number of active mobile telephone cards in Portugal has now overtaken the number of wireline main lines. Some of our wireline customers are using mobile services as an alternative to wireline telephone services. Mobile operators can bypass our international wireline network by interconnecting directly with wireline and mobile networks either in our domestic network or abroad. Competition is also forcing down the prices of our wireline telephone services for long distance and international calls. Lowering our international call prices has caused a decline in our revenues from international wireline telephone services. The decrease in wireline traffic and lower tariffs resulting from competition has significantly affected our overall revenues, and we expect these factors to continue to negatively affect our revenues. See "*Item 4 Information on the Company Competition Competition Facing our Wireline Business.*"

Increased competition in the Portuguese mobile markets may result in decreased tariffs and loss of market share. We operate in the highly competitive Portuguese mobile telecommunications market. We believe that our existing mobile competitors, Vodafone and Optimus will continue to market their services aggressively. In mid-2005, Optimus introduced a low-cost brand "Rede 4" in response to our new brand "Uzo." Vodafone also launched a product called Directo in mid-2005 targeting the same market as Uzo and Rede 4.

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In addition, the commercial introduction in Portugal of third-generation mobile services has heightened competition and reduced the profitability of providing third-generation services. In 2008, ANACOM, the Portuguese telecommunications regulator, launched a public competition for the attribution of a fourth mobile license. The only bidder, RNT, was initially awarded the license but was later excluded for because it could not comply with the requirements of ANACOM, namely the presentation of a bank guarantee to cover the bid payment. However, ANACOM could launch a competition for this license in the future.

In November 2007, CTT, the Portuguese postal company, launched a mobile virtual network operator, or "MVNO," operation supported by TMN's network. MVNOs do not have their own network infrastructure and thus do not have the fixed cost burdens facing our current GSM (Global System for Mobile Communications) and UMTS (Universal Mobile Telecommunications System) services. In November 2008, Zon Multimedia launched an MVNO under the brand "Zon Mobile" after signing an agreement with Vodafone Portugal to operate using its mobile network.

We expect competition from VoIP-based operators also to place increasing price pressure on voice tariffs and lead to reductions in mobile voice traffic. Competition from companies providing wireless local-area network, or "WLAN," services, which can deliver wireless data services more cheaply than UMTS in concentrated areas, may also affect the market and pricing for third-generation services. See "*Item 4 Information on the Company Competition Competition Facing TMN.*"

In addition, ANACOM began a period of consultation in November 2005 regarding regulation of VoIP services and issued a report on the subject in February 2006. Since then, some operators, including Zon Multimedia, have launched fixed and nomadic (mobile) VoIP commercial services that compete with our services. In July 2008, ANACOM refused to issue authorizations (namely for PT) for the provision of VoIP services at fixed locations, stating that it considers these services to be like regular fixed telephony services. As a result, it is possible that PT's VoIP offers will be regulated in a similar manner to traditional voice offers.

The broadband market in Portugal is highly competitive and may become more competitive in the future. Our competitors have been improving their commercial offers in broadband Internet, with most of them offering triple-play bundled packages (voice telephony, broadband Internet and pay-TV subscription). We believe that with competition in Internet broadband access intensifying, and with the development of existing technologies such as broadband wireless access, mobile broadband through UMTS, and high speed broadband supported by the deployment of a fiber optic network, we may face loss of market share in the broadband market, which could result in a loss of subscribers and a loss in revenues.

An adverse regulatory environment may negatively affect our profitability

Reduced interconnection rates have negatively affected our revenues for our mobile and wireline businesses and will continue to do so in 2009. In February 2005, ANACOM declared all mobile operators to have significant market power in call termination in the mobile networks market. ANACOM has accordingly imposed price controls on interconnection rates for the termination of calls on mobile networks. In 2005, interconnection rates (both fixed-to-mobile and mobile-to-mobile) were reduced by an average of 23.5% compared with 2004 rates. In 2006, these rates were further reduced by an average of 18.5% compared to the 2005 rates. These reductions have had a significant impact on interconnection revenues of our domestic mobile subsidiary, TMN Telecomunicações Móveis Nacionais, S.A. ("TMN") and consequently its earnings. Both fixed-to-mobile and mobile-to-mobile interconnection rates reached €0.11 per minute in October 2006. In July 2008, ANACOM issued a new draft decision proposing additional reductions in interconnection rates for the termination of calls on mobile networks but allowing lesser reductions for the third mobile operator, Optimus. The decision came into effect on August 23, 2008, and these rates will reach €0.65 by April 1, 2009, for TMN and

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Vodafone. Optimus will reach that level by October 1, 2009. This decision is expected to have a negative impact on our cash flows.

In June 2008, the European Commission started a public consultation process for its draft recommendation on voice calls termination rates (both in mobile and fixed networks), which are intended to harmonize regulation and drive down termination rates even further across all EU countries starting in 2012. This recommendation, which is expected to be published in the first quarter of 2009, will have a negative impact on our future revenues and may also affect our ability to obtain financing.

Since 2004, ANACOM has been in the process of determining who has significant market power in call origination in the mobile networks market. However, ANACOM has not issued a final decision and has yet to submit a draft decision for public consultation. In August, 2008, ANACOM published a "reasoning" about mobile rates for originating calls, trying to drive mobile operators into reducing these prices, by the end of September 2008, to a level equal or close to the level of mobile termination rates. ANACOM stated that it would either proceed with the market analysis or ask for the intervention of the Portuguese national competition authority ("Autoridade da Concorrencia"), in case mobile operators fail to comply with ANACOM's intentions. In the second half of 2008, the three mobile operators reduced their rates for originating calls but not to the extent desired by ANACOM. Although we cannot predict the outcome of this process, ANACOM's actions could negatively impact our revenues and results of operations.

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

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

ANACOM's decision in December 2006 requiring our wireline business to offer capacity-based interconnection rates (a flat-rate interconnection tariff) had a negative effect on our wholesale wireline revenues in 2007 and 2008.

The European Commission's review of roaming charges may lead to a reduction in domestic mobile revenues. In 2008, we received approximately 6.2% of our domestic mobile revenues from incoming and outgoing roaming charges, down from 6.8% in 2007. The European Commission has determined that roaming prices in Europe should be reduced and has published new regulations that have been effective since June 30, 2007. ANACOM recently announced the entry into force of these regulations and has announced that the roaming market will no longer be analyzed or further regulated in Portugal. These regulations set maximum roaming charges that may be charged in the wholesale market and the retail market. In the wholesale market, a maximum roaming charge of €0.30 per minute applied until August 30, 2008, a maximum roaming charge of €0.28 per minute will apply from August 30, 2008 until August 30, 2009, and a maximum roaming charge of €0.26 per minute will apply thereafter.

In the retail market, maximum roaming charges of €0.24 per minute (for received calls) and €0.49 per minute (for outgoing calls) were applied in the first year, maximum roaming charges of €0.22 per minute (for received calls) and €0.46 (for outgoing calls) will apply in the second year, and maximum

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roaming charges of €0.19 per minute (for received calls) and €0.43 per minute (for outgoing calls) will apply thereafter.

Pursuant to Regulation 727/2007 on roaming rates within the EU, the European Commission must submit to the European Parliament a report on the functioning of that regulation, indicating if its objectives have been reached. On May 7, 2008, the Commission launched a public consultation to assess the functioning and impact of the regulation on roaming rates within the EU, aiming to obtain the opinion from all stakeholders as to the accomplishment of the regulation's main goals (reduction of roaming wholesale and retail charges) and the impact on revenues and profits of operators. According to statements issued on July 15, 2008, the Commission intends to impose a reduction in roaming rates for data services, in particular SMS and MMS, which may occur during 2009. The Commission also requested clarification from operators with respect to price differences between data services while roaming compared to prices in the domestic market.

We believe these regulations will have an adverse effect on the revenues of our domestic mobile business and on our company as a whole.

Burdensome regulation in an open market may put us at a disadvantage to our competitors and could adversely affect our business. The Portuguese electronic communications sector is fully open to competition. However, many regulatory restrictions and obligations are still imposed on us. In the previous round of market analysis, carried out in 2004-2006, the Portugal Telecom group was found by ANACOM to have significant market power in all but one of the 16 markets analyzed and consequently is subject to regulatory restrictions and obligations. Not all of these obligations and restrictions have been imposed on other telecommunications operators and service providers. The substantial resources we must commit to fulfill these obligations could adversely affect our ability to compete. Pursuant to the new European Relevant Markets recommendation that significantly reduced the number of markets subject to ex-ante regulation, ANACOM recently finished its market analysis to determine the regulatory obligations that should be imposed on operators with significant market power in the provision of wholesale (physical) network infrastructure access and wholesale broadband access. See "*Item 4 Information on the Company Regulation Portugal.*"

The Portuguese government could terminate or fail to renew our wireline concession, our licenses and our authorization for data and mobile services. We provide a significant number of services under a concession granted to us by the Portuguese government and under licenses and authorizations granted to us by ANACOM. See "*Item 4 Information on the Company Regulation Portugal.*" The concession runs until 2025, but the Portuguese government can revoke the concession after 2010 if it considers the revocation to be in the public interest. It can also terminate our concession at any time if we fail to comply with our obligations under the concession. Even if the concession remains in force, its terms and conditions could be materially affected by the outcome of a public consultation process by the Portuguese government relating to the provision of universal service. The results of this public consultation process are expected to be released in 2009. The Portuguese government can also terminate our licenses under certain circumstances. Through TMN, we hold a renewable, non-exclusive license to provide GSM digital mobile telephone services throughout Portugal, valid until March 16, 2022, and a renewable, non-exclusive license to provide UMTS mobile telephone services throughout Portugal, valid until 2016. If the Portuguese government took such actions, we would not be able to conduct the activities authorized by the concession or the relevant licenses. This loss would eliminate an important source of our revenues.

Regulatory investigations and litigation may lead to fines or other penalties

We are regularly involved in litigation, regulatory inquiries and investigations involving our operations. ANACOM, the European Commission and the Competition Authority (the "Autoridade da Concorrência"), the Portuguese competition authority, can make inquiries and conduct investigations

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concerning our compliance with applicable laws and regulations. Current inquiries and investigations include several complaints before the Autoridade da Concorrência related to alleged anti-competitive practices in our wireline business, including complaints against:

PT Comunicações (this complaint was formerly against Telepac, which merged with a PT affiliate that later merged into PT Comunicações) for alleged anti-competitive practices in the broadband Internet market;

PT Comunicações for alleged anti-competitive practices in the public wireline telephone market and for granting discriminatory discounts on leased lines. On September 1, 2008, PT Comunicações was notified by the Autoridade da Concorrência of its decision imposing a fine of €2.1 million for PT Comunicações' alleged abuse of its dominant position in the lease line segment. On September 29, 2008, we appealed this decision before the Commercial Court of Lisbon; and

PT Comunicações for alleged abuse of dominant position relating to the alleged refusal to provide access to its ducts. On August 1, 2007, the Portuguese Competition Authority fined us €38 million for this alleged anti-competitive practice, and the Company has appealed this fine before the Commercial Court in Lisbon. We have decided not to record a provision for this contingency.

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

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

Risks Related to Our Brazilian Mobile Business

We are exposed to exchange rate and interest rate fluctuations

We are exposed to exchange rate fluctuation risks, mainly due to the significant level of our investments in Brazil. These investments are not hedged against exchange rate fluctuations. We are required to make adjustments to our equity on our balance sheet in response to fluctuations in the value of foreign currencies in which we have made investments. For example, as of December 31, 2008, cumulative foreign currency translation adjustments related to investments in Brazil were positive €291 million. Devaluation of the Brazilian Real in the future could result in negative adjustments to our balance sheet, which could limit our ability to generate distributable reserves.

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

The Central Bank's Monetary Policy Committee (Comitê de Política Monetária do Banco Central COPOM) establishes the basic interest rate target for the Brazilian financial system by referring to the level of economic growth of the Brazilian economy, the level of inflation and other economic indicators. As of December 31, 2004, 2005, 2006, 2007 and 2008, the basic interest rate was 17.8%, 18.0%, 13.3%, 11.3% and 13.8%, respectively. Increases in interest rates may have a material adverse effect on Vivo by increasing its interest expense on floating rate debt and increasing its financing costs.

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Macroeconomic factors in Brazil could reduce expected returns on our Brazilian investments and potentially lead to impairment charges

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

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

Fluctuations in the Real and increases in interest rates. The Brazilian currency has historically experienced frequent devaluations. The Real devalued against the Euro by 12.8% in 2001 and by 81.4% in 2002. During 2002, the Real underwent significant devaluation due in part to political uncertainty in connection with the elections and the global economic slowdown. In the period leading up to, and after, the general election in 2002, there was substantial uncertainty relating to the policies that the new government would pursue, including the potential implementation of macroeconomic policies that would differ significantly from those of the prior administration. This uncertainty resulted in a loss of confidence in the Brazilian capital markets, and the continued devaluation of the Real until the end of 2002. The Real appreciated against the Euro by 1.3%, 1.4% and 31.7% in 2003, 2004 and 2005 respectively, and depreciated by 1.97% against the Euro in 2006. In 2007, the Real appreciated against the Euro by 7.7% and depreciated by 24.9% in 2008. Any substantial negative reaction to the policies of the Brazilian government could have a negative impact, including devaluation. The devaluation of the Real could negatively affect the stability of the Brazilian economy and accordingly could negatively affect the profitability and results of our operations and our ability to distribute reserves. It would also increase costs associated with financing our operations in Brazil. In addition, a devaluation of the Real relative to the U.S. dollar may increase the costs of imported products and equipment. Our operations in Brazil rely on imported equipment and, as a result of such devaluation, such equipment would be more expensive to purchase.

During 2004 and 2005, the Brazilian Central Bank tightened its monetary policy to contain inflationary pressures resulting from high international prices for oil and other commodities, and increased the SELIC basic interest rate by 125 basis points to 17.75% at the end of 2004 and to 18.05% at the end of 2005. Since then, the Brazilian Central Bank has eased its monetary policy, decreasing the SELIC basic interest rate to 11.25% as of December 31, 2007. In response to the global economic and financial crisis, the Brazilian government increased the SELIC basic interest rate to 13.75% as of December 31, 2008. An increase in interest rates could negatively affect our profitability and results of operations and would increase the costs associated with financing our operations in Brazil, especially because all of Vivo's debt, after giving effect to hedging transactions, is linked to the CDI rate. In addition, an increase in interest rates would raise our interest costs since most of the interest on Vivo's debt is floating.

Inflation in Brazil. Brazil has historically experienced high rates of inflation. Inflation, as well as governmental measures put in place to combat inflation, have had a material adverse effect on the Brazilian economy. Since the implementation of the Real Plan in 1994, the rate of inflation has been substantially lower than in previous periods.

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However, inflationary pressures persist, and actions taken in an effort to curb inflation, coupled with public speculation about possible future governmental actions, have in the past contributed to economic uncertainty in Brazil and heightened volatility in the Brazilian securities market. The general price index, or the IGP-DI (the *Índice Geral de Preços Disponibilidade Interna*), an inflation index developed by the Fundação Getúlio Vargas, a private Brazilian economic organization, reflected inflation of 9.1% in 2008, compared to 7.9% in 2007, 3.8% in 2006, 1.2% in 2005 and 12.1% in 2004. The Consumer Prices Index (*Índice de Preços ao Consumidor*), or the IPCA, published by the Instituto Brasileiro de Geografia e Estatística, rose 5.9% in 2008, reaching the target fixed by the National Monetary Council. This index had risen 4.5% in 2007, 3.1% in 2006, 5.7% in 2005 and 7.6% in 2004. If Brazil experiences significant inflation, Vivo may be unable to increase service rates to its customers in amounts that are sufficient to cover its increasing operating costs, and its business may be adversely affected, which could in turn have an adverse effect on our results of operations.

Since 2006, Vivo's telephone rates have been indexed to the Índice de Serviços de Telecomunicações (Telecommunications Service Index - IST), which is a basket of national indexes that reflect the Brazilian telecommunications sector's operating costs. However, Brazilian monetary policy continues to use the IPCA as an inflation targeting system. The inflation target for 2009 is 4.5%. If inflation increases beyond this official 2009 target, basic interest rates may rise, causing direct effects on Vivo's cost of debt and indirect effects on the demand for telecommunications goods and services.

We could be required to record impairment charges relating to goodwill for our investment in Vivo.

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

Our strategy of enhancing our mobile operations in Brazil through our joint venture with Telefonica Moviles may not be successful, and we do not have free access to cash flows from Vivo

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

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

In addition, because Vivo is a joint venture, we do not have free access to cash flows from Vivo. Our joint venture agreement contains provisions relating to important decisions, including the declaration and/or payment of dividends or other distributions by Brasilcel, the corporate entity that holds the joint venture's interests in Vivo. A proposal by the managing board of Brasilcel for the

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payment of dividends or other distributions requires the approval of Brasilcel's supervisory board and Brasilcel's shareholders. Because of the composition of Brasilcel's supervisory board and the 50% interest of each party in the joint venture, it will effectively be necessary for Telefónica and us to agree to transfer funds from Vivo and its subsidiaries to us if we wish to do so. See "*Item 4 Information on the Company Our Businesses Strategic Alliances Alliance with Telefónica.*"

Vivo faces substantial competition in each of its markets that may reduce its market share and harm our financial performance

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

These factors have already had a negative effect on Vivo's market share and results of operations and could have a material adverse effect on our results of operations in the future.

Recently, there has been consolidation in the Brazilian telecommunications market. In this regard, in August 2007, Vivo signed a stock purchase agreement with Telpart Participações S.A. to acquire control of Telemig Celular Participações S.A. ("Telemig") and Tele Norte Celular Participações S.A. ("Tele Norte") (see "*Item 4 Information on the Company Our Businesses Brazilian Mobile Business*"). In December 20, 2007, Telemar Norte Leste S.A. ("Telemar") announced that Telemar executed a stock purchase agreement with Vivo for the acquisition of Tele Norte. In March 2008, ANATEL approved these transactions. This transaction is a significant development in the Brazilian telecommunications market, and we believe the consolidation trend may continue and may result in increased competitive pressures within Vivo's market. Vivo may be unable to respond adequately to pricing pressures resulting from consolidation, which would adversely affect its business, financial condition and results of operations and consequently could adversely affect our results of operations.

Vivo's results of operations have been negatively affected in the past by a decrease in its customer growth and could also be affected if its rate of customer turnover increases

Vivo's rate of acquisition of new customers has recently negatively affected by market penetration and increased competition. For example, Vivo's net additions of customers amounted to a loss of 752 thousand customers in 2006, compared to a gain of 3,262 thousand customers in 2005. This negative change was mainly due to a decrease in the rate of addition of new prepaid customers with a loss of 517 thousand in 2006, compared to the addition of 2,704 thousand new prepaid customers in 2005. In 2008, Vivo had net additions of 7,475 thousand customers, compared to net additions of 4,430 thousand customers in 2007. However, 3,986 thousand of the customers added in 2008 were obtained through the acquisition of Telemig described herein.

The change in the rate of new additions of customers has negatively affected Vivo's results of operations and could continue to do so in the future. In addition, if Vivo's rate of customer turnover were to increase significantly, its results of operations and or competitive position could be adversely affected. Several factors in addition to competitive pressures could influence Vivo's rate of acquisition

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of new customers and rate of customer turnover, including limited network coverage, lack of sufficient reliability of Vivo's services and economic conditions in Brazil.

Regulation may have a material adverse effect on Vivo's results

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

Brazilian tax reforms may affect Vivo's prices

The Brazilian government has proposed tax reforms that are currently being considered by the Brazilian Congress. If Vivo experiences a higher tax burden as a result of the tax reform, it may have to pass the cost of that tax increase to its customers. This increase may have a material negative impact on the dividends paid by Vivo's subsidiary to it and on its revenues and operating results.

Interconnection fees and regulated adjustments to those fees may not result in sufficiently remunerative revenues for terminating calls on the mobile networks of Vivo's subsidiaries and may negatively affect our revenues and results of operations

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

In 2005, ANATEL approved provisional agreements among the local fixed line and mobile operators to determine the interconnection fees for local calls (known as "VC1" calls). These agreements provide for a 4.5% annual adjustment of interconnection fees for these calls. In March 2006, ANATEL approved a provisional agreement for interconnection fees for long distance calls (known as "VC2" and "VC3" calls) that also provides for a 4.5% annual adjustment to interconnection fees. In July 2007, ANATEL approved a provisional agreement among the fixed line operators Telefónica, Telemar, Brasil Telecom, CTBC Telecom, Sercomtel and the mobile operators to determine the interconnection fees for VC1, VC2 and VC3 calls. The provisional agreement also provides for a 1.97143% annual adjustment to interconnection fees in the Region I (Telemar's region) and a 2.25356% in the Regions II (Brasil Telecom's region) and III (Telefónica's region).

In January 2008, ANATEL approved a provisional agreement among the fixed line long distance operator Embratel and the mobile operators to determine the interconnection fees for VC2 and VC3 calls taking into consideration the period since January 2004. The provisional agreement also provides for an annual adjustment of 4.5%, as of March 2006, and 1.97143% or 2.25356%, as of July 2007, to interconnection fees. In July 2008, ANATEL approved a provisional agreement among the fixed line operators Telefónica, Telemar, Brasil Telecom, CTBC Telecom, Sercomtel and the mobile operators to determine the interconnection fees for VC1, VC2 and VC3 calls. The provisional agreement also provides for a 1.89409% annual adjustment to interconnection fees in the Region I (Telemar's region) and a 2.06308% in Regions II (Brasil Telecom's region) and III (Telefónica's region). The annual

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adjustments under these agreements may not be sufficient to cover Vivo's costs and preserve its margins from interconnections with Vivo's network. In particular, because a significant number of mobile subscribers use prepaid mobile services and generally receive more calls than they make, Vivo derives an important part of its revenues from the interconnection fees paid to them by the wireline operators for traffic originating on wireline networks and terminating on its mobile networks.

In addition, ANATEL may further modify the regulatory regime governing interconnection fees. Under Resolutions 438/2006, 480/2007, 483/2007, and 503/2008 beginning in 2010, ANATEL will determine the reference cost of using mobile networks (RVU-M) for SMP providers who have significant market power, which will be used in arbitration cases by ANATEL to determine the value of interconnection fees. If this model results in lower annual adjustments to interconnection fees than under the provisional agreements reached in 2005, 2006, 2007 and 2008 described above, Vivo's revenues and results of operations will be adversely affected.

ANATEL has also published resolutions proposing new regulations regarding interconnection charges that could adversely affect Vivo's revenues and results of operations. These proposals include (1) a resolution that one SMP operator in its authorization area is to receive only one interconnection charge for calls originated and terminated on its network (a proposal whose implementation has already been demanded by ANATEL), (2) a resolution for new negotiation rules for interconnection charges in arbitration cases under which ANATEL would have a role in determining the charges and (3) a resolution for the unification of interconnection charges in any given region of the general authorization plan (*Plano Geral de Autorizações*) for the SMP regime among SMP providers of the same economic group that have significant market power, according to criteria still to be defined. In this regard, when ANATEL organized the auction in December 2007 for new licenses in the 1900-2100 MHz radio frequency bands (3G licenses), denominated Bands F, G, I and J, it specified that any license awarded to a holder of an existing SMP license in the same region would be unified with that existing license within 18 months from the publication of the terms of authorization awarding the new license (the publication of the terms occurred on April 30, 2008). Because Vivo and Telemig were awarded Band J licenses in regions where Vivo already possessed SMP licenses, the unification provision is likely to apply to Vivo and Telemig. In addition, the invitation document for the December 2007 auction modified the rule for renewal of radio frequency licenses and includes in operating profits (which is one of the criteria considered in the renewal process) not only the profits received from customers through mobile service plans but also the profits received from payments from other operators for the use of the SMP network.

Resolution 516/2008, published by Anatel in November 2008, relates to the General Plan to update the Brazilian telecommunications regulations ("*Plano Geral de Atualização da Regulamentação das Telecomunicações no Brasil*" or "PGR"). In this general plan, ANATEL targets several areas of vital importance for the mobile telecommunications business, such as the elaboration of proposals for service quality improvements (which may cause increases in operational costs), for the regulation of virtual mobile operations (MVNO) (which may increase competitive pressures), for the regulation of the significant market power ("*Poder de Mercado Significativo PMS*") (the VU-M price unification among SMP providers of the same economic group having significant market power is foreseen and could reduce Vivo's revenues) and for the regulation of multimedia communications services ("*Serviço de Comunicação Multimídia SCM*") (which may increase competitive pressures).

These new proposed regulations could have an adverse effect on Vivo's results of operations because (1) interconnection charges could drop, thereby reducing Vivo's revenues, (2) ANATEL may allow favorable prices for economic groups without significant market power and (3) the VU-M prices that Vivo charges in some regions in which it operates are higher than those in some other regions, and consolidation of those VU-M prices, competitive pressures and other factors could reduce Vivo's average prices and its revenues.

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Vivo also faces risks associated with litigation

Vivo is party to a number of lawsuits and other proceedings. An adverse outcome in, or any settlement of, these or other lawsuits could result in significant costs to Vivo. In addition, Vivo's senior management may be required to devote substantial time to these lawsuits, which could otherwise be devoted to the business. See "*Item 8 Financial Information Legal Proceedings Vivo Legal Proceedings.*"

Risks Relating to Our International Investments

Our other international investments are subject to political, economic, regulatory and legal risk in those countries, which could adversely affect the value of our investments and our results of operations

In accordance with our strategy, we continue to proactively manage our international businesses in selected markets and regions where we have a clear competitive advantage, especially in Africa. This strategy may be pursued either by investing alone or by developing partnerships and by acquiring existing companies or by investing in new projects.

These investments are exposed to political and economic risks that include, but are not limited to, exchange rate and interest rate fluctuations, inflation and restrictive economic policies and regulatory risks that include, but are not limited to, the process for the renewal of licenses and the evolution of regulated retail and wholesale tariffs. In addition, our ventures in international markets face risks associated with increasing competition, including due to the possible entrance of new competitors and the rapid development of new technologies.

The development of partnerships in these markets raises risks related to the ability of the partners to jointly operate the assets. Any inability of us and our partners to operate these assets may have a negative impact on our strategy and on our results of operations.

All these risks may have material adverse effects on our results of operations.

Adverse political, economic, and legal conditions in the countries where we have investments may hinder our ability to receive dividends from our international subsidiaries

The governments of many of the countries where we have investments have historically exercised, and continue to exercise, significant influence over their respective economies and legal systems. Countries in Africa and Asia where we have investments may enact legal or regulatory measures that restrict the ability of our subsidiaries to make dividend payments to us. Similarly, adverse political or economic conditions in these countries may hinder our ability to receive dividends from our subsidiaries. We receive significant amounts in dividends each year from our investments in Africa and Asia, and a limitation on our ability to receive a material portion of those dividends could adversely affect our cash flows and liquidity.

Risks Relating to Our ADSs and Ordinary Shares

An ADS holder may face disadvantages compared to an ordinary shareholder when attempting to exercise voting rights

Holders of our ADSs may instruct the depositary to vote the ordinary shares underlying the ADSs. For the depositary to follow the voting instructions, it must receive them on or before the date specified in our voting materials. The depositary must try, as far as practical, subject to Portuguese law and our articles of association, to vote the ordinary shares as instructed. In most cases, if the ADS holder does not give instructions to the depositary, it may vote the ordinary shares in favor of proposals supported by our Board of Directors, or, when practicable and permitted, give a discretionary proxy to a person designated by us. We cannot be certain that ADS holders will receive voting materials in time

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to ensure that they can instruct the depository to vote the underlying ordinary shares. Also, the depository is not responsible for failing to carry out voting instructions or for the manner of carrying out voting instructions. This means that ADS holders may not be able to exercise their right to vote and there may be nothing they can do if their ordinary shares or other deposited securities are not voted as requested.

If you are a U.S. tax resident, you will not be eligible for the reduced rates of Portuguese withholding tax on dividends under the U.S.-Portugal income tax treaty unless you fill out a form required by the Portuguese tax authorities and get it certified by the U.S. Internal Revenue Service

Under Portuguese law, dividends paid by Portuguese companies are subject to withholding tax at a 20% rate. However, under the U.S.-Portugal income tax treaty, the withholding tax rate on dividends distributed to U.S. tax residents may be reduced, as a general rule, to 15%. In order to apply the reduced treaty rate, confirmation that each shareholder is eligible for the benefits of the treaty is required. A specific form (Form 21-RFI of the Directorate-General of Taxes (*Direcção Geral de Impostos DGCI*) of the Portuguese Ministry of Finance), duly certified by the U.S. Internal Revenue Service, must be received by the custodian for the depository, if you are a holder of ADSs, or your financial intermediary, if you are a holder of Portugal Telecom ordinary shares, prior to the date the dividends are made available to shareholders.

If this form is not available as of the relevant date, Portuguese withholding tax will be levied at the 20% rate. If you are able to submit the form to the custodian for the depository, if you are a holder of ADSs, or to your financial intermediary, if you are a holder of ordinary shares no later than the 20th day of the month following the payment of the dividend, we believe that the custodian or the financial intermediary, as the case may be, should release the 5% excess Portuguese withholding tax to you. However, we cannot guarantee that the custodian or the financial intermediary will do so.

In addition, the 5% excess Portuguese withholding tax may be subsequently reimbursed by the Portuguese tax authorities pursuant to specific claims of individual shareholders on Form 22-RFI of the Directorate-General of Taxes (*Direcção Geral de Impostos DGCI*) of the Portuguese Ministry of Finance, duly certified by the U.S. Internal Revenue Service and presented to the Portuguese tax authorities within two years following the date the dividends are made available. See "*Item 10 Additional Information Taxation Dividends.*"

You should know that receiving certification of a Form 21-RFI or Form 22-RFI from the U.S. Internal Revenue Service can be a lengthy process. In addition, although Portuguese law states that the excess withholding tax should be reimbursed within one year from the date the claim was submitted, we cannot guarantee if or when you will receive any reimbursement of the 5% excess Portuguese withholding tax even if you fill out Form 22-RFI and are eligible to receive reimbursement as described above. Please contact your tax advisor if you wish to fill out Form 21-RFI or Form 22-RFI to claim eligibility for the benefits of the treaty.

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ITEM 4 INFORMATION ON THE COMPANY

Overview

Our legal and commercial name is Portugal Telecom, SGPS S.A. We are a limited liability holding company, organized as a *Sociedade Gestora de Participações Sociais* under the laws of the Portuguese Republic. The company was originally incorporated as Portugal Telecom, S.A., a *sociedade anónima* in June 1994. Our principal offices are located at Avenida Fontes Pereira de Melo, 40, 1069-300 Lisboa, Portugal. Our telephone number is +351 21 500 1701, and our facsimile number is +351 21 500 0800. Our agent for service of process in the United States is Puglisi & Associates at 850 Library Avenue, Suite 204, Newark, Delaware 19711. Our home page is located at www.telecom.pt. The information on our website is not part of this report. The website address is included as an indicative textual reference only.

We provide telecommunications services mainly in Portugal, Brazil and certain countries in Africa, including:

wireline services, which include fixed line telephone services for residential and nonresidential customers, leased lines, unbundled local loop access and wholesale line rental, interconnection, Internet access (dial-up and broadband ADSL), data and business solutions, portal and e-commerce services through our subsidiaries, in particular PT Comunicações, S.A. ("PT Comunicações");

mobile telecommunications services, such as voice, data and Internet-related services in Portugal through our subsidiary TMN Telecomunicações Móveis Nacionais, S.A. ("TMN") and in Brazil through our 50%-owned joint venture Vivo;

Internet Protocol Television ("IPTV") and direct-to-home ("DTH") satellite pay-TV services, through PT Comunicações; and

sales of telecommunications equipment.

In Portugal, we are the leading provider of all of these services, except for IPTV and DTH services, according to data provided by ANACOM, the Portuguese telecommunications regulator. The provision of wireline services in Portugal continues to account for a large proportion of our revenues (26.8% during 2008) as compared to revenues derived from any other line of business. In Brazil, we have a leading position in the mobile market, according to data provided by ANATEL, the Brazilian regulator. To strengthen our position in the Brazilian mobile telecommunications market, we entered into a strategic alliance with Telefónica Móviles S.A. ("Telefónica Móviles") (the Spanish mobile telecommunications company that has merged with and into Telefónica S.A. ("Telefónica"), the Spanish telecommunications company), pursuant to which we created, on December 27, 2002, a mobile telecommunications services company in Brazil, Brasilcel, which was rebranded Vivo on April 8, 2003.

Strategy

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

enhancing the performance of our operations in the evolving domestic competitive landscape, including initiatives such as rolling out fixed-mobile convergent services, bundled offerings of voice, broadband and pay TV services and offering differentiated broadband services;

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

continuing our focus on the operational enhancement of Vivo; and

continuing to develop business in Africa and seek opportunities to selectively expand our footprint.

Our specific strategies in our domestic market include the following:

Wireline

expansion and diversification of triple-play services through the expansion of IPTV services and satellite pay-TV, which was launched in April 2008;

marketing of satellite television services, leveraging the availability of those services to the mass market given the national coverage of DTH services achieved in 2008;

obtain economies of scale in the television business through further investments in these platforms and with the launch of FTTH commercial offers;

continue to develop and market voice services at flat rates;

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

in our data and corporate unit, increase our emphasis on value-added, integrated information technology (IT) and solutions to business;

continue to implement cost control measures in the fixed network; and

focus on fixed-mobile convergent services, taking advantage of brand recognition of SAPO and TMN.

Domestic Mobile

consolidate leadership in the mobile market, including by building on recent gains in the corporate and youth segments;

continue to develop and bring to market innovative data and video services for third-generation mobile phones, as well as continue to deploy mobile broadband services; and

continue to seek operational efficiency.

Group-Wide Initiatives

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

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

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Business Units

Our market is characterized by increasing competition and rapid technological change. Our business unit subsidiaries are held directly and indirectly by Portugal Telecom in its role as holding company. We have integrated certain functions across the company, in particular information systems (PT Sistemas de Informação), research and development capabilities (PT Inovação), back office activities (PT Pro), central purchasing capabilities (PT Compras) and call center operations (PT Contact). The diagram below presents our different businesses as of the date of filing of this Annual Report on Form 20-F.

-
- (1) Providing wireline services in Portugal, including our fixed telephone service, Internet access services, wholesale services, data and business solutions services, portal and e-commerce solutions, and IPTV and DTH services.
 - (2) Various international investments, including global telecommunications operators in the Cape Verde Islands, São Tomé and Príncipe Islands and Macau, mobile operators in Namibia, Morocco and Angola, and other investments.
 - (3) Various companies providing services to Portugal Telecom group companies, including PT Sistemas de Informação (information systems), PT Inovação (research and development), PT Pro (shared services), PT Compras (central purchasing) and PT Contact (call centers).

For additional information on our significant subsidiaries, see Exhibit 8.1, which is incorporated herein by reference.

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The following table sets forth the operating revenues of each of our major business lines, on a standalone basis, for the years ended December 31, 2006, 2007 and 2008:

	Year Ended December 31,		
	2006	2007	2008
	(€ millions)		
Wireline Business:			
Retail	1,173.5	1,023.2	953.5
Wholesale	464.2	486.9	488.5
Data and Corporate	250.5	265.6	286.5
Directories	108.9	98.0	90.2
Sales	32.8	40.5	51.0
Other	41.9	48.1	61.8
Total	2,071.8	1,962.4	1,931.4
Domestic Mobile Business:			
Services	1,363.2	1,393.1	1,432.8
Sales	129.7	141.8	159.4
Other	9.4	8.1	9.3
Total	1,502.4	1,542.9	1,601.5
Brazilian Mobile Business:			
Services	1,789.8	2,157.2	2,676.1
Sales	254.8	258.1	293.3
Other	60.2	47.7	70.4
Total	2,104.7	2,463.0	3,039.8
Other Businesses	549.7	668.1	707.1
Eliminations in consolidation	(463.3)	(488.0)	(545.5)
Total consolidated operating revenues	5,765.3	6,148.4	6,734.3

For information about the effects of seasonality on our business, see "Item 5 Operatin and Financial Review and Prospects Overview Business Drivers and Measures Seasonality."

Our Businesses

Wireline Business

Our wireline business consists of two operating companies, PT Comunicações and PT Prime (since the merger on March 31, 2008 of PT.com and PT Corporate with PT Comunicações), which provide the following services on our wireline network:

retail, including fixed line telephone services, pay TV (IPTV and DTH satellite TV) services and Internet access services to residential customers, small office home office customers, and corporate clients;

wholesale, including leased lines, interconnection services, unbundled access to our local loops, broadband ADSL services, wholesale line rental, access to ducts, transmission of television and radio signals and international carrier services;

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data and corporate, including data, Internet, video and voice communications, services to major clients, fixed mobile convergence solutions, and selected information technology services, network managing and outsourcing; and

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

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

PT Comunicações is the leading internet company in Portugal, operating as an Internet Service Provider ("ISP"), using our fixed line network and the brands SAPO and Telepac, as well as in portal and related activities through *sapo.pt*, Portugal's leading Internet portal. PT Comunicações also serves the largest economic groups and government related entities in Portugal and offers them solutions for fixed and mobile telecommunications, Internet, technology and information systems, and outsourcing.

PT Prime offers corporate customers in Portugal data and corporate services through a "one-stop-shop" for a variety of flexible, efficient and innovative solutions using information technology, telecommunications, Internet and outsourcing.

Fixed Line Network

We had approximately 4.3 million telephone and asymmetric digital subscriber line ("ADSL") access lines in service at December 31, 2008, excluding external supplementary lines, direct extensions and active multiple numbers. We break our fixed line network down into traditional main lines ("PSTN"), ISDN lines and ADSL lines. We count ISDN lines, which transmit voice and data at higher rates than analog lines, as equivalent to either two or up to 30 (depending on whether they are basic or primary ISDN lines) traditional main lines. We offer high-speed Internet access through ADSL lines. As of December 31, 2008, we had 780 thousand ADSL lines, of which 727 thousand were attributable to our ADSL retail business (which is operated by PT.com), and 2,828 thousand PSTN/ISDN lines. We launched IPTV services in the third quarter of 2007 and launched DTH services in the second quarter of 2008. We had over 300 thousand TV lines by the end of 2008. The following table shows the number of our main lines by category.

	As of December 31,				
	2004	2005	2006	2007	2008
Fixed line main lines in service (thousands)					
Traditional main lines	3,165	3,011	2,590	2,312	2,170
ISDN main line equivalents	783	758	727	699	657
ADSL	420	637	749	714	780
TV				21	312
Unbundled local loop (ULL)	9	72	196	291	306
Wholesale line rental (WLR)			142	140	76
Total	4,377	4,478	4,404	4,177	4,301
PSTN/ISDN fixed line main lines per 100 inhabitants	40.6	40.5	39.9	40.0	37.9
Public pay phones (thousands)	47.3	57.8	65.7	61.7	39.9

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Over past years, we have made significant investments to meet subscriber demand for lines and to modernize our fixed line network. As a result, the number of PSTN/ISDN lines per 100 inhabitants has almost doubled from 20.9 fixed line main lines at the end of 1989 to approximately 37.9 fixed line main lines at the end of 2008.

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

All of our local switches in Portugal have been digital since 1999. Digital technology is used on all long distance and trunk connections. This level of digitalization of our fixed line network permits us to market and provide network-based value-added services, such as call waiting, call forwarding and voice mail, resulting in increased line usage. By the end of December 2008, PT Comunicações was providing approximately 1,044 thousand voice mail boxes.

We have offered ISDN services commercially since 1994. We offer a basic-rate service, which provides two communications channels. We also offer a primary-rate service, which provides up to 30 communications channels. At the end of December 2008, we had 220,721 subscribers to the basic-rate ISDN service and 7,186 subscribers to the primary-rate ISDN service. By the end of 2008, ISDN lines represented 23.2% of our total equivalent fixed line main lines, unchanged from 23.2% one year before. The conversion of traditional main lines to ISDN lines results in increased quality of service, and our ISDN subscribers tend to produce higher levels of usage per line than traditional main line subscribers.

We launched ADSL service in Lisbon and Oporto in 2002 and now cover virtually all of Portugal. We offer ADSL lines both to retail customers, such as residential customers and small and medium-sized businesses, and to wholesale customers. In 2007 and 2008, we continued to deploy ADSL as one of our principal strategies, increasing geographic coverage to almost all of Portugal and increasing transmission speeds, namely through the launch of ADSL2+ services. We also introduced new pricing plans targeted to specific customer needs. The following chart shows the evolution of our ADSL retail and wholesale customer base for the periods indicated.

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**ADSL Customers
(Thousands)**

We had 0.2 billing complaints per 1,000 bills and 12.9 reported faults per 100 main lines in the year ended December 31, 2008. The percentage of faults repaired in less than 12 working hours was 69.0% in 2008, compared with 77.4% in 2007. We offer residential customers detailed billing on request without extra charge.

Traffic

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

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The following table shows the breakdown of total traffic originated on our fixed line network between retail and wholesale traffic for the periods indicated.

	Total Traffic									
	Year Ended December 31,									
	2004		2005		2006		2007		2008	
	Millions of minutes	%	Millions of minutes	%	Millions of minutes	%	Millions of minutes	%	Millions of minutes	%
Retail	7,250	44.0	6,400	43.2	5,575	41.5	5,218	41.7	4,892	41.4
Wholesale	9,229	36.0	8,418	56.8	7,867	58.5	7,284	58.3	6,898	58.6
Total	16,479	100.0	14,818	100.0	13,442	100.0	12,502	100.0	11,781	100.0

We offer other ISPs access to our network under one of two regulated access regimes that may be chosen by the ISP: (1) the Reference Offer for Internet Access, which allows ISPs either to pay us a call origination charge and a fee for invoicing customers on their behalf or to pay a per minute charge or a flat rate and (2) the Reference Interconnection Offer, based on per minute call origination charges. The applicable access regime depends on the manner in which the ISPs' infrastructures are connected to our network and billing arrangements. For additional information, see " *Regulation-Portugal Interconnection Internet Access.*" Traffic under these access regimes is included in the line "Wholesale" in the table above.

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

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

Marketing

We have increased our marketing efforts aimed at customer loyalty and promoting increased use of our wireline telephone services. We aggressively promoted the sale of products and services targeted to specific customers in both 2008 and 2007 through, among other things, the rollout of flat-rate pricing plans. We have a flat-rate pricing plan for calls made between 9:00 p.m. and 7:00 a.m., which contributed to customer loyalty and increased traffic in 2008.

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

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

We have developed a distribution network through our retail service centers and agents such as supermarkets and other retail outlets. Our customer support system allows us to develop and

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implement strategies to sell new and expanded services to our customers. We often use telemarketing to both the residential and small and medium-sized enterprise market segments to develop closer relationships with our customers.

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

In 2008, we launched a renewed marketing campaign aimed at strengthening PT's Pay-TV offer's image as the best and most sophisticated pay-TV offer in the Portuguese market and highlighting its multiple-play positioning as a 5-play offer, including pay-TV, fixed broadband, voice, video-on-demand and mobile broadband. The Christmas campaign had a strong focus on the video-on-demand offer, and we believe this contributed to maintaining high brand awareness levels. Our video-on-demand offer has been successful, as over 40% of our TV customer base already uses this feature, and users average 3.8 rentals per month.

Retail

Fixed Line Telephone Services. We provide public fixed line telephone services in Portugal to retail customers, primarily through our subsidiary PT Comunicações. This business area provided €953.5 million and €1,023.2 million during 2008 and 2007, respectively. We distinguish between two principal sources of revenue in the provision of fixed telephone services:

Fixed charges, including network access charges based on a monthly line rental and an initial installation fee, as well as, in most cases, a monthly fee from pricing packages; and

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

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

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

Fixed Charges. Our fixed charges to domestic fixed line telephone subscribers include a one-time installation charge and a monthly line rental fee. These fixed charges provided €444.0 million and €488.5 million to our wireline operating revenues during 2008 and 2007, respectively.

In 2005, we created two different tariffs one for the residential market and another for the business market. The installation charge remained the same for both markets, €71.83. The standard line rental fee was €12.66 for the residential market and €12.98 for the business market. The fee for basic ISDN lines was €26.46 per month for both markets. In 2007, we amended the tariff schedule for our residential market and the standard line rental fee schedule for our business market. In March 2007, fixed line on-network calls within our residential market became free from 9 p.m. to 9 a.m. on weekdays. In September 2007, the line fee for the business market was set at €14.40. In September 2008, fixed line on-network calls on weekend nights also became free. The chart below illustrates changes in our prices and fees from 2004 through 2008. All prices are in Euros and exclude VAT.

Table of Contents**Fixed Fees for Fixed Line Telephone Services(1)**

	As of December 31,				
	2004	2005	2006	2007	2008
Installation fee	71.83	71.83	71.83	71.83	71.83
Line rental per month					
Residential	12.66	12.66	12.66	12.66	12.66
Business		12.98	13.35	14.40	14.40

(1) Amounts rounded to nearest hundredth.

Traffic. Traffic contributed €305.3 million and €352.7 million to our wireline operating revenues during 2008 and 2007, respectively. Measured in minutes, total fixed line traffic decreased by 5.8% in 2008 compared with 2007. The decrease was primarily due to the continuing effects of the trend toward use of mobile services instead of fixed line services and the migration of Internet users to ADSL, as well as the strong competition from other fixed and cable operators.

Domestic. Domestic traffic contributed €257.5 million and €306.1 million to our wireline business's operating revenues in 2008 and 2007, respectively.

Since 2006, we have had two domestic tariffs: local (former local + regional) and national. Between the end of 2001 and the end of 2006, weighted average prices for domestic fixed line telephone services decreased by 0.83% per year in nominal terms. Compared with 2007, domestic prices decreased an estimated 0.65% over the course of 2008, in nominal, annualized terms. See " *Regulation-Portugal Pricing of Wireline Services.*"

The chart below illustrates changes in our prices from 2004 through 2008. The call prices from 2004 through 2008 are for a three-minute call at peak rates in 2008 constant prices. All prices are in Euros and exclude VAT.

Principal Prices for Domestic Fixed Line Telephone Services(1)

	As of December 31,				
	2004	2005	2006	2007	2008
Local call prices					
Residential	0.13	0.12	0.12	0.12	0.12
Business		0.13	0.13	0.13	0.13
Regional call prices					
Residential	0.16	0.12	0.12	0.12	0.12
Business		0.13	0.13	0.13	0.13
National call prices					
Residential	0.20	0.19	0.19	0.19	0.19
Business		0.19	0.19	0.19	0.19

(1) Amounts rounded to nearest hundredth.

Our pricing structure has come more into line with pricing structures in the rest of the EU over the last ten years. The following table compares our estimates of average domestic services prices per minute, excluding VAT, for a three-minute call at peak rates in the EU with average prices in Portugal in effect at December 31, 2008.

Table of Contents**Principal Prices for Domestic Fixed Line Telephone Services: EU and Portugal**

	As of December 31, 2008		
	EU Average(1)	EU Average(2)	Portugal
Local call prices:			
Residential	0.036	0.041	0.041
Business	0.034	0.038	0.042
National call prices:			
Residential	0.062	0.069	0.065
Business	0.056	0.061	0.063

(1) The average including all 27 member states of the EU, as of the third quarter of 2008.

(2) The average including only the previous 15 member states of the EU, as of the third quarter of 2008.

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

International. Revenues from international fixed line telephone services come primarily from charges to our individual and business subscribers in Portugal for outgoing calls. Revenues from international fixed line telephone services have generally decreased in recent years as a result of decreases in volume and prices for outgoing international calls.

Historically, the amount of incoming traffic was significantly greater than the amount of outgoing traffic. As a result of this imbalance, we received higher amounts from other international telecommunications operators than we pay out to these operators. In the past several years, however, the difference between the incoming and outgoing traffic has diminished due to competitors that transport increased incoming traffic from foreign operators and an increase in outgoing traffic primarily due to the increase of immigrants in Portugal. As a result, the income and outcome payments relating to this traffic from foreign operators has almost become equal. We periodically renegotiate the applicable rates with these operators. In recent years, the billing rates among operators have been declining steadily, both for incoming and outgoing traffic. We estimate that, on an aggregate basis in Euros, settlement rates for international traffic at the end of 2008 decreased by a weighted average of approximately 7.1% for incoming traffic and 6.4% for outgoing traffic compared to the end of 2007.

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

We set retail traffic charges for international fixed line telephone services by groups of countries. Within each group, we charge different prices according to the time of day and the day of the week that the customer makes the call. Between the end of 2004 and the end of 2008, international traffic has remained broadly the same in real terms.

ADSL Services and ISPs. According to ANACOM, we are the leader in providing Internet access in Portugal. As of December 31, 2008, we had approximately 727 thousand ADSL retail customers, which represented an overall increase of 11.5% over the previous year. From 2006 to 2007, ADSL retail

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customers had decreased 4.8% in part due to a database cleanup in which we eliminated 103 thousand inactive prepaid broadband customers from our database.

In 2008, revenues from ADSL services fell 5.3% to €166.6 million due to a general decrease in prices due to intense competition. We also offer dial-up paid and free Internet access services. Dial-up revenues declined from €4.9 million to €2.0 million as customers continued to switch to broadband service.

Application Service Provider ("ASP"). We also provide ASP services in Portugal, which include remote applications services, web hosting and web design services to small and medium-sized enterprises. We had approximately 2,178 customers for our ASP business as of December 31, 2008.

ISP Traffic Revenues. PT.com offers Internet access through the lines of our fixed line network. PT.com retains all of the revenues from Internet traffic and pays PT Comunicações for use of the fixed line network.

IPTV Services. In April 2008 we announced the launch of our nationwide DTH satellite TV offer, which complements our existing IPTV offer launched in 2007. Our television strategy is based on a multiplatform concept that aims to provide the same content, independent of the customer interface. Meo is PT's TV brand across the various platforms, namely at home (through IPTV and satellite), through mobile handsets (through Meo Mobile) or through personal computers (through the horizontal Sapo content platform). Meo provides access to a comprehensive content offering, with more than 110 TV channels and over 1500 video-on-demand titles. We offer tiered packages of channels, as well as on-demand availability that can be subscribed for directly through the TV set in real time. Meo also provides access to advanced features such as digital recording and pause live-TV. The set-top boxes in the Meo service are all HD compliant, using MPEG4. We were the first operator in Portugal to introduce HDTV and have the most extensive video-on-demand offer in the market.

In 2008, we continued to endeavor to differentiate our service through the development of partnerships with key content producers and suppliers. On June 1, 2008, PT included Disney Channel in its basic pay-TV offer. On June 7, 2008, in an exclusive partnership with the local free-to-air TVI, we broadcasted the first free-to-air program in high-definition ("HD") to all Meo customers, making available the Euro 2008 football championship in this format. Meo also broadcasted the Olympic Games in HD, in partnership with Eurosport. On September 15, 2008, Meo started to broadcast the channels of five leading European football clubs (Barcelona, Chelsea, Inter, Manchester United and Real Madrid) thus reinforcing and further differentiating its sports programming offer. In addition, we entered into a partnership with a leading Portuguese football club, Sport Lisboa e Benfica, to create and broadcast for an exclusive period the club channel, Benfica TV. Experimental broadcasting of this channel started on October 2, 2008, with the exclusive live display of the UEFA cup game Benfica-Napoli. Meo also enhanced its catch-up TV service by including content from SIC (free-to-air) in addition to RTP (free-to-air). In addition, Meo launched a "quintuple-play" offer, including pay-TV, fixed broadband, voice, video-on-demand and mobile broadband. On November, 28, 2008, Meo launched JimJam, a new children's channel fully dubbed into Portuguese and with a special programming line-up for the Christmas season. On December 6, 2008, Meo, in partnership with NBC Universal Global Networks, launched Sci-Fi, the first exclusive science fiction channel in Portugal. Furthermore, as part of Meo's ongoing innovation strategy in pay-TV, since November 2008 we have included content from Sapo, our internet portal, in the Meo platform, such as news and geographically-specific information on traffic, weather and pharmacies, available onscreen to all Meo customers.

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DTT Services. In October 2008, we were notified of the final decision of ANACOM endorsing the Draft Final Decision of the Portuguese Committee of Evaluation to allocate to us the frequency usage rights associated with Mux A (transport of free-to-air signal) and Muxes B to F (pay-TV service). The election of PT in both Digital Terrestrial Television (DTT) contests confirms our commitment towards the successful rollout of DTT in Portugal as well as towards the implementation of our multi-platform pay-TV strategy, based on IPTV, DTH, DTT and mobile.

As of December 31, 2008, we had 312 thousand TV customers.

Wholesale

Our wireline wholesale services business, which is provided primarily through PT Comunicações, consists of:

domestic and international interconnection telephone services (including capacity-based domestic interconnection) that we provide to other telecommunications service providers in Portugal;

provision of carrier pre-selection and number portability;

leasing of domestic and international lines to other telecommunications service providers and Portuguese cable television operators;

provision of ADSL (including "naked" DSL from February 11, 2008 onward) on a wholesale basis to other ISPs;

provision of unbundled access (including shared access) to metallic loops and sub-loops to provide broadband and voice services to other telecommunications operators in Portugal;

provision of wholesale line rental to other telecommunications service providers in Portugal;

provision of co-location services and access to ducts, poles, and associated facilities to other telecommunications operators in Portugal;

transmission of television and radio signals for major broadcast television companies in Portugal;

narrowband Internet access origination services, which we provide to ISPs;

international carrier services (transport, transit and/or termination) for international switched traffic; and

other services provided to telecommunications service providers and operators, such as IP international connectivity.

Wholesale services provided €488.5 million and €486.9 million to our wireline operating revenues in 2008 and 2007, respectively.

Traffic. Interconnection and narrowband Internet access traffic comprised about 55.6% of our wholesale business in terms of revenues in 2008. The service providers who purchase interconnection services include fixed and mobile network operators, voice and data communications service providers, ISPs, value-added service providers and service providers whose international calls are terminated on or carried by our network. Providing interconnection services means allowing third parties to connect their networks to our network, and vice versa. We have interconnection rates namely for call termination, call origination, transits and international interconnection. In 2008, interconnection rates per

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minute for call termination included local rates equal to €0.0054, single tandem rates equal to €0.0075 and double tandem rates equal to €0.012, each based on a three-minute call made during peak hours.

Wholesale traffic is generated by the interconnection portion of our wholesale business and decreased by 5.3% in 2008 compared to 2007 and 7.4% in 2007 compared with 2006. This decrease was primarily due to a decrease in dial-up Internet traffic and flat performance in termination traffic, which

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was partially compensated for an increase in international incoming traffic and other traffic, including national transit traffic and intelligent network services.

Leased Lines. We lease lines to other telecommunications providers for fixed, mobile and data communications services, including our own subsidiaries and competitors. Leased line services involve making a permanent point-to-point connection with dedicated and transparent capacity between two geographically separate points. We offer both national terminating segments and trunk segments at the wholesale level. We also lease international circuits to national and international operators to allow them to complete their circuits (often circuits that pass through Portugal linking other countries), and we sell segments of international circuits to international operators.

The three current mobile telephone operators in Portugal, which include our subsidiary TMN, Vodafone Portugal and Optimus, are among our wireline business's largest leased line customers.

Prices. Domestic interconnection revenue per minute for calls terminated on our network declined by 12.1% in nominal terms in 2008 compared to 2007 and by 17.1% in 2007 compared with 2006, due to our introduction of capacity-based interconnection offers and ANACOM's decision to lower interconnection rates. International interconnection revenue per minute for wholesale operators' outgoing traffic increased 3.3% in nominal terms in 2008 compared with 2007, and by 4.1% in 2007 compared with 2006. In accordance with EU and Portuguese regulations, our national interconnection prices are cost-oriented (with costs audited by ANACOM) plus a margin.

Data and Corporate Services

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

broadband data and IP/MPLS, VPN and Ethernet services;

digital leased lines;

networking, VSAT services, and systems integration solutions;

telephone services using Internet protocol;

Internet-related services and applications, including Intranet and Extranet services;

web design and site management;

videocommunication services and other video applications for business customers;

housing and hosting information technology solutions;

fixed line and mobile convergence services;

security and disaster recovery solutions;

special bundling services aimed at the small and medium-sized enterprise market using the "Office Box" brand name;

consultancy services;

managed services; and

outsourcing.

We are the leading supplier of the full range of these services in Portugal. Data and corporate operating revenues contributed €286.5 million and €265.6 million to our wireline operating revenues in 2008 and 2007, respectively.

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

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

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

We also provide reporting services targeted to special customers to control service level agreements and the overall performance of the network. In addition, we provide outsourced corporate network services for our customers. For example, we operate and manage the SIBS network, as well as the corporate networks of our strategic partners Caixa Geral de Depósitos, Banco Espírito Santo and CATT.

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

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

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

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We have a strong and competitive position in the development of information technology solutions where communications are an integral part of the services provided. To reinforce our position as a leader in this area, we are pursuing a partnership strategy with the primary information technology suppliers in the market, particularly software and hardware providers. To support these new services and to respond to the increasing demand of e-business integrators, we developed Data Centers in Lisbon and Oporto. During 2008 we opened two more Data Centers in Funchal and Ponta Delgada, in the Madeira and Azores islands, respectively. These facilities allow us to provide services, such as co-location, sophisticated web hosting, ISP services, data storage, disaster recovery and ASP services.

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

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

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

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

Other Wireline Services

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

Directories. Operating revenues from our directories business amounted to €90.2 million and €98.0 million in 2008 and 2007, respectively. We subcontract to Páginas Amarelas (an affiliated company 25% owned by us) for the publication and distribution of telephone directories throughout Portugal in return for an annual payment of approximately 64% of its gross revenues from the sale of advertising space.

Sales of Telecommunications Equipment. Revenues from sales of telecommunications equipment amounted to €51.0 million and €40.5 million in 2008 and 2007, respectively, including the sale of handsets, modems and other telecommunications equipment.

Capital Expenditures. See "Item 5 Operating And Financial Review And Prospects Capital Expenditures".

Domestic Mobile Business

We conduct our mobile business in Portugal through our wholly-owned subsidiary TMN. TMN is the leading provider of mobile voice, data and Internet services in Portugal in terms of the number of active mobile telephone cards connected to its network, as well as by revenues, margins and profits.

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Operating revenues from TMN amounted to €1,601.5 million in 2008 compared to €1,542.9 million in 2007. At December 31, 2008, there were approximately 140.4 active mobile telephone cards per 100 Portuguese inhabitants according to ANACOM. The table below provides statistical information relating to TMN.

	As of December 31,				
	2004	2005	2006	2007	2008
<i>TMN-Portugal</i>					
Number of subscribers (thousands)(1)	5,053	5,312	5,704	6,261	6,944
Subscriber growth per annum (%)	3	5	7	10	11
Number of subscribers per 100 inhabitants (including competitors' subscribers)(2)	95	108.7	115.7	126.9	140.4
Estimated market share by number of subscribers (%) (3)	48.8	46.4	46.7	46.5	46.6
Number of employees	1,133	1,184	1,140	1,144	1,082

- (1) Including mobile virtual network operators, or "MVNO," customers.
- (2) Source: ANACOM.
- (3) Sources: ANACOM and TMN; calculated as TMN's total number of subscribers divided by the mobile market in terms of subscribers, as disclosed by ANACOM.

Services

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

TMN provides GSM mobile telephone services in the 900 MHZ and 1800 MHZ band spectrums. TMN's strategy has been to use GSM 1800 services to offer an increased number of channels in high traffic density areas without compromising the quality of the network. Dual-band handsets, which select available channels from each frequency band, enable users to benefit from the wider range of available channels.

In 2004, TMN began providing UMTS services to its customers, with an emphasis on new services, such as video telephony and high-speed data. TMN has pursued a strategy of gradual improvements to network coverage, using existing GSM sites where possible in order to minimize the need to install costly new sites. At the end of 2008, TMN's UMTS population coverage was approximately 90.5%, and its geographic coverage was about 59.9%, or 4,121 municipalities out of a total of 4,252 in Portugal, including every municipality with over five thousand inhabitants.

In April 2006, TMN launched HSDPA (High Speed Downlink Packet Access), the first step in the evolution of mobile broadband UMTS services. This technology will evolve in the coming years, positioning mobile operators as competitors in the high speed Internet services market. In the first half of 2006, TMN also launched a mobile TV service and a mobile ticketing service for cinemas.

TMN paid spectrum fees in 2008 and 2007 of €27 million and €28 million, respectively, for the use of its 900 MHZ and 1800 MHZ GSM network and its UMTS network. These spectrum fees are recorded as an operating expense under "indirect taxes" in our financial statements.

We expect the development of third generation services to require certain additional investments by TMN. TMN made direct investments of €155.1 million in 2008 and €118.2 million in 2007 in building out its third-generation network and services. In 2008, the investments made by TMN in

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connection with UMTS represented approximately 63% of its total capital expenditures in 2008, excluding investments in the Portuguese information society associated with the UMTS license.

During 2008, TMN introduced the following new products and services in Portugal:

"Contacto Disponível", an innovative service that informs customers through SMS when previously unavailable service numbers are again available;

"TELEMULTIBANCO" service, allowing customers to access typical ATM services, such as, consulting bank account information and transactions;

TMN launched Zlango, an innovative messaging system with images and icons that allows customers to replace ordinary text messages (SMS) with a new way of communicating using emotion icons;

TMN launched, in partnership with ArenaMobile, MusicBox, an innovative service that allows unlimited music downloads of major brands like Sony BMG, Emi, Universal and Warner to the mobile phone or to the PC through the i9 portal;

At the end of 2008, TMN launched Localizz, a service that allows a user to identify the location of a SIM card holder if he or she previously authorizes it;

Prepaid broadband, mobile broadband without fixed charges, by which customers pay according to usage; and

TMN launched, in partnership with Imaginarium, "Cami", a mobile handset for children, allowing for taking and receiving photos.

Peer-to-peer ("P2P"), messaging services via Short Messaging Services ("SMS") or Multimedia Messaging Services ("MMS") continue to account for a significant portion of TMN's data revenues and are an area where TMN continues to experience significant growth. In addition, TMN offers a wide range of other services in its data service portfolio, such as a multimedia mobile portal (I9-Inove) and a standard mobile portal (myTMN), multimedia content services (including Logos & Ring Tones or Java games), access to third-party branded content, corporate solutions and mobile payment services. TMN also offers a m-payment service called Telemultibanco that allows the payment of utility bills by mobile phone.

TMN also offers a variety of services for access to e-mail or Internet through Wi-Fi, GPRS and UMTS. GPRS is a mobile data service standard for GSM handsets. The launch of HSDPA in April 2006, which allows speeds of up to 1.8 Mbps, significantly improved mobile Internet access. In October 2006, TMN made available speeds of up to 3.6 Mbps. Currently, TMN offers speeds up to 7.2 Mbps. In January 2009, TMN launched a worldwide pilot testing speeds of up to 21 Mbps using HSPA+. TMN also provides internet access through more than 1,500 hot spots.

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

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

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

Subscribers and Traffic

TMN is the market leader in mobile services in Portugal. At December 31, 2008, TMN had approximately 6.944 million subscribers, representing an increase of 10.9% from December 31, 2007. At December 31, 2008, TMN's subscribers represented 46.6% of the total mobile subscribers in Portugal. During 2008, TMN's share of new mobile subscribers (net additions) was 46.8% according to ANACOM.

In addition to the increase in the number of subscribers, mobile usage grew during 2008. TMN's voice traffic in terms of minutes grew by 6.7% to 9.047 billion minutes in 2008, compared to 8.477 billion minutes in 2007. Average monthly usage per subscriber decreased by 4.5% to 115.1 minutes in 2008, compared to 120.6 minutes in 2007, primarily because a greater proportion of subscriber growth was in the lower segment of the market.

In terms of traffic from data transmission services, SMS increased by 27.3% during 2008, and there were an average of 94 SMS messages per month per user in 2008, 13.9% more than the average of 83 SMS messages per month per user in 2007. Traffic from WAP services supported by GPRS and UMTS networks increased by 99.3% in 2008.

Prices and Revenue Breakdown

We believe that mobile services in Portugal are priced lower than the European average and are among the lowest in Europe. Mobile telephone charges are not regulated. Traffic charges, sales of handsets and connection and subscription fees represented approximately 89.6%, 10.0% and 0.4%, respectively, of TMN's revenues in 2008 and approximately 90.1%, 9.2% and 0.7%, respectively, of TMN's revenues in 2007. Monthly subscription fees range from €12.73 (Rede t, Flat S) to €85.33 (Pack t xl), excluding VAT.

Fixed-to-mobile and mobile-to-mobile interconnection charges are regulated by ANACOM and have a significant impact on TMN's business. In 2005, ANACOM declared all mobile operators to have significant market power in call termination in mobile networks market. ANACOM has accordingly imposed price controls on interconnection rates for the termination of calls on mobile networks. In 2005, interconnection rates (both fixed-to-mobile and mobile-to-mobile) were reduced by an average of 23.5% compared with 2004 rates. In 2006, these rates were reduced by an average of 18.5% compared to the 2005 rates, and in 2007, these rates were further reduced by an average of 6.2% compared to the 2006 rates. In 2008, these rates were reduced by an average of 10.9% compared to the 2007 rates by ANACOM. These reductions have had, and are expected to continue to have, a significant impact on TMN's interconnection revenues and consequently its earnings. In July 2008, ANACOM issued a decision proposing additional reductions in interconnection rates for the termination of calls on mobile networks but allowing lesser reductions for the third mobile operator, Optimus. The decision came into effect on August 23, 2008 and these rates will reach €0.65 by April 1, 2009, for TMN and Vodafone. Optimus will reach that level by October 1, 2009.

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Products and Marketing

TMN offers a variety of innovative products. It was the first operator in the world to offer pre-paid services, and its prepaid and discount products are popular. We estimate that at the end of 2008, approximately 71.9% of its subscribers were using TMN's prepaid products. TMN has been expanding its subscriber base through increased advertising and the use of its own distribution network. TMN has recently focused on encouraging the use of mobile services by young people through SMS incentive packages. TMN experienced a 30.7% increase in the number of postpaid subscribers in 2008 as a result of a promotional campaign aimed at encouraging customers to switch from prepaid to postpaid services, continued marketing efforts directed at corporations and in the middle and high-end segment of the market and successful marketing of postpaid mobile broadband services.

TMN markets its services through more than 2,500 points of sale, including TMN's sales force, Portugal Telecom retail shops, TMN shops, supermarket chains and independent dealers.

Network and Capital Investment

In recent years, TMN has made significant investments in its second and third generation networks. As a result of its investments, TMN has a technologically advanced high capacity network that provides extensive coverage across Portugal. As of the end of 2008, TMN's digital network had 4,482 GSM base stations, including 248 base stations added during 2008, and 3,207 UMTS B nodes, including 447 B nodes added during 2008. As of December 31, 2008, these GSM base stations covered more than 98% of continental Portugal and 99% of the Portuguese population, and the UMTS B nodes covered approximately 60% of continental Portugal and 91% of the Portuguese population.

Roaming. Roaming agreements between operators allow their subscribers to make and receive voice calls automatically, send and receive data, or access other services when traveling outside the geographical coverage area of the home network, by using a visited network. As of the end of 2008, TMN had entered into GSM roaming agreements with a total of 425 operators (in 218 countries), 252 GPRS roaming agreements (in 156 countries) and 124 3G roaming agreements (in 73 countries).

Equipment Sales

TMN sells mobile phones and related equipment in Portugal. Equipment sales contributed €159.4 million, €141.8 million, and €129.7 million to TMN's operating revenues in 2008, 2007 and 2006, respectively.

TMN's Commitment to the Portuguese Information Society

Under the terms of its UMTS license, TMN has committed to invest in the development of the Portuguese information society. TMN's outstanding commitments were determined in May 2007 to be approximately €355 million. As part of these commitments, TMN must coinvest with the Portuguese State in providing laptop computers with wireless broadband connectivity, at a discount, to teachers, students and certain other individuals through 2015. See "*Item 5 Operating and Financial Review and Prospects Contractual Obligations and Off-Balance Sheet Arrangements*" for more information about TMN's commitments. We believe these initiatives should increase PC and broadband penetration in Portugal, strengthening TMN's position in this key market segment.

In 2007, we recorded an intangible asset and a corresponding liability on our balance sheet in the amount of €233 million, equivalent to the present value of the contributions related to those information society initiatives that are not in the ordinary course of TMN's business. In addition, in 2007 TMN assumed the payment of one-third of the commitment of Oniway, a mobile operator that withdrew from the market, in the amount of €8 million. As of December 31, 2008, the outstanding liability related to these contributions amounted to €79 million following contributions made in 2008. The amounts of contributions we make to meet our commitments is subject to approval by ANACOM.

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Brazilian Mobile Business

We provide mobile telecommunications services in Brazil through Vivo Participações S.A., the leading mobile company in Brazil with a total of 44,945 thousand customers at December 31, 2008. We hold 50% of Vivo, which is a joint venture with Telefónica. The joint venture operates in every Brazilian state and in the Federal District of Brasília. Vivo had an estimated market share of approximately 29.8% in Brazil at December 31, 2008, according to ANATEL. We believe that the joint venture facilitates our ability to serve our Brazilian subscribers on a seamless basis throughout Brazil.

History and Organizational Structure

Until 2002, our mobile operations in Brazil, a country with a population of approximately 190 million people, had been active only in the states of São Paulo, Paraná and Santa Catarina. In January 2001, we entered into a strategic agreement with Telefónica Móviles (the former mobile subsidiary of Telefónica, which has since merged with and into Telefónica) to combine all of our mobile assets in Brazil to the extent permitted under Brazilian law.

On December 27, 2002, after receiving regulatory approval, Portugal Telecom, through its subsidiary PT Móveis, and Telefónica, through its then subsidiary Telefónica Móviles, transferred all of their direct and indirect interests in Brazilian mobile services companies to the joint venture company, named Brasilcel N.V. These interests consisted of:

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

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

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

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

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

Our consolidated financial statements as of and for the year ended December 31, 2003 and thereafter proportionally consolidate the results of Vivo.

On April 25, 2003, TCP acquired 61.1% of the voting capital stock of TCO (a band A operator in the midwestern and northern regions of Brazil) from Fixcel, a Brazilian company, for R\$1,529 million. On November 18, 2003, TCP acquired an additional 25.5% of the common shares of TCO in a tender offer to TCO minority shareholders for R\$538.8 million. Following the tender offer, TCP held 86.6% of the voting capital stock and 28.9% of the total capital stock of TCO, including treasury shares held by TCO. In October 2004, TCP successfully completed a tender offer for additional shares of TCO, thereby increasing its economic interest in TCO to 50.6%, for total consideration of approximately

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

On February 22, 2006, the shareholders of the Vivo companies approved a corporate reorganization. The corporate reorganization consisted of a merger of shares under Brazilian law (*incorporação de ações*) of TCO with TCP and the merger of companies under Brazilian law (*incorporação de empresas*) of Tele Leste, Tele Sudeste and Celular CRT Participações with TCP. In connection with these mergers, TCP was renamed "Vivo Participações S.A." On March 31, 2006, common shares and preferred shares of Vivo began trading on the São Paulo Stock Exchange under the ticker symbols "VIVO3" and "VIVO4," respectively, and ADSs of Vivo began trading on the New York Stock Exchange under the ticker symbol "VIV." In October 2006, Vivo completed a further restructuring with the merger into Global Telecom (the company that provided mobile services in the states of Paraná and Santa Catarina and that was fully owned by TCP) of all other companies of Vivo that provided mobile services in the other states mentioned above. In connection with this transaction, Global Telecom was renamed "Vivo S.A."

The diagram below presents the simplified ownership structure of Vivo as of December 31, 2008:

As of December 31, 2008, Brasilcel held 89.52% of the common shares of Vivo Participações, 48.67% of its preferred shares and 63.54% of its total share capital.

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Acquisition of Telemig

On April 4, 2008, pursuant to the stock purchase agreement and after ANATEL authorization, Vivo acquired from Telemig Participações SA ("Telpart") a 22.7% stake of Telemig Celular Participações SA ("Telemig Celular Participações"), which provides mobile services in the Brazilian state of Minas Gerais through Telemig Celular, for an amount of R\$1,239 million (€450 million). The total shares acquired included 53.9% of the ordinary shares, which grant shareholder control to Vivo, 4.3% of preferred shares and certain subscription rights. On April 8, 2008, Vivo launched two voluntary tender offers to purchase up to $\frac{1}{3}$ of the outstanding preferred shares of Telemig Celular Participações and Telemig Celular. These offers were concluded on May 15, 2008, and as a result, Vivo acquired additional stakes of 20.0% and 3.8% of Telemig Celular Participações and Telemig Celular, respectively, for a total amount of R\$522 million (€204 million). The acquisition of Telemig Celular Participações and Telemig Celular was completed after the mandatory tender offers concluded on August 15, 2008, following which Vivo acquired additional stakes of 16.0% and 3.5% of Telemig Celular Participações and Telemig Celular, respectively, for a total amount of R\$912 million (€379 million). As a result of these transactions, Vivo has paid a total amount of €517 million (Portugal Telecom's 50% share). Vivo has a stake of 58.8% of Telemig Celular Participações and 56.3% of Telemig Celular, corresponding to voting rights of 97.0% and 95.7%, respectively.

Transfer of the Share Control of Telemig to TCO IP S.A.

On August 26, 2008, Vivo Participações increased the capital stock of TCO IP by R\$2.05 billion, of which R\$1.15 billion corresponded to the book value of the 7,258,108 common shares and 969,932 preferred shares held by Telemig Participações, corresponding to 22.73% of the total capital of Telemig Celular. As from such date, TCO IP became the controlling shareholder of Telemig Participações.

Corporate Reorganization

In December 2008, Vivo undertook a corporate reorganization in which the assets of TCO IP, the subsidiary of Vivo that held the controlling stake in Telemig Participações and, indirectly, in Telemig Celular, were spun off to Telemig Participações and Telemig Celular and TCO IP's separate existence was extinguished. An agreement relating to the corporate reorganization was signed on December 3, 2008. ANATEL approved the transaction on December 16, 2008, and the shareholders of the three entities involved in the transaction approved it on December 19, 2008.

The spin-off of TCO IP's assets, consisting of the controlling stake in Telemig Participações and Telemig Celular, including the premium paid in the acquisition of these shares and a related provision for the maintenance of shareholders' equity, did not generate an increase of capital in the merged companies. The premium and the related provision were recorded in deferred assets accounts (income tax and social contribution) as a counter-entry to a special premium reserve in the stockholders' equity for future capitalization, in accordance with regulations of the CVM, the Brazilian securities regulator.

Regions

Vivo provides mobile telecommunications services on the A, B, E, L and J band frequencies in every Brazilian state in addition to the federal district, representing a total of approximately 8.4 million square kilometers. This area includes more than 190.4 million people.

On September 25, 2007, Vivo acquired a license to operate on the L Band frequency in six additional states located in the Northeast region (Alagoas, Ceará, Pernambuco, Piauí, Paraíba and Rio Grande do Norte). Together with the acquisition of Telemig (as described above under "Acquisition of Telemig"), this expansion by Vivo into northeast Brazil provides it with national coverage. Vivo may also be permitted to acquire the Band L license for the State of Minas Gerais that was sought by Telemig, depending on the decision of ANATEL in the matter.

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The following table sets forth population, GDP, and per capita income statistics for each state in Vivo's service regions at the dates and for the years indicated:

Area	Frequency Range Band	At December 31, 2008		Last Available IBGE Data		
		Population (in thousands)(1)	Percent of Brazil's population(1)	GDP (in millions of Reais)(2)	Percent of Brazil's GDP(2)	Per capita income (in Reais)(2)
São Paulo state	A, L and J	40.853	21.5%	727,052	33.9%	17,797
Paraná state	A, L and J	10.630	5.6%	126,621	5.9%	11,912
Santa Catarina state	A, L and J	6.109	3.2%	85,295	4.0%	13,961
Goiás state	A, L and J	5.891	3.1%	50,536	2.4%	8,578
Tocantins state	A, L and J	1.306	0.7%	9,083	0.4%	6,952
Mato Grosso state	A, L and J	3.022	1.6%	37,466	1.7%	12,397
Mato Grosso do Sul state	A, L and J	2.379	1.2%	21,641	1.0%	9,096
Rondônia state	A, L and J	1.522	0.8%	12,902	0.6%	8,477
Acre state	A, L and J	695	0.4%	4,481	0.2%	6,446
Amapá state	B and J	629	0.3%	4,366	0.2%	6,936
Amazonas state	B and J	3,414	1.8%	33,359	1.6%	9,772
Maranhão state	B and J	6,418	3.4%	25,325	1.2%	3,946
Pará state	B and J	7,396	3.9%	39,150	1.8%	5,294
Roraima state	B and J	423	0.2%	3,178	0.1%	7,504
Federal district	A, L and J	2,538	1.3%	80,516	3.7%	31,726
Bahia state	A, L and J	14,597	7.7%	90,942	4.2%	6,230
Sergipe state	A, L and J	2,036	1.1%	13,422	0.6%	6,953
Rio de Janeiro state	A, L and J	15,716	8.3%	246,936	11.5%	15,713
Espírito Santo state	A, L and J	3,456	1.8%	47,190	2.2%	13,654
Rio Grande do Sul state	A, L and J	10,875	5.7%	144,344	6.7%	13,273
Alagoas state	L and J	3,182	1.7%	14,135	0.7%	4,442
Ceará state	L and J	8,498	4.5%	40,923	1.9%	4,816
Pernambuco state	L and J	8,765	4.6%	49,904	2.3%	5,694
Piauí state	L and J	3,172	1.7%	11,125	0.5%	3,507
Paraíba state	L and J	3,802	2.0%	16,864	0.8%	4,435
Rio Grande do Norte state	L and J	3,163	1.7%	17,862	0.8%	5,648
Minas Gerais state	A, E and J	19,953	10.5%	192,611	9.0%	9,653
Vivo's service regions		190,442	100%	2,147,229	100%	11,275

Source: Instituto Brasileiro de Geografia e Estatística ("IBGE"), except where indicated.

- (1) According to the last revision published by the IBGE in 2008.
- (2) According to the most recent IBGE data (2005). Nominal Brazilian GDP was R\$2,147,239 million as of December 2005, as calculated by IBGE.

Operating and Other Data

Vivo generates revenue from:

- usage charges, which include measured service charges for calls, monthly subscription charges and other similar charges;
- interconnection charges (or network usage charges), which are amounts we charge other cellular and fixed-line service providers for the use of our network;

the sale of wireless devices and accessories; and

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other charges, including charges for call forwarding, call waiting, text messaging (SMS), call blocking and Data Services, such as WAP, downloads and MMS services, which are charged only when the customer's plan does not include these services.

The table below sets forth certain operating and other data for Vivo for 2006, 2007 and 2008.

	2006	2007	2008
<i>Vivo-Operating Data</i>			
Cellular lines in service at year-end (in thousands)	29,053	33,484	44,945
Customer growth during year (net additions)	(752)	4,430	7,475
Prepaid lines in service at year-end (in thousands)	23,543	27,236	36,384
Minutes of use (MOU)(1)	74	77	86
Average revenues per user (in Reais)(2)	27.2	30.4	29.2
Churn(3)	34.8%	27.7%	31.2%
Penetration at year-end(4)	55.0%	65.6%	79.1%
Estimated market share(5)	38.2%	36.7%	29.8%
Estimated market share of net additions(5)	(8.5)%	28.8%	25.5%
<i>Vivo-Financial Data(6)</i>			
Net operating revenues (in millions of Reais)(6)	11,498.0	13,133.0	16,255.1
Net income (loss)(in millions of Reais)(6)	(144.5)	(114.6)	436.8

- (1) Monthly average, in minutes, of traffic per customer.
- (2) Net revenues from services per month divided by the monthly average of customers.
- (3) Churn is the number of customers that leave Vivo during the year, calculated as a percentage of the sum of the monthly average of customers.
- (4) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (5) Source: ANATEL.
- (6) Reflects 100% of Vivo's results in accordance with IFRS.

Services

Vivo provides voice and ancillary value-added services, including voicemail and voicemail notification, call forwarding, three-way calling, caller identification, short messaging, limitation on the number of used minutes, cellular chat rooms, and data services such as wireless application protocol services through which clients can access WAP sites and portals. Additionally, Vivo offers direct access to the Internet through PCMCIA, USB Card or Express Card designed to connect personal computers and laptops to the Internet, and PDAs and Smartphones that can be used as modems connected to the PC by cable, infra red or Bluetooth, offering secure access to Internet and office resources.

In 2008 Vivo launched:

"TV Digital," offers TV services through exclusive handsets from any location;

"Rede 3G," 3G services offering high-speed signal quality;

"iPhone 3G," services for iPhones using 3G wireless technology, including GPS maps, support of corporate functions such as Microsoft Exchange. Existing Vivo customers were given priority for purchasing iPhones, strengthening Vivo's customer base;

"Vivo Windows Live," a service that allows access to Messenger, Hotmail and Spaces services;

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"Vivo Residencial," a terminal for residential use, similar to a traditional fixed telephone line, consisting of a portable phone but which does not require installation;

"Vivo 4 em 1," a service offering convergent solutions combining the following four services into one (available in the states of Rio de Janeiro, Espírito Santo, Rio Grande do Sul, Paraná and Santa Catarina): (1) subscription TV (TVA); (2) a package of calls to a fixed phone (Vivo Casa Livre); (3) a postpaid plan for mobile phones (Vivo Escolha); and (4) 3G mobile wide band (Vivo Zap);

"Vivo Play," a Latin American digital music shop that markets songs by digital means, with more than 300 thousand songs purchased monthly;

"Vivo Co-Piloto," an LBS and navigation service, currently available in 152 cities in Brazil and compatible with four smartphone models. The service was elected by InfoExame magazine as the best navigator for mobile phones; and

Services offering interactivity with TV and radio.

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

Subscribers and Traffic

At the end of 2008, there were approximately 150.6 million wireless subscribers in Brazil, and there was an estimated total market penetration rate of approximately 78.1% in Brazil as a whole, according to information published by ANATEL. In 2008, the Brazilian market experienced a 24.5% increase in the number of wireless subscribers. The greatest increase in subscribers was in the Brazilian states of São Paulo, Rio de Janeiro, Minas Gerais and Bahia. As of December 31, 2008, Vivo had approximately 44.945 million wireless subscribers, with an estimated market share of 29.8% in Brazil (including the subscribers gained through the Telemig acquisition), compared to approximately 33.484 million wireless subscribers and an estimated market share of 27.7% as of December 31, 2007.

Marketing and Sales

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

As of December 31, 2008, Vivo had 331 sales outlets (90 in São Paulo, 50 in the states of Rio de Janeiro and Espírito Santo, 34 in the state of Rio Grande do Sul, 37 in the states of Paraná and Santa Catarina, 25 in the states of Bahia and Sergipe, 27 in the state of Minas Gerais, three in the states that make up the northwest region of Brazil, and 65 in the states that make up the midwestern and northern regions of Brazil). Vivo also had a network of 10,447 authorized retail and resales dealerships with a total of 10,778 points of sale as of December 31, 2008.

Prepaid telephone card recharging was available at 571,808 locations in 2008, including Vivo's own stores, dealers, lottery shops, physical and online card distributors, and at smaller shops, drugstores, newspaper stands, book stores, bakeries, gas stations, bars and restaurants. Online recharging is also provided by several banks' websites.

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Customer Service

In 2008, Vivo started the process of changing its call centers' CMS, which is the system responsible for the management of incoming calls. With the implementation of Alcatel's Genesis platform, Vivo will modernize its call management systems and increase operating efficiency. Another important initiative was a shift to a more proactive approach in our call centers, seeking to not only respond to the demands of our customers, but also to offer them promotions and appropriate services according to their profile. Thus, we expect that call centers should generate revenues for Vivo and increase the aggregate value of their services.

Additionally, the recently incorporated Telemig Celular call centers are now managed in accordance with Vivo's quality and cost control guidelines.

In 2008, Anatel issued a regulation aimed at improving the quality of call center services, followed by new government legislation on telephone number portability and finally a new law specific to call centers, which regulates every aspect of the services of a call center, such as quality requirements and procedures.

In spite of the changes in regulations, systems and procedures, Vivo improved its position in Anatel's ranking of mobile operators in Brazil to first, with the lowest rate of customer complaints.

Network

In 2006, Vivo began to implement a GSM network and in 2007 began to implement a WCDMA Network. Digitalization offers certain advantages, such as greater network capacity and additional revenue through the sale of value-added services. The network consists of cellular switches, base stations and other network elements such as voicemail, prepaid service, SMS, Home Location Registers, Signaling Transfer Point, PDSN and gateways. Vivo continues to increase network capacity and coverage to improve the quality of service and to meet customer demand.

As of December 31, 2008, Vivo's network in the state of São Paulo provided CDMA digital, WCDMA digital services and GSM digital services covering 100% of the municipalities. Vivo's network is connected primarily through a fiber optic and radio transmission system, parts of which are owned and parts of which are leased, mainly from TeleComunicações de São Paulo S.A., or Telesp. NEC do Brasil S.A., Nortel Networks Northern Telecom do Brasil, Motorola do Brasil Ltda., Lucent Technologies do Brasil, Ind. e Com. Ltda., Huawei do Brasil Telecomunicações Ltda. and Ericsson Telecomunicações S.A. are Vivo's main suppliers in the state of São Paulo.

As of December 31, 2008, Vivo's network in Paraná and Santa Catarina provided CDMA digital, WCDMA digital services and GSM digital services covering 60.4% of the municipalities, or 92.55% of the population, in its region. The Paraná-Santa Catarina network is primarily connected by a fiber optic and radio transmission system, parts of which are owned and parts of which are leased, mainly from fixed operating companies (Brasil Telecom) and Copel Companhia Paranaense de Energia S.A. Motorola do Brasil Ltda., Huawei do Brasil Telecomunicações Ltda., Alcatel Telecomunicações S/A, Ericsson Telecomunicações S.A. and NEC do Brasil S.A. are Vivo's main suppliers for the Paraná-Santa Catarina network.

As of December 31, 2008, Vivo's network provided WCDMA digital, CDMA Digital, GSM digital, TDMA digital and AMPS analog services in the midwestern and northern regions covering 47.17%, of the municipalities, or 81.74% of the population, in the region. Vivo's network is connected primarily through a fiber optic and radio transmission system, parts of which are owned and parts of which are leased, from incumbent wireline companies. Nortel Networks Northern Telecom do Brasil, Motorola do Brasil Ltda. (currently Motorola Industrial Ltda. and Motorola Services Ltda.), Huawei do Brasil Telecomunicações Ltda. and Ericsson Telecomunicações are Vivo's main suppliers in the midwestern and northern region.

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As of December 31, 2008, Vivo's network in Bahia and Sergipe provided WCDMA digital, CDMA digital and GSM digital services covering 51.63% of the municipalities, or 83.14% of the population, in the region. The network is connected primarily through a fiber optic and radio transmission system, parts of which are owned and parts of which are leased, mainly from Tele Norte Leste Participações S.A., or Telemar. NEC do Brasil S.A., Ericsson Telecomunicações S.A., Nortel Networks-Northern Telecom do Brasil, Motorola Industrial Ltda., Motorola Services Ltda., Huawei do Brasil Telecomunicações Ltda. and Lucent Technologies do Brasil, Ind. e Com. Ltda. are Vivo's main suppliers in the Bahia and Sergipe regions.

As of December 31, 2008, Vivo's network in the states of Rio de Janeiro and Espírito Santo provided WCDMA digital, CDMA digital, and GSM digital services covering 100% of the municipalities in the area. This network is connected primarily through a fiber optic and radio transmission system, parts of which are owned and parts of which are leased, mainly from the incumbent wireline companies. Nortel Networks Northern Telecom do Brasil, Ericsson Telecomunicações S.A., Huawei do Brasil Telecomunicações Ltda. and Lucent Technologies do Brasil, Ind, e Com. Ltda. are Vivo's main suppliers in Rio de Janeiro and Espírito Santo.

As of December 31, 2008, Vivo's network in the state of Rio Grande do Sul provided WCDMA digital, CDMA digital, and GSM digital services covering 75.0% of the municipalities, or 96.83% of the population, of this region. The Rio Grande do Sul network is connected primarily through a fiber optic and radio transmission system, parts of which are owned and parts of which are leased, mainly from Brasil Telecom. Nortel Networks Northern Telecom do Brasil, Huawei do Brasil Telecomunicações Ltda., and Ericsson Telecomunicações S.A. are Vivo's main suppliers in Rio Grande do Sul.

As of December 31, 2008, Vivo's network in the northeast regions provided WCDMA digital and GSM digital services covering 2.21% of the municipalities, or 24.38% of the population, of this region. The northeast network is connected primarily through a fiber optic and radio transmission system, parts of which are owned and parts of which are leased, mainly from the incumbent wireline companies. The network consists of cellular switches, base stations and other communication devices such as signaling transfer points. Huawei do Brasil Telecomunicações Ltda., Ericsson Telecomunicações S.A. and NEC do Brasil S.A. are Vivo's main suppliers in the northeast.

As of December 31, 2008, Vivo's network in the state of Minas Gerais provided WCDMA, GSM digital, TDMA digital services and AMPS analog services (which have been substantially phased out) covering 70.81% of the municipalities, or 91.89% of the population, of this region. The Minas Gerais network is connected primarily through a fiber optic and radio transmission system parts of which are owned and parts of which are leased mainly from the incumbent wireline companies. The network consists of cellular switches, base stations and other communication devices such as voicemail, prepaid service, short message service, home location registers and signaling transfer points. Nortel Networks Northern Telecom do Brasil, Huawei do Brasil Telecomunicações Ltda., and Ericsson Telecomunicações S.A. are Vivo's main suppliers in Minas Gerais.

Vivo's advanced network management technology increasingly ensures global management and supervision of all its network processes and network performance. The network management centers are located in São Paulo, Brasília and Minas Gerais. The network management center of São Paulo monitors the critical network operational parameters of the nationwide transmission network, third parties' networks, IP networks and service platforms. The network management center in Brasília monitors the critical network operational parameters in the Midwestern Region, Rio de Janeiro, Espírito Santo, Rio Grande do Sul, Paraná and Santa Catarina. The network management center in Minas Gerais monitors the critical network operational parameters in the Northeastern region, Northern region, São Paulo and Minas Gerais. These centers are able to identify abnormalities in both our network and in third parties' networks using failure and signaling monitoring systems. In addition,

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quality and service standards are constantly monitored. The network management centers are integrated with maintenance and operations teams that maintain and operate cellular and radio network elements, computing bases, service platforms and communications backbones.

Vivo's network is prepared to provide continuity of service for its customers in the event of network interruptions. Vivo has developed contingency plans for potential catastrophes in its switching centers, power supply interruptions and security breaches.

Vivo is required to meet certain requirements for service quality and annual network expansion. See " *Regulation Brazil*." Vivo achieved all of its required network expansion obligations for 2008.

Capital Expenditures

The following table sets forth Vivo's total capital expenditures for the periods indicated:

Vivo	Year Ended December 31,			
	2005(1)	2006(1)	2007(1)	2008(1)
	(in millions of Reais)			
Switching equipment	523.0	375.9	417.3	464.8
Transmission equipment	862.8	844.4	726.9	1,515.2
Information technology	407.6	414.8	267.2	286.5
Other(2)	401.7	468.8	494.3	1,730.9
Total capital expenditures	2,195.1	2,113.0	1,905.7	3,997.4

(1) This financial information represents 100% of Vivo's capital expenditures.

(2) Consisting primarily of free handset rentals, network construction, furniture and fixtures, office equipment and store layouts.

Vivo's capital expenditures over the past three years have related primarily to increasing Vivo's network capacity and coverage. Vivo continued its projects for the improvement and expansion of the capacity of services rendered, which provided support to increase the WCDMA and the GSM/EDGE network, expansion of transmission routes, system centralization and integration (billing, collection and CRM, among others), development of new services and opening and renovating points of sale and terminals for the corporate segment.

In the aggregate, R\$1,905.7 million and R\$3,997.4 million were invested during the years ended December 31, 2007 and 2008, respectively, which included investments in the WCDMA network and in the GSM/EDGE network. This amount represented 17.2% and 25.8%, respectively, of Vivo's net operating revenues.

Vivo's capital expenditures in 2009 will be directed towards the increase of network expansion and the introduction of products and services that aim at maximizing the use of cellular telephony, as well as seeking ways to constantly improve the quality of services provided to its customers. Vivo intends to pay for these capital expenditures with funds generated from operations and available borrowing capacity.

Interconnection Charges

Vivo earns revenue from any call that originates from another cellular or fixed-line service provider's network connecting one of Vivo's customers, Vivo charges the service provider from whose network the call originates a network usage charge for every minute that Vivo's network is used in connection with the call. See " *Operating Agreements Interconnection Agreements*." Tariff increases are subject to ANATEL review and approval.

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In 2003, ANATEL adopted "Bill & Keep" rules for interconnection charges for traffic between the networks of SMP operators. Under these rules, an SMP mobile operator paid for the use of another SMP mobile operator's network in the same authorization area only if the traffic carried from the first operator to the second exceeded 55% of the total traffic exchanged between them (known as a partial "Bill & Keep" regime). In that case, only those calls that have surpassed the 55% level were subject to payment for network usage. In 2005, this regulatory regime contributed to a decrease in Vivo's revenues from interconnection fees charged to other companies. In 2006, the partial Bill & Keep regime was discontinued. The current rule is "full billing," pursuant to which the SMP operator pays the entire call termination fee of the other mobile network. The partial "Bill and Keep" rule is still used between the SMP and SME (trunking) networks. See " *Regulation Brazil*."

Taxes on Telecommunications Services and Wireless Device Sales

The cost of telecommunications services and wireless device sales to customers incorporates a variety of taxes, including:

ICMS (Imposto sobre Circulação de Mercadorias e Serviços) is a state tax imposed at varying rates from 7% to 35% on certain revenues from the sale of goods and services, including telecommunications services.

COFINS (Contribuição para Financiamento da Seguridade Social) is a federal social contribution tax imposed on the gross operating revenue less discounts and returns. In December 2003, Law No. 10,883 was enacted, making such contribution noncumulative and increasing the rate from 3.0% to 7.6%, except in connection with telecommunications services, where the rate continues to be 3.0%.

PIS (Programa de Integração Social) is a federal social contribution levied over the total revenues received by a company and its subsidiaries, with the deductions foreseen by the governing law. On December 2002, Law No. 10,637 came into force, making this contribution noncumulative and raising the rate from 0.65% to 1.65%, except for telecommunications services, where the rate continues to be 0.65%.

FUST (Fundo de Universalização dos Serviços de Telecomunicações) corresponds to 1% of the net revenue generated by the telecommunications services (except over interconnection services), and provides funds to cover a portion of the cost of the fulfillment of universal service targets for telecommunication services.

FUNTTEL (Fundo para Desenvolvimento Tecnológico das Telecomunicações) is a federal social contribution which corresponds to 0.5% of the net revenues generated by the telecommunication services (except those for interconnection services) and is aimed at stimulating technological development, the qualification of human resources and generation of jobs and to promote the access of small and medium companies to capital resources, so as to broaden the competitiveness of the Brazilian telecommunications industry.

FISTEL (Fundo de Fiscalização das Telecomunicações) is a federal tax applicable to telecommunications transmission equipment which serves to provide funds to cover the expenses incurred by the Brazilian federal government in performing inspections of telecommunication services and in developing the means and improving the techniques necessary for carrying out these inspections.

License

Under the SMP regime, Vivo converted its former concessions to SMP licenses. These SMP licenses have substantially the same terms and conditions as the other SMP licenses issued under the SMP regime, although some of the terms of Vivo's former concessions, such as limits on prices charged

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to subscribers under its postpaid service plan (the Basic Plan), continue to apply despite conversion to SMP licenses. See "*Regulation Brazil SMP Regulation*."

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

Equipment Sales

Vivo sells WCDMA GSM handsets and broadband cards in WCDMA and CDMA EVDO technology (800MHz, 1.900MHz, 2.100MHz), through its stores and dealers. Although Vivo still has some customers using TDMA service, Vivo has implemented a series of actions such as providing discounts on digital handsets, discounts on monthly fees for digital services, digital handset rentals and free digital handsets, to encourage TDMA customers to transfer to WCDMA GSM service. Vivo's current suppliers for handsets are Motorola, LG, Samsung, Nokia, SonyEricsson, Aiko, HTC, Palm, Apple, Semp-Toshiba, RIM (BlackBerry), Alcatel, and Huawei.

Management

In accordance with the shareholders' agreement between Portugal Telecom and Telefónica, Portugal Telecom is responsible for the appointment of Vivo's chief executive officer and Telefónica is responsible for the appointment of Vivo's chief financial officer. Vivo's shareholders elect the members of the Board of Directors. The Board of Directors must have between three and twelve members, each serving a three-year term. The Board of Vivo (Vivo Participações S.A.) continues to consist of nine members, and the terms of the current members of the Board will expire in April 2009. The Board of Directors holds regular quarterly meetings, and the chairman or two board members may call special meetings.

Operating Agreements

Vivo has agreements with major fixed-line and mobile operators in Brazil in order to lease physical space, real estate, air conditioning, energy, security and cleaning services. Vivo also leases transmission capacity necessary to complete the construction of our network infrastructure.

Interconnection Agreements. The terms of Vivo's interconnection agreements include provisions with respect to the number of connection points and traffic signals. See "*Regulation Brazil SMP Regulation*" and "*Interconnection*."

Roaming Agreements. Vivo has agreements with major fixed-line providers for roaming with all mobile service providers in Brazil and with some wireless service operators abroad. These contracts allow its subscribers to access the network of other mobile service providers when traveling outside its coverage area without having to change their handsets or mobile numbers. Vivo provides reciprocal services to subscribers of other mobile service providers when they are within its coverage area. The agreements require the contracting parties to provide service to roaming subscribers on the same basis as they provide service to their own subscribers and to carry out a monthly reconciliation of roaming customer usage charges. Vivo provides international GSM roaming to over 200 destinations worldwide by means of over 500 roaming agreements. Vivo also offers CDMA international roaming in the United States, Canada, China, Mexico, Venezuela, Puerto Rico, New Zealand, the Dominican Republic and South Korea.

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International Operations

Our subsidiary Portugal Telecom Investimentos Internacionais Consultoria Internacional, S.A. manages all of our international businesses other than our investment in Vivo described above.

Operations in Brazil

We have certain additional investments in Brazil, in addition to our investment in Vivo described above, including, most significantly, Mobitel, a call center company, and Universo Online S.A. ("UOL"), a leading Internet Service Provider.

Mobitel. Mobitel provides call center services in Brazil primarily to Vivo. Mobitel's operating revenues were R\$308 million in 2008, R\$270 million in 2007, and R\$267 million in 2006. As of December 31, 2008, our participation in Mobitel was 100%.

UOL. UOL is a leading Internet Service Provider in Brazil. In December 2005, we sold a 16% stake in UOL in its initial public offering in Brazil and received net proceeds of R\$201.0 million. As of December 31, 2008, our participation in UOL was 29%. UOL's total operating revenues were R\$577.2 million in 2008, R\$525.1 million in 2007 and R\$480.7 million in 2006.

Operations in Africa

We have certain investments in Africa, including investments in Angola, the Cape Verde Islands, Namibia and Morocco. On August 13, 2007, we established a strategic partnership with Helios Investors LP ("Helios"), a private equity firm operating in sub-Saharan Africa. Under the terms of the agreement, Helios acquired a 22% stake in Africatel, the holding company formed to hold all of our interests in sub-Saharan Africa and whose main assets are (or, in certain instances, will be following the completion of the formal transfer to Africatel) Unitel, Cabo Verde Telecom and MTC. In September 2008, Helios increased its stake in Africatel to 25%. Our interest in the individual companies described below reflects the percentage of capital of those companies owned or to be owned by Africatel.

Unitel in Angola. At the end of 2000, we acquired 25% of the share capital of Unitel, a GSM mobile operator in Angola. Unitel's other shareholders are Sonangol, which holds 25%, and other local partners, which hold the remaining 50%. Unitel began operations in Luanda in April 2001. As of December 31, 2008, Unitel had 4,572 thousand subscribers, of which 99.5% were prepaid cards.

Unitel's total gross operating revenues were US\$1,269.4 million in 2008 (€863.1 million), US\$891.0 million in 2007 (€648.9 million), and US\$649.3 million in 2006 (€517.1 million).

Cabo Verde Telecom. We own 40% of the share capital of Cabo Verde Telecom. Cabo Verde Telecom provides fixed, mobile and data services in the Cabo Verde Islands.

At December 31, 2008, Cabo Verde Telecom had 71.9 thousand fixed lines in service, which represents approximately 14.2 fixed main lines per 100 inhabitants. Cabo Verde Telecom had 252.2 thousand active mobile telephone cards at December 31, 2008, of which 99.4% were prepaid customers.

Cabo Verde Telecom's total gross operating revenues were €73.1 million in 2008, €67.6 million in 2007, and €63.3 million in 2006.

MTC in Namibia. In September 2006, we acquired 34% of the capital of MTC, the Namibian mobile operator. In connection with this transaction, we entered into an agreement with the other shareholders of MTC that allows us to set and control the financial and operating policies of this company. As of December 31, 2008, MTC had 1,078 thousand customers, of which 84.3% were customers under prepaid plans. MTC revenues were 1,277.0 million Namibian dollars (€105.9 million)

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in 2008, 1,140.0 million Namibian dollars (€117.7 million) in 2007, and 979.2 million Namibian dollars (€113.4 million) in 2006.

Medi Telecom in Morocco. In August 1999, Medi Telecom, a consortium made up of Portugal Telecom, Telefónica Móviles and certain Moroccan entities, bid for and won a license to operate a GSM mobile network in Morocco. Medi Telecom entered into a €1 billion project financing facility. We initially held 34.5% of Medi Telecom, having invested approximately €166 million, but in January 2000 we sold 4% of our interest in compliance with a condition of the bid process for the same license. At the end of 2002, following a capital increase, we raised our equity share to 31.34%, equal to Telefónica's position. In 2003, following another share capital increase, we raised our equity share to 32.18%.

Medi Telecom began operations at the end of March 2000. As of December 31, 2008, it had 7,797 thousand mobile subscribers. Approximately 98.1% of its active mobile telephone cards are prepaid. We manage the operations of Medi Telecom jointly with Telefónica.

Medi Telecom's total gross operating revenues were 5,151 million Dirhams (€453.2 million) in 2008, 4,926 million Dirhams (€438.4 million) in 2007, and 4,691 million Dirhams (€425.1 million) in 2006.

Operations in Asia

We have investments in Asia in CTM and in Timor Telecom.

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

At December 31, 2008, CTM had 181 thousand fixed main lines in service. This figure represents approximately 32.8 fixed main lines per 100 inhabitants. CTM's mobile telephone services are growing rapidly, with 439 thousand customers at December 31, 2008. CTM uses GSM digital mobile technology.

CTM's total gross operating revenues were 2,442.0 million Patacas (€206.9 million) in 2008, 2,289.5 million Patacas (€207.4 million) in 2007, and 2,101 million Patacas (€209.1 million) in 2006.

Timor Telecom. We also have a 41.12% interest in Timor Telecom, S.A. ("Timor Telecom"), a telecommunications provider for fixed and mobile services in East Timor pursuant to a concession contract negotiated with the United Nations and the Timorese government. At December 31, 2008, Timor Telecom had a total customer base of 127.6 thousand.

Shared Services Companies

PT SI. PT SI is the group unit responsible for data centers, information systems and information technology activities of our business units in Portugal. PT SI provides integrated information systems and information technology services to our business units in Portugal, as well as to our existing and new customers. We hold 100% of the share capital of PT SI. In recent years, PT SI has subcontracted certain information technology services to DCSI-Dados, Computadores e Soluções Informáticas ("DCSI"), an information technology company controlled by IBM. In March 2006, we signed a contract with IBM to purchase DCSI, and in 2007, PT SI assumed the activity of DCSI.

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PT Inovação. PT Inovação is our unit responsible for research and development activities. Our research and development programs focus on intelligent networks, network management systems, advanced services and systems and network integration and have led to the introduction of innovative products and services. PT Inovação's activities have been a driving force behind the development of new products and services, telecommunications infrastructure and information systems.

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

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

PT Compras. In 2003, we created PT Compras and transferred our newly created central purchasing unit to this company. PT Compras optimizes our purchasing function on an integrated basis, taking advantage of scale and specialization.

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

Discontinued Operations Multimedia Business

Spin-Off of PT Multimedia

On August 3, 2006, we announced our intent to spin off our 58.43% interest in PT Multimedia through a distribution to shareholders, subject to shareholder approval. Following the approval of the spin-off at the annual general meeting of our shareholders on April 27, 2007, we reclassified the results of operations of PT Multimedia under discontinued operations for all future reportable periods. On November 7, 2007, we announced the completion of the spin-off of PT Multimedia.

Until the spin-off, we provided multimedia services in Portugal through PT Multimedia and its subsidiaries. Our operating revenues from PT Multimedia were €586.7 million in the ten-month period ended October 31, 2007 and €666.5 million in the year ended December 31, 2006.

Strategic Alliances

Alliance with Telefónica

In April 1997, we entered into a cooperation agreement with Telefónica. The agreement focused principally on cooperation in international investments, particularly in Latin America. In 1998, we acquired interests, together with Telefónica, in Brazilian companies. In 1999, we commenced operations with Telefónica in Morocco.

On January 23, 2001, we entered into a strategic agreement with Telefónica to create a mobile services joint venture company in Brazil that would aggregate all of our Brazilian mobile assets with those of Telefónica Móviles (which has now merged into Telefónica). The joint venture was formed on December 27, 2002. We and Telefónica transferred all of our respective interests in Brazilian mobile services companies to the joint venture, named Brasilcel and operating under the brand name Vivo since April 2003, with its head office in the Netherlands. We hold our interest in Brasilcel through PT

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Móveis. Our agreements governing the ownership and management of Brasilcel have been entered into by those entities.

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

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

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

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

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

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

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

As part of our initial agreement with Telefónica, we acquired 1.0% of Telefónica's share capital and Telefónica acquired 3.5% of our share capital. We and Telefónica also gave each other a right of first refusal on any transfer of our respective interests. In addition, a member of Telefónica's board who is an executive officer is serving on our board as a non-executive director. Under the terms of our strategic agreement with Telefónica, we may acquire up to 1.5% of Telefónica's share capital, and Telefónica may increase its ownership interest in our share capital up to 10%. As of December 31, 2008, Telefónica's interest in our share capital was 10.0%, and we had no interest in the share capital of Telefónica. Neither party controls the operations or management of the other.

Alliance with Banco Espírito Santo and Caixa Geral de Depósitos

In April 2000, we signed a strategic partnership agreement with the Banco Espírito Santo Group ("BES") and Caixa Geral de Depósitos ("Caixa") for the development of "new economy" initiatives. Pursuant to this agreement, BES increased its stake in Portugal Telecom to 6% of Portugal Telecom's share capital, and in August 2000, we acquired a stake in BES of 3% of its share capital. As of December 31, 2008, BES owned 9.34% of our share capital. In accordance with this arrangement, two executive officers of BES serve as non-executive members of our Board of Directors.

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

In the second quarter of 2007, we disposed of the interest in BES held directly by Portugal Telecom for €110 million, recording a gain of €36 million. Our pension funds continue to hold shares of BES.

On March 25, 2008, we announced an agreement with Espírito Santo Financial Group, S.A., an affiliate of BES, to sell it our 34% stake of BEST Banco Electrónico de Serviço Total, S.A. ("Banco Best") for €16 million, subject to approval of the Bank of Portugal. Banco Best is a financial institution involved in e-banking, asset management and Internet trading and was developed pursuant to our strategic partnership agreement with BES.

Properties

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

Portugal Telecom and its subsidiaries own several office buildings in Portugal. Our main proprietary office space is located at the following addresses:

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

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

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

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

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

Av. de Zarco, Funchal, Portugal (7,025 square meters);

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

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

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

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

Rua Ricardo Jorge, 131/135, Porto Portugal (3,320 square meters); and

Rua Passos Manuel, 2, Lisboa, Portugal (1,395 square meters);

Portugal Telecom and its subsidiaries also lease office buildings owned by the pension funds created for Portugal Telecom employees. These buildings are located at the following addresses:

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

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

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

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

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

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

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

Tagus Park, Edifício Inovação III, IV, 414, Oeiras, Portugal (8,970 square meters).

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

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

Competition

We face substantial and increasing competition. The Portuguese telecommunications sector has been fully open to competition since January 1, 2000. The competitive conditions of each of our business segments are described below.

Competition Facing Our Wireline Business

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

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Retail

Our wireline business faces increasingly strong competition from new fixed-line operators (including VoIP providers) as well as from mobile telephone service providers, including our own mobile service provider, TMN. The number of subscribers to mobile services in Portugal is now more than three times greater than the number of wire lines in Portugal. At the end of 2008, there were approximately 140.4 active mobile telephone cards per 100 inhabitants in the Portuguese market. This growth is a result of residential subscribers adding mobile cards for family members and businesses adding mobile cards for their employees. Vodafone Portugal and Optimus are already marketing their mobile services as an alternative to our wireline telephone services, and we compete with them for market share. For example, Optimus and Vodafone have launched services called "Optimus Home" and "Vodafone Casa," respectively, that use their GSM mobile networks but use fixed line phone numbers. TMN requested an authorization to launch a similar service and received that authorization in 2007. The low-cost brands launched by TMN (Uzo), Optimus (Rede 4) and Vodafone (Directo) are designed to reach the lower-end segment of the mobile market and have also had an effect on our fixed line retail service, exacerbating the trend among consumers toward switching from fixed line to mobile service.

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

According to ANACOM figures, as of December 31, 2008, PT Comunicações, which provides retail services as part of our wireline business, had an estimated 68.4% market share of access lines (71.2% in 2007 and 78.7% in 2006). According to ANACOM figures and our estimates as of December 31, 2008, PT Comunicações had an estimated 63.1% market share of total outgoing traffic (in minutes), a decrease of 6.4% from December 31, 2007.

Our primary competitors in the wireline voice market include Tele 2 (recently acquired by Sonaecom), Novis (owned by Sonae and France Telecom), Oni Telecom InfoComunicações, S.A. (owned by certain investment funds), AR Telecom (formerly Jazztel) and Colt. All of the new entrants have focused on providing their customers with national and international services over their networks without direct interconnection. These customers must still connect to our competitors' services through our fixed lines.

Since January 2007, Zon Multimedia has been intensifying its triple-play strategy, which offers voice, pay TV and broadband Internet. The cable operator Cabovisão also offers a triple-play package. Zon Multimedia and Cabovisão have attracted some of our local customer market and will likely continue to do so.

Measures such as call-by-call selection (introduced on January 1, 2000) and carrier pre-selection (introduced on October 1, 2000), as well as number portability (introduced on July 1, 2001), make it easier for our competitors to attract our customers to their services. At December 31, 2008, we estimate that there were approximately 174 thousand lines in pre-selection. For example, Tele 2 has been effective in using carrier pre-selection to increase its market share.

We are losing revenues from our international telephone services because we no longer have the exclusive right to provide fixed-line telephone services, and large telecommunications users lease lines through which they connect to networks outside Portugal. At December 31, 2008, according to ANACOM data and our estimates, PT Comunicações had an estimated 71% market share of international traffic (in minutes), a decrease of 5.6% from December 31, 2007. In addition, we are losing revenues from our international telephone services as mobile operators establish direct international interconnections with mobile or fixed-line networks outside of Portugal, enabling them to

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offer international telephone services without using our network. We also face indirect competition in international fixed-line telephone services from calling cards and rerouting of calls by other international operators. Together with falling international call prices worldwide, these factors put pressure on us to reduce international fixed-line telephone prices.

In response to full competition, we have been lowering the prices of our wireline telephone services. In 2008, prices decreased by 4.1% for local and domestic long distance calls, on average, for residential customers, compared with 2007. Local and national calls for business customers remained unchanged. We believe our price structure is now competitive.

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

Wholesale

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

Our interconnection business faces more direct competition now that other operators may install and operate their own public wireline telephone networks. Mobile and wireline networks, which are our interconnection customers, can interconnect directly without using our network.

Some international operators are now providing wholesale services in Portugal, namely for international telephone services, network interconnection, data services, and to provide broadband access to Portuguese ISPs.

Data and Corporate

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

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

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Competition Facing TMN

TMN competes with Vodafone Portugal and Optimus, the two other mobile operators licensed to provide mobile telephone services in Portugal. According to figures from ANACOM, at the end of 2008, in terms of the number of active mobile telephone cards in the Portuguese market, TMN had a 46.6% market share. TMN has made maintaining its market share a priority. Although facing a very competitive market, TMN's market share of mobile subscribers increased in 2008.

We believe that our mobile competitors, Vodafone and Optimus, will continue to market their services aggressively. In mid-2005, Optimus introduced a low-cost brand "Rede 4" in response to our new brand "Uzo." Vodafone also launched a similar product called Directo in mid-2005 targeting the same market as Uzo and Rede 4. Vodafone Portugal and Optimus each have major shareholders that could provide them with substantial resources to compete aggressively against us in the Portuguese mobile telephone market. Sonae and France Telecom are the major shareholders in Sonaecom, the holding company that controls Optimus.

Competition is increasing in the mobile services sector in Portugal as TMN and its competitors develop new services. In addition, the commercial introduction in Portugal of third-generation mobile services has heightened competition and reduced the profitability of providing third-generation services. In 2008, ANACOM launched a public competition for the attribution of a fourth mobile license. The only bidder, RNT, was initially awarded the license but was later excluded for because it could not comply with the requirements of ANACOM, namely the presentation of a bank guarantee to cover the bid payment.

In November 2007, CTT, the Portuguese postal company, launched a mobile virtual network operator, or "MVNO," operation supported by TMN's network. MVNOs do not have their own network infrastructure and thus do not have the fixed cost burdens facing our current GSM (Global System for Mobile Communications) and UMTS (Universal Mobile Telecommunications System) services. In November 2008, Zon Multimedia launched an MVNO under the brand "Zon Mobile" after signing an agreement with Vodafone Portugal to operate using its mobile network.

Competition from companies providing WLAN services, which can deliver wireless data services more cheaply than UMTS in concentrated areas, may also affect the market and pricing for third-generation services.

Competition Facing Vivo in Brazil

Vivo faces intense competition in all the areas in which it operates, principally from other mobile service providers and also from fixed-line operators. Many of these competitors are part of large, national or multinational groups and therefore have access to financing, new technologies and other benefits that are derived from being a part of such a group. Fixed-line operators generally charge much lower tariffs than mobile service providers.

Our principal cellular competitor in the state of São Paulo is Claro. Claro is controlled by a consortium led by the Telecom Américas Ltd. (controlled by América Móvil S.A. de C.V.). The main fixed-line operator in this state is Telecomunicações de São Paulo S.A. Telesp, controlled by Telefónica.

Vivo's principal cellular competitor in the states of Paraná and Santa Catarina is Tele Celular Sul Participações S.A., or "TIM Sul." The main fixed-line operator in those states is Brasil Telecom S.A. In 2008, the Brazilian government published a law (6654/2008 Decree of revision of the fixed-line general concession plan ("Plano Geral de Outorgas" or "PGO")) allowing fixed-line concessionaires to operate in more than one region of the country. This change allowed Telemar Norte Leste S.A. Telemar or Oi to buy Brasil Telecom.

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Vivo's principal mobile competitor in the region encompassing the states of Mato Grosso do Sul, Mato Grosso, Goiás, Tocantins, Rondônia and Acre and the Federal District is Claro, and its principal competitor in the region encompassing the states of Amazonas, Roraima, Pará, Amapá and Maranhão is TIM. The main fixed-line operators in this area are Brasil Telecom S.A., in the region encompassing the states of Mato Grosso do Sul, Mato Grosso, Goiás, Tocantins, Rondônia and Acre and the Federal District, and Telemar Norte Leste S.A. Telemar or Oi, in the region encompassing the states of Amazonas, Roraima, Pará, Amapá and Maranhão. Other competitors include Oi, the Telemar mobile operator and TIM.

In the states of Bahia and Sergipe, Vivo's main mobile competitor is Oi (TNL PCS S.A.). Other mobile competitors are Claro (Stemar Telecomunicações Ltda.) and TIM (Maxitel S.A.), which also operates in the state of Minas Gerais. The principal fixed-line competitor in this area is Telemar Norte Leste S.A.

In the Ceará, Pernambuco, Paraíba, Alagoas, Rio Grande do Norte and Piauí service areas, our principal cellular competitor is Oi (TNL PCS S.A.). Other cellular competitors are TIM (TIM Nordeste S.A.) and Claro. The principal fixed-line competitor in this area is Telemar Norte Leste S.A.

In the Rio de Janeiro and Espírito Santo service areas, Vivo's main mobile competitor is Claro. Claro began providing cellular telecommunications services in this region at the end of 1998. The rights and obligations under Claro's license are substantially identical to our rights and obligations. Although Claro provides only digital service, its customers use TDMA dual mode cellular handsets that can operate on an analog network, GSM and 3G handsets. The principal fixed-line operator in this area is Telemar Norte Leste S.A. Oi is the third competitor and is integrated with Telemar.

In Rio Grande do Sul, Vivo's primary mobile competitor is Claro, and its other mobile competitors are Brasil Telecom S.A. and TIM. Vivo's main fixed-line competitor in this area is Brasil Telecom.

In Minas Gerais, there are four other wireless service providers operating within Vivo's authorization area. Vivo faces competition from the following operators: (a) TIM, the B Band frequency range operator that launched its services in December 1998 (TIM is primarily owned by Telecom Italia and operates in the entire State of Minas Gerais using TDMA, GSM and 3G technologies); (b) Oi, the D Band operator that launched its services in June 2002 (Oi is a subsidiary of Tele Norte Leste Participações S.A. (Telemar) and operates in the entire State of Minas Gerais using GSM and 3G technology); (c) Claro, the E Band operator that launched its services in the fourth quarter of 2005 (Claro is controlled by América Móvil and operates a GSM and 3G technology network); and, (d) CTBC Celular, an A Band and 3G Band operator (CTBC Celular is controlled by CTBC, a fixed-line operator and uses TDMA, GSM and 3G technologies).

Vivo also competes with certain other wireless telecommunications services in specific segments, such as mobile radio (including digital trunking technology offered by Nextel), paging and beeper services, which are used by some operators in its areas as a substitute for cellular telecommunications services. These competing wireless telecommunications services are generally less expensive than mobile telecommunications services.

Satellite-operated services, which provide nationwide coverage, are also available in Brazil. Although these services have the advantage of covering much larger areas than those covered by the cellular telecommunications services, they are considerably more expensive than the mobile telecommunications services Vivo offers and do not provide competitive coverage inside buildings.

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Regulation

In addition to the descriptions of regulatory matters set forth below, see the description of certain legal proceedings, including judicial and administrative proceedings relating to regulatory matters, set forth in "*Item 8 Financial Information Legal Proceedings.*"

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

Portugal

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

restrictions on the products we offer and the prices it charges in its wireline retail business;

restrictions on our broadband retail products and leased lines through the application of retail-minus rules;

price controls on our wholesale reference offers, such as local loop unbundling, wholesale line rental, interconnection offers, ADSL bitstream offers, access to ducts, leased lines trunks and local segments;

obligations to allow our competitors to interconnect with and use our wireline network;

certain wireline services that we are obliged to provide to the public under our "universal service obligation";

measures that are intended to make it easier for our customers to migrate to our competitors' services, including carrier pre-selection, number portability, unbundling of the local loop, and wholesale line rental; and

the terms of our concession and our licenses, including the third-generation mobile license that TMN received at the end of 2000.

EU Regulatory Framework and Relevant Markets

In February 2002, the European Union agreed upon a new regulatory framework for electronic communications networks and services, consisting of five directives governing procedures, authorizations, access, universal service and data protection; one decision on the availability and use of radio spectrum; and a recommendation on relevant product and service markets within the electronic communications sector subject to "ex ante" regulation in accordance with Directive 2002/21/EC of the European Parliament and Council on a common regulatory framework for electronic communications networks and services. Four of the five directives that make up the new EU framework were adopted into law in Portugal on February 10, 2004 as part of Law 5/2004, the Basic Law of Electronic Communications, or "Law 5/2004." The fifth directive was adopted into law on August 18, 2004. In 2006, the European Commission began a review of the new EU framework, and a new version of the European directives is expected in 2009. Final proposals were sent to the European Parliament and the European Council for approval in November 2007.

The implementation of the new EU framework is changing the current regulatory framework applicable to us. The new EU directives and recommendations, which adopt competition law principles

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such as market dominance for the designation of significant market power and the definitions of relevant product and geographic markets which may be subject to "ex ante" regulation, will result in significant changes and refinements to the current regulatory regime applicable to us in Portugal.

Under the new regulatory regime, regulatory obligations can be imposed on operators having significant market power in any one of the relevant retail and wholesale markets identified by the European Commission. The European Commission issued its new European Relevant Markets Recommendation in 2007, which defines one retail market and six wholesale markets. Since we are active in all of these markets, any new regulatory measures could affect our businesses and operations.

Prior to the release of the new European Relevant Markets Recommendation, ANACOM had analyzed 16 of 18 retail and wholesale markets (as defined under a prior European Union Recommendation). ANACOM found Portugal Telecom group to have significant market power in all the markets it has analyzed except for one in which it did not find any operator to have significant market power (wholesale transit services). These markets include the following: (1) retail markets access to the public telephone network at a fixed location (residential and business), publicly available local and/or national telephone services provided at a fixed location (residential and business), publicly available international telephone services provided at a fixed location (residential and business), and leased lines; and (2) wholesale markets call origination on the fixed telephone network provided at a fixed location, call termination on individual public telephone networks provided at a fixed location and wholesale unbundled access to local metallic loops, wholesale leased lines (trunk segments and terminating segments) and wholesale broadband access. ANACOM notified the European Commission regarding its conclusions about the markets it analyzed. In addition, ANACOM added a nineteenth market, covering telephone services at a fixed location using non-geographic numbers, such as toll-free numbers, and has declared the Portugal Telecom group to have significant market power in this area. Now, under the new EU framework directive, ANACOM will be required to re-analyze the retail and wholesale markets and identify which electronic communications operators and service providers it considers to have significant market power in such markets in Portugal and notify the European Commission with respect to its findings.

Wholesale markets numbers 4 and 5 (for the provision of wholesale (physical) network infrastructure access and wholesale broadband access) were analyzed by ANACOM in 2008 and early 2009. ANACOM decided to segment the broadband market geographically between "C" (competitive) areas and "NC" (non competitive) areas. ANACOM also removed the regulation that was imposed on PT regarding wholesale broadband access in "C" areas, namely the retail-minus rule. Additionally, the obligation imposed on PT to provide a bitstream reference offer (Rede ADSL PT) will expire after a transitional period of one year from the date of the final decision in January 2009.

In addition to the Portugal Telecom group, all other wireline operators in Portugal were determined to have significant market power in the call termination on individual public telephone networks provided at a fixed location wholesale market. Likewise, all mobile network operators were found to have significant market power in the call termination on individual mobile networks. We expect that, in the near future, ANACOM will provide further analysis on relevant markets.

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

Regulatory Institutions

ANACOM. The Autoridade Nacional das Comunicações, or "ANACOM," created in January 2001 (formerly the Instituto das Comunicações de Portugal, or "ICP"), is the Portuguese telecommunications regulator. Since it commenced operations in 1989, it has been closely involved in developing the telecommunications regulatory framework in Portugal. It advises the Portuguese government on

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telecommunications policy and legislation and monitors compliance with concessions, licenses and permits granted to telecommunications providers in Portugal.

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

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

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

The Directorate-General for Competition of the European Commission is responsible for considering, on its own initiative as well as in response to complaints by interested parties, potential claims that our business activities or Portuguese government regulations are inconsistent with the key provisions of the Treaty of Amsterdam, also known as the EC Treaty, relating to competition in the EU. Article 81 of the treaty prohibits agreements or coordinated action between competitors that may affect trade between EU member states and have as their objective or effect the prevention, restriction or distortion of competition within the EU. Article 82 of the treaty prohibits any abuse of a market-dominating position within the EU, or a substantial part of the EU, that may affect trade between EU member states. The Directorate-General for Competition enforces these rules in cooperation with the national competition authorities. In addition, national courts have jurisdiction over violations of EU competition law.

We understand that at the end of 2001, the Directorate-General for Competition and the Directorate-General for Information Society of the European Commission requested information from the Portuguese government regarding the telecommunications rights-of-way regime in Portugal, which provided PT Comunicações with the exclusive right to use public rights-of-way free of municipalities' fees and taxes. However, the rights-of-way regime was modified in 2004 through Law 5/2004, as described below in "*Summary of Our Concession and Existing Licenses.*" Since we have not been party to the communications between the Directorates-General and the Portuguese government, we are unable to assess whether or not Law 5/2004 has resolved any concerns the Directorates-General may have had regarding the regulation of rights-of-way in Portugal. We further understand that the Directorate General for Information Society of the European Commission requested information from the Portuguese government regarding the designation of the universal service provider (currently, PT Comunicações) and regarding the Portuguese government's intention to launch a transparent procedure in order to appoint the universal service provider. We understand that in January 2009, the European Commission referred the case to the European Court of Justice, where it is pending.

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In April 2006, the European Commission sent to the Portuguese government a formal request to abandon the special rights the Portuguese government holds as the sole owner of our A shares. The European Commission believes that the special powers granted to the Portuguese government through the sole ownership of our A shares act as a disincentive for investment by other EU member states in a manner that violates European Community Treaty rules. The Portuguese authorities have taken the position that these special rights are justified in order to protect relevant public interests. However, in 2008, the European Commission referred the case to the European Court of Justice, where it is pending.

Autoridade da Concorrência. Our activities are also overseen by the Autoridade da Concorrência (formerly Direcção Geral do Comércio e da Concorrência, or "DGCC"), which is responsible for enforcement of Portuguese competition law. It is also responsible for considering complaints relating to our business practices or other business arrangements. We and our subsidiaries are permitted under Portuguese law to appeal any adverse decision of the Autoridade da Concorrência to the courts. Such an appeal suspends the decision of the Autoridade da Concorrência pending a decision by the courts.

On February 10 and 11, 2004, the Autoridade da Concorrência conducted an unannounced search of the offices of PT Comunicações and PT Prime, seizing several documents, in order to investigate alleged abusive practices, including predatory pricing, price discrimination at the wholesale level, price discrimination at the retail level in the wireline telephone market and margin squeezes. The potential penalty for such practices could be as high as 10% of our revenues in the preceding fiscal year. This investigation is still in a preliminary stage involving document collection and review. The Autoridade da Concorrência periodically requests that we provide it with additional information regarding the alleged abusive practices, which we have responded to in a timely manner. We expect that the next phase could involve the Autoridade da Concorrência formally charging us with the alleged abusive practices, which would result in an administrative proceeding, referred to as a "statement of objections," in which we would defend our position before the competition authority. If we are unsuccessful in our defense, the competition authority could issue a fine in connection with such abuses. We are permitted under Portuguese law to appeal any adverse decision of the Autoridade da Concorrência to the Commerce Court. To our knowledge, the Autoridade da Concorrência has not yet reached any decision on this matter. In March 2004, we appealed to the courts regarding the seizure of certain documents by Autoridade da Concorrência, and in July 2007, the Courts confirmed that Autoridade da Concorrência is obliged to immediately return all the documents illegally seized and ruled that the potential proof obtained by those documents is null. The Autoridade da Concorrência returned those documents to us on August 20, 2007. However, the Autoridade da Concorrência's investigation is continuing.

To our knowledge, there are also several other complaints related to our activities pending before the Autoridade da Concorrência, including complaints against: (i) PT Comunicações (this complaint was formerly against Telepac, which merged with a PT affiliate that later merged into PT Comunicações) regarding alleged anti-competitive practices in the broadband Internet market; and (ii) PT Comunicações for alleged anti-competitive practices in the public wireline telephone market.

In addition, in 2004, the Autoridade da Concorrência initiated a proceeding against PT Comunicações, referred to as a "statement of objections," alleging that PT Comunicações was denying access to the ducts in which the basic telecommunications network is installed. In June 2005, the Autoridade da Concorrência issued a revised statement of objections on this matter. PT Comunicações has responded to these statements of objections and does not believe it has violated applicable law and regulations. However, on August 1, 2007, the Autoridade da Concorrência imposed a fine of €38 million on PT Comunicações. PT Comunicações appealed to the Commercial Court (Tribunal do Comércio) on August 30, 2007. The appeal suspended the decision of Autoridade da Concorrência pending a decision by the court.

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In April 2007, the Autoridade da Concorrência, also accused PT Comunicações of alleged abuse of dominant position for granting discriminatory discounts on lease lines. On September 1, 2008, PT Comunicações was notified by the Autoridade da Concorrência of its decision imposing a fine of €2.1 million for PT Comunicações' alleged abuse of its dominant position in the lease line segment. PT Comunicações considers these allegations unfounded and appealed the fine to the Commercial Court (Tribunal do Comércio) on September 29, 2008. The appeal suspended the decision of the Autoridade da Concorrência pending a decision by the court.

ERC. The Entidade Reguladora para a Comunicação Social ("ERC") is the independent regulatory authority for the Portuguese media. It was established by Law 53/2005 of November 8, 2005 and began activity on February 17, 2006. ERC's primary responsibilities are the regulation and supervision of all entities that undertake media activities in Portugal. ERC is a legal entity endowed with administrative and financial autonomy.

ERC is responsible for ensuring respect for fundamental rights such as freedom of the press, right to information, independence from political and economic power and freedom of speech. It is also responsible for monitoring compliance by all companies operating in the media sector, with standards for media and broadcast content, as well as for promoting the proper and effective functioning of the market where such companies operate.

ERC's decisions may affect, among others, news agencies, periodicals, radio or television operators, and radio and television broadcasters. PT Comunicações and TMN are usually considered television broadcasters, and as such we must pay ERC supervisory and regulatory fees, which are calculated based on the amount of work ERC does related to PT Comunicações and TMN, the technical complexity of matters, the geographic range of networks used by the broadcasters, and the impact of the activity developed by each broadcaster.

Pricing of Wireline Services

ANACOM established a new pricing regime for wireline services in 2004 in accordance with the terms of the new EU regulatory framework. This pricing regime created the following regulatory obligations for the retail market for telephone services at a fixed location:

The price cap applying to residential access and domestic calls is the Portuguese Consumer Price Index ("CPI") minus 2.75%;

The fixed component of fixed-to-mobile calls (residential and non-residential) is required to be cost-oriented, and price controls are in place in the form of a cap of 6.3 Euro cents on the amount retained by the fixed operator with respect to fixed-mobile calls;

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

Since December 2006, we have been required to grant a monthly fee discount for retired people.

In 2006, PT Comunicações submitted to the regulator a new pricing scheme that included a flat-rate plan with unlimited off-peak calls on weekdays. This new price plan was approved and came into effect on March 26, 2007. In September 2008, this flat-rate plan was extended to also include weekend nights.

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

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

See also " *Interconnection*" below.

Universal Service Obligations

Law 5/2004 and our concession impose universal service obligations on us in Portugal. These obligations include providing connection to the public telephone network at a wireline location. They also include providing access to public switched wireline telephone services, including enabling users to make and receive local, national and international telephone calls, facsimile communications and data communications. They also include providing public pay telephones, publishing directories and making available at least one telephone directory enquiry service covering all public voice telephone subscribers' numbers.

According to Law 5/2004, if ANACOM determines that the provision of universal service obligations has become an excessive burden, it may compensate us accordingly. PT Comunicações has submitted its annual universal service costs from 1996 to 2003 to ANACOM in order to obtain compensation. Since 2004, it has been the responsibility of ANACOM to calculate the costs of providing the universal service. We believe that obtaining significant compensation under this provision of the law will be very difficult and may not be possible.

On January 30, 2008, ANACOM issued a decision in which it refused to accept our calculations related to the costs of universal service for 2001, 2002 and 2003. ANACOM proposed to define a methodology to calculate the net costs of universal service and to provide definitional clarity on the concept of "excessive burden." Any conclusions will be submitted for public consultation, which we expect will take place in late 2009.

Interconnection

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

make interconnection access to their networks available to other network operators;

not discriminate between interconnection customers;

provide to those requesting interconnection the information and technical specifications necessary for them to interconnect their networks;

offer interconnection prices that are transparent and cost-oriented and do not discriminate between interconnection customers; and

maintain a separate accounting system for interconnection activities.

Law 5/2004 implemented the EU Access and Interconnection Directive in Portugal and established the general conditions for access and interconnection among telecommunications operators in

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competitive markets. It guarantees the rights of new entrants to obtain interconnection from telecommunications operators with significant market power.

Pursuant to Law 5/2004, ANACOM is entitled to review and modify our proposed interconnection rates and arrangements in our reference interconnection offer. ANACOM has established in Portugal an overall interconnection framework based on cost and consistent with the EU legal framework for both wireline and mobile services.

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

Mobile Interconnection. In February 2005, all mobile operators were declared to have significant market power in call termination in mobile networks market. ANACOM has accordingly imposed price controls on interconnection rates for the termination of calls on mobile networks. In 2005, interconnection rates (both fixed-to-mobile and mobile-to-mobile) were reduced by an average of 23.5% compared with 2004 rates. In 2006, these rates were reduced by an average of 18.5% compared to the 2005 rates. These reductions have had, and are expected to continue to have, a significant impact on TMN's interconnection revenues and consequently its earnings. A final decision concerning mobile termination rates (MTR) was announced by ANACOM on July 4, 2008, which stipulated a reduction in termination tariffs from €0.11 down to €0.065 as of April 1, 2009, for TMN and Vodafone. Optimus will reach that level by October 1, 2009. The first cut to €0.08 cents per minute was effective as of August 23, 2008. The impact of this regulatory decision was a reduction in wireline and domestic mobile revenues of €10.1 million and €23.6 million, respectively, in the year ended December 31, 2008.

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

Next Generation Access Networks

On June 18, 2008, ICP-ANACOM launched a public consultation on the regulation of Next Generation Access Networks (NGA), which addressed several issues, namely market and technological issues, the impact of NGA on existing networks, the development models, public policy considerations

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and regulatory models. As of December 31, 2008, ICP-ANACOM had not published the results of this consultation, which has prevented a consistent definition of the regulatory framework for NGA.

On September 18, 2008, the European Commission launched a consultation on a draft recommendation on the regulated access to NGA, which intends to define general regulatory principles, as well as regulatory solutions for FTTH and FTTN, including the unbundling of fiber and bitstream solutions. The Commission is still working on a final version of the recommendation.

Number Portability and Carrier Selection

Number portability allows a subscriber at a specific location to change service providers without having to change telephone numbers. PT Comunicações introduced number portability for wireline services in July 2001. Number portability for mobile services was introduced in January 2002.

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

Law 5/2004 requires that all wireline network operators with significant market power must offer carrier pre-selection. Carrier pre-selection allows customers to select the carrier that will be their default carrier. This removes the need for customers to dial any code to connect to their selected carrier when making calls. Full carrier pre-selection has been available throughout Portugal since October 15, 2000. Regulations for carrier pre-selection were published in early 2006, extending carrier pre-selection to some non-geographic services. These regulations were revised on October 15, 2007, reinforcing contractual relations between pre-selection carriers and consumers.

Unbundling of the Local Loop

In 2000, the European Commission approved a regulation requiring wireline network operators to make the local loops between their customers and the local switches on their networks available to competitors. Such a requirement also exists in Law 5/2004. This allows such competitors to connect their networks to the copper "local loop" and use it to provide their services directly to those customers without having to invest in the local loop or to rely upon the network operator's relationship with the customers. According to the regulation and Law 5/2004, we are required to maintain a reference offer for unbundled access to our local loops and related facilities and to meet reasonable requests for unbundled access to our local loops and related facilities under transparent, fair and non-discriminatory conditions. Prices charged must be cost-oriented. The conditions under which the local loop unbundling services are provided are set forth in a published reference offer for unbundled access to our local loops in accordance with terms established by ANACOM. This reference offer covers all of our main distribution framework buildings where technical and space conditions allow co-location. Co-location means providing space and technical facilities to competitors to the extent necessary to reasonably accommodate and connect the relevant equipment of the competitor.

Other Requirements

The regulatory framework requires PT Comunicações to submit periodic reports on quality of service and comply with specified indicators. Penalties may occur if we do not achieve such indicators. We must also provide white page directories and certain other facilities to certain specified categories of subscribers free of charge.

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Internet and Related Services

Various regulatory developments may affect our Internet business. Portugal has adopted Decree Law 290-D/99 regarding digital signatures, which established a legal framework for electronic documents and digital signatures. This framework is a key component for developing e-commerce business. Portugal is expected to enact further measures pursuant to the EU Electronic Signature Directive, adopted in December 1999. The EU Electronic Commerce Directive, which was implemented in January 2002, further promotes the free movement of electronically provided services and commerce within the EU. For example, it requires EU member states to absolve information carriers and host-services providers from liability for the content of information transmitted over the Internet. Such provisions provide us with legal protection that is important in carrying out our business. The 1995 EU Data Protection Directive, which was implemented in Portugal in 1998, places restrictions on the use by Internet companies of personal data stored on their networks. A new Data Protection Directive was adopted by the European Commission in 2006, imposing data-retention obligations on operators. A law implementing this directive was published in July 2008 and requires Internet service providers and other electronic communications providers to preserve data for a specified period of time and imposes other obligations in this field. We could also be subject to other self-regulation and content-monitoring requirements that could affect our Internet business.

EU Competition Directive

The European Commission issued a directive on September 16, 2002 (Directive 2002/77/EC) that requires member states to enact legislation directing incumbent telecommunications operators to separate their cable television and telecommunications network operations into distinct legal entities. We believe that the spin-off of our interest in PT Multimedia in November 2007 satisfied the requirements of the directive as implemented in Portugal.

Licensing Framework

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

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

Summary of Our Concession and Existing Licenses

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

Our Wireline Concession. The Portuguese government granted us a concession on March 20, 1995. The concession had an initial term of 30 years, expiring in 2025. As part of a reorganization of our business, we transferred the concession to our subsidiary PT Comunicações in 2000. The concession

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granted to us the right to install, manage and operate the infrastructure that forms part of the basic telecommunications network and the terrestrial broadcasting network for a fee of up to 1% of our operating revenues from the services provided under the concession, after certain deductions. Some of our assets that are part of the basic telecommunications network (as defined in Portuguese legislation) were treated as being within the "public domain" under the terms of the concession. During the term of the concession, we were permitted to receive economic benefits from the use of public domain assets as if we owned them completely. However, such public domain assets would have reverted to the Portuguese government without compensation when the concession expired.

On December 11, 2002, we agreed to prepay the future rental payments due under the concession in exchange for full ownership of the basic telecommunications network and to ensure that there will be no reversion of the assets related to the provision of concession services to the government in 2025. On December 27, 2002, we acquired full ownership of the basic telecommunications network for €365 million, which included the 2002 concession fee of €16.6 million. As a result of this acquisition, the terms of the concession have been modified so that PT Comunicações is no longer obligated to pay a concession fee to the Portuguese government, and ownership of the network and assets related to the concession will not revert back to the Portuguese government in 2025. On February 17, 2003, Decree Law 31/2003 was enacted, establishing the basic regulatory principles supporting the terms of our modified Concession. On April 3, 2003, we entered into an agreement formally modifying the terms of our concession with the Portuguese government.

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

In addition, after 2010 the Portuguese government may revoke the concession upon at least one year's notice if it deems such action to be justified in the public interest. If this occurs, we would be entitled to compensation equaling our annual average net profits for the five years prior to notification of revocation multiplied by the number of years remaining before the concession expires.

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

We are required to provide a special 50% discount on the monthly line rental fee to certain eligible retired and pensioner Portuguese citizens. Until December 31, 2006, the costs of providing this special discount were directly reimbursed by the Portuguese State. In May 2007, ANACOM determined that PT Comunicações should bear the costs of providing this special discount, as part of its universal obligations, a decision that applied retroactively from January 2007. In addition, in the past, we voluntarily offered supplementary discounts to eligible senior citizens in the form of an additional 10% discount on the monthly line rental fee and a special discount on telephone calls. We phased out these supplementary discounts in July 2007 as we became burdened with the cost of the mandatory 50%

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discount. The cost of all these discounts for our wireline business was approximately €18.9 million in 2007 and €15.3 million in 2008.

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

The Ministry of Finance is responsible for monitoring financial issues with respect to the concession. The Ministry of Economy is responsible for all other issues under the concession. ANACOM is authorized to monitor and assess penalties up to a maximum of €5 million if we fail to fulfill our obligations under the concession or other obligations imposed by law. Disputes concerning the application and interpretation of the concession are dealt with by arbitration.

PT Prime's Data Licenses and Registrations. Our subsidiary PT Prime holds:

a non-exclusive license to provide wireline services;

a non-exclusive license to be a "Public Telecommunications Networks" operator; and

all the licenses formerly held by Telepac, including a data communications license.

Our data communications license authorizes us to provide X.25/X.32 synchronous services and X.28 asynchronous services and other switched and non-switched data communications services, including frame relay and virtual private networks for data communications. The license also authorizes us to provide value-added services such as electronic data interchange and videotext services. In addition, the license authorizes us to construct certain network infrastructure in connection with licensed services. With respect to packet switched data, the data communications license is valid for 30 years, unless our wireline concession is terminated earlier. Licenses have also been granted to other providers of data communications and Internet access services, including companies associated with major international telecommunications providers. However, under Law 5/2004, and in accordance with the EU licensing regime, companies are not required to have a license to provide data communications services and Internet access. Instead, it is sufficient to register their intended services with ANACOM under its service registration scheme.

In April 1997, ANACOM granted PT Prime a license to provide data communications services using satellite infrastructure and a license to offer voice services to corporate networks and other closed groups of users.

TMN's Mobile Service License. Mobile telephone service licenses are valid for 15 years and are issued by ANACOM under Law No. 5/2004. These licenses authorize the use of radio spectrum and the installation of base stations, base station controllers and control switching centers and require the licensee to construct networks capable of reaching at least 75% of Portugal's population within a specified period of time. Charges for the provision of mobile telephone services are not subject to regulation.

Through TMN, we hold a renewable, non-exclusive license to provide traditional and GSM digital mobile telephone services throughout Portugal. The authorization for the use of GSM radio spectrum was renewed in March 2007 and is now valid until March 16, 2022. Two other operators hold licenses to provide GSM digital mobile telephone services on substantially the same terms as those applicable to TMN. Vodafone Portugal was awarded its license in 1991. Optimus was awarded a license in 1997 and began operations in September 1998.

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

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calls on a quarterly basis. We are also required to provide annual information to ANACOM about the development of infrastructure.

The UMTS licenses were issued by ANACOM in January 2001. UMTS services are the European version of the globally accepted technical standards for "third-generation" mobile communications. UMTS constitutes a significant advance over the "second-generation" digital GSM mobile services currently provided. The "first-generation" services were traditional analog mobile services. The broadband capacity of the frequency spectrum allocated under the UMTS licenses enables operators to supply video and Internet content to mobile handsets at higher transmission speeds. The licenses cover all of Portugal and are valid for 15 years. The license fee was €100 million per license. TMN and the other two main mobile operators in Portugal were each awarded one of these licenses at the beginning of 2001, and TMN's license expires in January 2016.

In April 2004, TMN launched UMTS in Portugal with an emphasis on new services, such as video telephony and high-speed data. Since then, TMN has pursued a strategy of gradual improvements to network coverage, using existing GSM sites where possible in order to minimize the need to install costly new sites. UMTS license holders are required to offer their services to 65.7% by the end of the third year and 77.3% by the end of the fifth year.

In addition, in 2000, TMN and the other mobile operators assumed commitments to make contributions to the information society during the period through the maturity of the license in 2015. In May 2007, pursuant to an agreement between TMN and the Portuguese State, and based on contributions already made, the outstanding commitments were valued at €355 million. Under the agreement, €260 million of this amount is to be spent on "E Initiatives," an initiative led by the Portuguese State to offer to school teachers and students laptops and discounted broadband services. The remaining €95 million is to be spent on subsidies for equipment, service discounts and network investments. The amount related to the "E Initiatives" was recognized as a license cost in 2007 in the amount of its net present value (€233 million), and the remaining € 95 million will be recorded when incurred, as its expected that these investments will be made in the ordinary course of business of TMN. In addition, TMN assumed the payment of one-third of the commitment of Oniway, a mobile operator that withdrew from the market, in the amount of €8 million. In 2008, we submitted a report to ANACOM on our costs for 2008 relating to these initiatives, and we are awaiting ANACOM's approval.

Brazil

Vivo's mobile business, the services it provides and the prices it charges are subject to regulation under the General Telecommunications Law and various administrative enactments, which regulate the services provided by Brazilian telecommunications operators.

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

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Concessions and Authorizations

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

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

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

ANATEL considers Vivo to be affiliated with Telefónica, which provides wireline long distance services in the state of São Paulo and was awarded a license to provide such services nationwide. For this reason, a wireline long distance license would not be available to Vivo if it were to apply for such a license.

SMP Regulation

Vivo holds a number of licenses to provide wireless communications services under the Brazilian Personal Mobile Service (*Serviço Móvel Pessoal*, or "SMP") regime. These regulations divide Brazil into three main regions covering the same geographic area as the concessions for the fixed-line telecommunications services, and the three regions are divided into registration areas, or tariff areas.

Some of Vivo's licenses were converted from concessions granted prior to the introduction of the current regulatory regime, and others were acquired by Vivo in auctions by ANATEL. Each SMP license in fact consists of two licenses – one to provide mobile telecommunications services, and another to use the frequency spectrum for a period of 15 years. The frequency license is renewable for a second 15-year period upon the payment of an additional license fee.

In September 2007, ANATEL organized auctions for fifteen new licenses in the 1900 MHz radio frequency band, denominated as Band L. Vivo acquired 13 spectrum licenses in Band L. In December 2007, ANATEL organized auctions for 36 new licenses in the 1900-2100 MHz radio frequency bands (3G licenses), denominated as Bands F, G, I and J. Vivo was awarded seven spectrum licenses in Band J and Telemig Celular was awarded two licenses. As a result, Vivo filled the last gaps in its coverage in Brazil and will soon be operating in the entire Brazilian territory.

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The table below provides certain information regarding Vivo's SMP licenses.

Area	Frequency Range Covered by License (Expiration of Right to Use Spectrum)
São Paulo state	Band A (2023, except 2024 for the cities of Ribeirão Preto and Guatapar)
	Band L (2023, except 2024 for the cities of Ribeirão Preto and Guatapar, excluding the cities covered by CTBC Telecom)
	Band L (2022, for the cities also covered by CTBC Telecom)
Paran state	Band J (2023)
	Band B (2013)
Santa Catarina state	Band L (2013, excluding cities of Londrina and Tamarana)
	Band J (2023)
	Band B (2013)
Gois state	Band L (2013)
	Band J (2023)
	Band A (2023)
Tocantins state	Band L (2023, excluding the cities covered by CTBC Telecom)
	Band J (2023)
	Band A (2023)
Mato Grosso state	Band L (2023)
	Band J (2023)
	Band A (2024)
Mato Grosso do Sul state	Band L (2024)
	Band J (2023)
	Band A (2024)
Rondnia state	Band L (2024, excluding the city of Paranaba)
	Band L (2022, for the city of Paranaba)
	Band J (2023)
Acre state	Band A (2024)
	Band L (2024)
	Band J (2023)
Amap state	Band B (2013)
	Band J (2023)
Amazonas state	Band B (2013)
	Band J (2023)
Maranho state	Band B (2013)
	Band J (2023)
Par state	Band B (2013)
	Band J (2023)
Roraima state	Band B (2013)
	Band J (2023)
Federal district	Band A (2021)
	Band L (2021)
	Band J (2023)
Bahia state	Band A (2023)
	Band L (2023)
	Band J (2023)

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Area	Frequency Range Covered by License (Expiration of Right to Use Spectrum)
Sergipe state	Band A (2023)
	Band L (2023)
	Band J (2023)
Rio de Janeiro state	Band A (2020)
	Band L (2020)
	Band J (2023)
Espírito Santo state	Band A (2023)
	Band L (2023)
	Band J (2023)
Rio Grande do Sul state	Band A (2022)
	Band L (2022)
	Band L (2022, for the metropolitan area of Pelotas)
	Band J (2023)
Minas Gerais state (Telemig Celular)	Band A (2023)
	Band E (2020, for the cities also covered by CTBC Telecom)
	Band J (2023)
Other	Band L (2022, covering the states of Alagoas, Ceará, Paraíba, Pernambuco, Piauí and Rio Grande do Norte)
	Band J (2023)

All Band A and B services are provided on the 850 MHz radio frequency, Band E is provided on the 1,800 MHz and 900 MHz radio frequency, and all Band L and J services are provided in the 1,900-2,100 MHz radio frequency range.

Under an SMP license, an operator may optionally provide domestic and international long-distance services in its licensed area, and a cellular operator and its controlling shareholders may not have a geographical overlap between licenses.

Interconnection

Under the General Telecommunications Law, telecommunications service providers are classified as providers of either collective or restricted services. All mobile operators, including SMP service providers, are classified by ANATEL as collective service providers. All providers of collective services are required to provide interconnection upon request to any other collective service providers. The terms and conditions of the interconnection agreements are freely negotiated between parties, subject to price caps and other rules established by ANATEL. Providers must enter into interconnection agreements, regarding, among other things, tariffs, commercial conditions and technical issues, with all requesting parties on a non-discriminatory basis. If the parties cannot agree on the terms and conditions of interconnection, ANATEL may determine the terms and conditions by arbitration. Interconnection agreements must be approved by ANATEL and may be rejected if they are contrary to the principles of free competition and the applicable regulations relating to traffic capacity, use of interconnection infrastructure by requesting parties and other matters.

In 2003, ANATEL adopted "Bill & Keep" rules for interconnection charges for traffic between the networks of SMP operators. Under these rules, an SMP mobile operator paid for the use of another SMP mobile operator's network in the same authorization area only if the traffic carried from the first operator to the second exceeded 55% of the total traffic exchanged between them (known as a partial "Bill & Keep" regime). In that case, only those calls that have surpassed the 55% level will be subject to payment for network usage. In 2006, the partial Bill & Keep regime was discontinued. The current rule is "full billing," pursuant to which the SMP operator pays the entire call termination fee of the

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other mobile network. The partial "Bill and Keep" rule is still used between the SMP and SME (trunking) networks.

In 2005, ANATEL approved provisional agreements among the local fixed line and mobile operators to determine the interconnection fees for local calls (known as "VC1" calls). These agreements provide for a 4.5% annual adjustment of interconnection fees for these calls. In March 2006, ANATEL approved a provisional agreement for interconnection fees for VC2 and VC3 long distance calls that also provides for a 4.5% annual adjustment to interconnection fees. In July 2007, ANATEL approved a provisional agreement among the fixed line operators Telefónica, Telemar, Brasil Telecom, CTBC Telecom, Sercomtel and the mobile operators to determine the interconnection fees for VC1, VC2 and VC3 calls. The provisional agreement also provides for a 1.97143% annual adjustment to interconnection fees in Region I (Telemar's region) and 2.25356% in Regions II (Brasil Telecom's region) and III (Telefónica's region). Then in July 2008, ANATEL approved a provisional agreement among the fixed line operators Telefónica, Telemar, Brasil Telecom, CTBC Telecom, Sercomtel and the mobile operators to determine the interconnection fees for VC1, VC2 and VC3 calls. This latest provisional agreement provides for a 1.89409% annual adjustment to interconnection fees in Region I (Telemar's region) and a 2.06308% in Regions II (Brasil Telecom's region) and III (Telefónica's region). The annual adjustments under these agreements may not be sufficient to cover Vivo's costs and preserve its margins from interconnection with Vivo's network. In particular, because a significant number of mobile subscribers use prepaid mobile services and generally receive more calls than they make, Vivo derives an important part of its revenues from the interconnection fees paid to it by the wireline operators for traffic originating on wireline networks and terminating on its mobile networks.

In 2005, ANATEL further standardized regulations governing wireline service, referred to as the Sistema de Telefonia Fixa Comutada (*Fixed Telephony Interconnection System*, or "STFC"), and those regulations affect the interconnection of mobile service with wireline service.

In addition, ANATEL may further modify the regulatory regime governing interconnection fees. Under Resolutions 438/2006, 480/2007, 483/2007, and 503/2008, beginning in 2010, ANATEL will determine the reference cost of using mobile networks (RVU-M) for SMP providers who have significant market power, which will be used in arbitration cases by ANATEL to determine the value of interconnection fees.

ANATEL has also published resolutions proposing new regulations regarding interconnection charges that could adversely affect Vivo's revenues and results of operations. These proposals include (1) a resolution that one SMP operator in its authorization area is to receive only one interconnection charge for calls originated and terminated on its network (a proposal whose implementation has already been demanded by ANATEL), (2) a resolution for new negotiation rules for interconnection charges in arbitration cases under which ANATEL would have a role in determining the charges and (3) a resolution for the unification of interconnection charges in any given region of the general authorization plan (*Plano Geral de Autorizações*) for the SMP regime among SMP providers of the same economic group that have significant market power, according to criteria still to be defined. In this regard, when ANATEL organized the auction in December 2007 for new licenses in the 1900-2100 MHz radio frequency bands (3G licenses), denominated Bands F, G, I and J, it specified that any license awarded to a holder of an existing SMP license in the same region would be unified with that existing license within 18 months from the publication of the terms of authorization awarding the new license (the publication of the terms occurred on April 30, 2008). Because Vivo and Telemig Celular were awarded Band J licenses in regions where they already possess SMP licenses, the unification provision is likely to apply to Vivo and Telemig Celular. In addition, the invitation document for the December 2007 auction modified the rule for renewal of radio frequency licenses and includes in operating profits (which is one of the criteria considered in the renewal process) not only the profits received from customers through mobile service plans but also the profits received from payments from other operators for the use of the SMP network.

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Resolution 516/2008, published by Anatel in November 2008, relates to the General Plan to update Brazilian telecommunications regulations ("Plano Geral de Atualização da Regulamentação das Telecomunicações no Brasil" or "PGR"). In this general plan, ANATEL targets several areas of vital importance for the mobile telecommunications business, such as the necessity of proposals for service quality improvement (which will likely cause the rise of operating costs), the regulation of virtual mobile operation (MVNO) (which will likely increase competition), the regulation of significant market power ("Poder de Mercado Significativo PMS") (the VU-M price unification among SMP providers of the same economic group having significant market power is expected and could reduce Vivo's revenues) and the regulation of multimedia communication services ("Serviço de Comunicação Multimídia SCM") (which will likely increase competition).

These new proposed regulations could have an adverse effect on Vivo's results of operations because (1) interconnection charges could drop, thereby reducing Vivo's revenues, (2) ANATEL may allow favorable prices for economic groups without significant market power and (3) the VU-M prices Vivo charges in some regions in which it operates are higher than those in some other regions, and consolidation of those prices, competitive pressures and other factors could reduce Vivo's average prices and its revenues.

Regulation of Quality of Service and Customer Rights

As a telecommunications service provider, Vivo is subject to regulations concerning quality of service and network expansion, as established in its SMP licenses and original concession agreements. Any breach of telecommunications legislation or of any obligation set forth in Vivo's authorizations may result in a fine of up to R\$50 million.

Vivo's SMP licenses impose obligations to meet quality of service standards, such as the system's ability to make and receive calls, call failure rates, the network's capacity to handle peak periods, failed interconnection of calls and customer complaints.

In 2007, ANATEL published Resolution 477/2007, addressing several areas of vital importance for the mobile telecommunications business, such as the necessity for retail stores in cities in an operator's coverage areas, increases in the validity periods of prepaid cards and limits on the period of time after which customers may leave service plans. The objective of the regulations is to reduce the number of customer complaints and improve the quality of services, with an emphasis on operators' duties and customers' rights.

ANATEL also published Resolution 460/2007, relating to fixed and wireless number portability with full activation in March 2009. For SMP operators like Vivo, number portability will only be applied for wireless codes of access in the same registration area. For fixed operators, number portability will only be applied for fixed codes of access in the same local area.

In 2008, ANATEL published Resolution 516/2008 containing a general plan to update the regulation of telecommunications in Brazil (Plano Geral de Atualização da Regulamentação das Telecomunicações no Brasil PGR), addressing several areas of vital importance for the mobile telecommunications business, such as the necessity of preparation of proposals for the improvement of the quality of service, offers of new bands of radio frequencies (450 MHz, 2.5 GHz and 3.5 Ghz), the regulation of virtual mobile network operations (MVNO), the regulation of significant market power (Poder de Mercado Significativo PMS) and for the regulation of multimedia communications services (Serviço de Comunicação Multimídia SCM).

In 2008, the Brazil Government published Decree 6654/2008 revising the fixed-line general concession plan (Plano Geral de Outorgas PGO), allowing fixed-line concessionaires to operate in more than one region of the country. This change allowed Telemar Norte Leste S.A. (Region I) Telemar or Oi to buy Brasil Telecom (Region II).

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Rate Regulation

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

Internet and Related Services

In Brazil, Internet service providers are deemed to be suppliers of value-added services and are not considered telecommunications service providers. ANATEL's Resolution 190 requires cable operators to act as carriers of third-party ISPs. The Brazilian House of Representatives is considering a law that would penalize Internet service providers for knowingly providing services that allow illegal goods or services to be sold on the Internet and would impose confidentiality requirements on Internet service providers regarding nonpublic information transmitted or stored on their networks. This would affect Vivo indirectly because mobile phones are used extensively for Internet traffic.

Competition Issues

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

ITEM 4A UNRESOLVED STAFF COMMENTS

None.

ITEM 5 OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion in conjunction with our audited consolidated financial statements and the accompanying notes included elsewhere in this report. Our audited consolidated financial statements have been prepared in accordance with International Financial Reporting Standards, or IFRS, as adopted by the European Commission for use in the European Union.

Overview

Our Business and Revenue Reporting Categories

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

Wireline Business

Offering the following wireline services:

Retail services, including fixed line telecommunications service and Internet services to residential customers;

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	Wholesale services; and
	Data and corporate services, including data communications, leased lines, outsourcing and net solutions, and Internet business-to-business.
Domestic Mobile Business	Offering mobile services, such as voice, data and Internet-related services, through TMN.
Brazilian Mobile Business	Offering mobile services in Brazil, such as voice, data and Internet-related services, through Vivo.
Other	International investments other than Vivo, instrumental companies and the Portugal Telecom, SGPS S.A. holding company. Our international investments other than Vivo mainly include:
	Mobitel, providing call center services in Brazil, which we fully consolidate in our audited consolidated financial statements;
	UOL, an Internet service provide in Brazil in which we hold a 29% stake and account for using the equity method;
	Cabo Verde Telecom, providing fixed and mobile telecommunications services in the Cabo Verde Islands, which we fully consolidate in our audited consolidated financial statements;
	MTC, providing mobile telecommunications services in Namibia, in which we acquired a 34% stake in September 2006 and which we fully consolidated in our audited consolidated financial statements as of that date;
	Medi Telecom, providing mobile telecommunications services in Morocco, which we account for using the equity method;
	Unitel, providing mobile telecommunications services in Angola, which we account for using the equity method; and
	CTM, providing fixed and mobile telecommunications services in Macao, which we account for using the equity method.

Consolidation Treatment of Vivo

We provide mobile telecommunications services in Brazil through Vivo S.A., which is fully owned by Vivo Participações, S.A., and through Telemig Celular, which has been controlled by Vivo Participações since April 2008. As of December 31, 2008, following the acquisition of control and the subsequent voluntary and mandatory tender offers concluded in May and August 2008, respectively, Vivo Participações S.A. held, directly or indirectly, 95.7% of the common shares of Telemig Celular, 36.1% of its preferred shares and 56.3% of its total share capital. We hold our participation in Vivo Participações, S.A. through our 50% interest in Brasilcel N.V., a joint venture with Telefónica. As of December 31, 2008, Brasilcel and its subsidiaries held 89.0% of the common shares of Vivo Participações, 48.7% of its preferred shares and 63.6% of its total share capital. We proportionally consolidate the financial results of Vivo in our consolidated financial results for the years ended December 31, 2006, 2007 and 2008, which include the financial results of Telemig Celular from April 1, 2008.

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Business Drivers and Measures

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

Wireline Business

Traffic Trends. Since 2002, we have experienced a continuing decrease in traffic on our fixed line network, primarily as a result of the trend among consumers to use mobile phones rather than fixed line service and increasing competition from mobile operators, other fixed line operators and, more recently, cable and VoIP providers. This decrease in traffic has negatively affected both our retail and wholesale revenues. See "*Item 4 Information on the Company Our Businesses Wireline Business Fixed Line Network*" and "*Traffic.*"

Changes in Revenue Mix. Our pay-TV customers have increased since we introduced pay-TV service in 2008. In addition, our ADSL retail accesses increased 11.5% from 2007 to 2008 due to our marketing of service packages that include pay-TV and ADSL broadband, but our overall ADSL revenues decreased 5.3% as the effects of regulatory changes in the last several years (requiring, among other things, unbundling of the local loop, as described elsewhere in this annual report) continued to lead to downward pricing pressure for our ADSL wholesale services. In recent years, we also experienced a migration in customers from dial-up Internet use to ADSL broadband Internet services. The mix of the revenues of our wireline business has therefore shifted significantly in recent years, with pay-TV related revenues partially offsetting the continued pressure on the traditional voice business. In addition, in the future we expect that broadband services will continue to be an important driver of our wireline business, and the architecture and regulation of the developing fiber optic network in Portugal will be an important factor affecting our business and revenues.

Decreasing Fixed Line Calling Prices and Greater Focus on Pricing Plans. Retail calling prices, particularly for regional, national and international calls, have been decreasing steadily in recent years, which has negatively affected our retail revenues. One of our strategies in response to this trend has been to aggressively market a variety of pricing plans to promote customer loyalty in our competitive market. Our pricing plans tend to increase our revenues from fixed charges but contribute to a decrease in our traffic revenues, particularly with respect to the growing percentage of pricing plans that offer calls at a flat rate. In our wholesale business, the decrease in regulated fixed-to-mobile interconnection charges has also affected our revenues because our wholesale wireline unit records revenue from international incoming calls through our network that terminate on the networks of mobile operators. Decreases in transit traffic (calls that use our network but neither originate nor terminate on our network) also have affected our wholesale revenues. See "*Item 4 Information on the Company Our Businesses Wireline Business Retail Fixed Line Telephone Services*" and "*Wholesale Prices.*"

Workforce Reductions and Post Retirement Obligations. In recent years, we have used workforce reductions to decrease our labor costs and increase our productivity. In 2008, we reduced our workforce in Portugal by 357 employees, incurring expenses of €100 million to do so. In addition, we have substantial unfunded liabilities for pension and healthcare benefits. These unfunded liabilities increased significantly in 2008, with gross unfunded obligations amounting to €1,809.9 million as of December 31, 2008, compared to €1,304.0 million as of December 31, 2007. In addition, in 2005, we established an autonomous fund, to which we contributed €300 million in 2005 and €302 million in 2006 to finance our post retirement healthcare obligations, and we also made contributions to our pension funds. We expect that contributions

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to these funds will continue to represent significant outflows in the coming years. See "*Liquidity and Capital Resources Post Retirement Benefits*" below and Note 9 to our audited consolidated financial statements.

Increasing Competitive Pressure. The telecommunications sector underwent a major transformation in Portugal, with the consolidation of a new operator Zon Multimedia. This, coupled with increased commercial aggressiveness from Sonaecom and Vodafone, has enhanced competition in the Portuguese telecommunications sector.

Domestic Mobile Business

Decreasing Interconnection Charges. In 2005, ANACOM declared all mobile operators, including TMN, to have significant market power in call termination in the mobile networks market. As a result, ANACOM imposed price controls on interconnection charges that caused both fixed-to-mobile and mobile-to-mobile interconnection rates to decrease by an average of 23.5% in 2005, 18.5% in 2006, 6.2% in 2007 and 10.9% in 2008. Both interconnection rates reached €0.065 per minute at the end of 2008. These reductions have had a significant adverse impact on TMN's revenues and results of operations. See "*Item 4 Information on the Company Our Business Domestic Mobile Business Prices and Revenue Breakdown.*"

Continuing Roll-Out of 3G Services. One of the ways in which we respond to intense competition in the mobile networks market is by continuing to develop and bring to market innovative third generation (3G) services that increase revenues and customer loyalty. We list several of our recently launched services in "*Item 4 Information on the Company Domestic Mobile Business Services.*" Remaining competitive requires continuing investments to build out our third generation network and develop new services, and our capital expenditures on our third generation network have increased in recent years.

Brazilian Mobile Business

Changes in Technology and Expansion of Services: In Brazil, Vivo began to implement a GSM network in 2006 and a WCDMA network in 2008. In September 2007, Vivo acquired 13 Band L licenses to enable it to expand its GSM network, and in December 2007, Vivo acquired seven Band J licenses to provide 3G services. Telemig, which Vivo acquired in 2008, acquired another two Band J licenses. The Telemig acquisition and Vivo's newly acquired licenses allowed to expand its services to the northeast region of Brazil and provide nationwide coverage. Vivo believes that continuing to develop and implement its GSM, WCDMA and 3G networks and addressing competitive pressures from other operators who are engaged in similar efforts will be a significant management focus in the coming years.

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

Shift to Prepaid Services. The Brazilian mobile market has been influenced in recent years by a shift to prepaid services. Prepaid services generate usage charges and interconnection charges but do not generate fixed monthly charges. Prepaid services have also attracted lower income customers to Vivo's services, and prepaid customers tend to make fewer outgoing calls than contract customers. Prepaid services involve lower customer credit risk, but they also tend to

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generate lower revenues per user for these reasons. Because of the importance of contract customers to Vivo's business, Vivo has undertaken initiatives to maintain and develop the contract customer base.

Impact of Regulatory Matters. The introduction of carrier pre-selection codes in 2003 has tended to decrease both the outgoing call revenues of Vivo and the interconnection charges it pays to other companies. At the same time, the partial "Bill & Keep" regime governing interconnection charges also introduced in 2003 tended to decrease the revenues received by Vivo from interconnection fees charged to other companies. Then in July 2006, ANATEL eliminated the partial "Bill & Keep" regime and established "full billing," under which the SMP operator pays the entire call termination fee of the other mobile network. The termination of the partial "Bill & Keep" regime had a positive impact on interconnection revenues in 2006. However, significant uncertainty remains regarding future regulation of interconnection charges and other matters by ANATEL. See "*Item 4 Information on the Company Regulation Brazil.*"

Socioeconomic Factors. The Brazilian mobile market continues to be affected by economic growth and the distribution of income among social classes. Use of mobile phones tends to grow when the economy grows and to decrease when there is an economic downturn. Vivo therefore pays close attention to socioeconomic trends in operating its business.

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

Seasonality

Although our revenues and costs fluctuate from quarter to quarter, we do not experience large fluctuations due to seasonality. We tend to have higher revenues in our fourth quarter in our wireline, domestic mobile and Brazilian mobile businesses due to promotional campaigns centered around the Christmas holiday. To a lesser degree, promotional campaigns at the time of the Easter and Mother's Day holidays also tend to increase our revenues in the second quarter. Our revenues from our wireline and domestic mobile businesses tend to be lower during the Portuguese summer holidays during the third quarter. Likewise, our revenues from our Brazilian mobile business tend to be lower during the Brazilian summer holidays and the Carnival holiday in the first quarter.

Discontinued Operations Multimedia Business

On August 3, 2006, we announced our intent to spin off our 58.43% interest in PT Multimedia, our former multimedia business, through a distribution to shareholders, subject to shareholder approval. Following the approval of the spin-off at the annual general meeting of our shareholders on April 27, 2007, we reclassified the results of operations of PT Multimedia as discontinued operations. On November 7, 2007, we announced the completion of the spin-off of PT Multimedia.

Until the spin-off, we provided multimedia services in Portugal through PT Multimedia and through PT Multimedia's subsidiaries. Operating revenues from PT Multimedia were €666.5 million in 2006 and were €527.6 million and €489.1 million in the nine-month period ended September 30, 2007 and 2006, respectively.

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Transition to International Financial Reporting Standards

Our consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as endorsed by the EU ("EU-IFRS"). EU-IFRS may differ from IFRS as issued by the International Accounting Standards Board ("IASB") if, at any point in time, new or amended reporting standards have not been endorsed by the EU. At December 31, 2008, 2007 and 2006, there were no unendorsed standards effective as of and for the years ended December 31, 2008, 2007 and 2006, respectively, that affected our consolidated financial statements, and there was no difference between EU-IFRS and IFRS as issued by the IASB as applied by Portugal Telecom. Accordingly, our financial statements as of and for the years ended December 31, 2008, 2007, and 2006 are prepared in accordance with IFRS as issued by the IASB. IFRS comprise the accounting standards issued by the IASB and its predecessor body and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and its predecessor body.

IFRS requires that an entity develop accounting policies based on the standards and related interpretations effective at the reporting date of its first annual IFRS consolidated financial statements. These accounting policies must be applied as of the date of transition to IFRS (January 1, 2004) and throughout all periods presented in the first IFRS consolidated financial statements.

Explanation of Exemptions Applied Under IFRS 1

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

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

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

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investments by a total amount of approximately €197 million at January 1, 2004, the date of transition to IFRS.

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

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with IFRS. We summarize our significant accounting policies, judgments and estimates in Note 3 to our audited consolidated financial statements. Our reported financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie preparation of the financial statements. We base our estimates on historical experience and on various other assumptions, the results of which form the basis for judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

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

Property, Plant and Equipment, and Intangible Assets

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

The determination of impairments of property, plant and equipment, and intangible assets involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment analysis is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the telecommunications industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, discontinuance of services, current replacement costs, prices paid in comparable transactions and other changes in circumstances that indicate an impairment exists. The determination of recoverable amounts and fair values are typically based on discounted cash flow methodologies that incorporate reasonable market assumptions. The identification of impairment indicators, the estimation of future cash flows and the determination of fair values of assets (or groups of assets) require management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows, applicable discount rates, useful lives and residual values. At December 31, 2008, we concluded that the carrying value of these assets did not exceed their recoverable amounts.

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Goodwill

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

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

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

The goodwill impairment analysis that we conducted as of December 31, 2008 did not suggest that any such impairment was likely in a future period.

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

Accrued Post Retirement Liability

As of December 31, 2008, we recorded an accrued post retirement liability amounting to €1,835.3 million to cover our net unfunded obligations regarding pensions and post retirement healthcare benefits. We estimate our obligations regarding post retirement benefits based on actuarial valuations prepared annually by our actuaries, which use the projected unit credit method and consider certain demographic and financial assumptions. The key financial assumptions affecting post retirement benefit costs are based, in part, on actuarial valuations, including discount rates used to calculate the amount of the post retirement benefit obligations. The discount rate reflects the weighted average timing of the estimated defined benefit payments (duration of approximately 14 years). The discount rate premium is determined based on European corporate bonds with a high quality rating. The assumptions concerning the expected return on plan assets are determined on a uniform basis, considering long-term historical returns, asset allocation and future estimates of long-term investment

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returns. In the event that further changes in assumptions are required with respect to discount rates and expected returns on invested assets, the future amounts of our post retirement benefit costs may be materially affected.

Provisions and Adjustments

Provisions are recorded when, at the end of the period, we have an obligation to a third party that is probable or certain to create an outflow of resources to the third party, without at least equivalent return expected from the third party. This obligation may be legal, regulatory and contractual in nature. It may also be derived from our practice or from public commitments having created a legitimate expectation for such third parties that we will assume certain responsibilities. To estimate the expenditure that we are likely to bear to settle its obligation, our management takes into consideration all of the available information at the closing date for its consolidated financial statements. If no reliable estimate of the amount can be made, no provision is recorded; information is then presented in the notes to the financial statements.

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

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

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

Assessment of the Fair Value of Financial Instruments

We choose an appropriate valuation method for financial instruments not traded in an active market based on our knowledge of the market and of the asset. In this process, we apply the valuation methods commonly used by market practitioners and use assumptions based on market rates.

Assessment of the Fair Value of Certain Assets Using the Revaluation Model

In 2008, we adopted the revaluation model of measuring the carrying value of certain classes of assets, namely the duct infrastructure and real estate assets. In order to determine the revalued amount of those assets, we used the replacement cost method for the duct infrastructure and the market value for real estate assets, which required the use of certain assumptions related to construction costs and the use of specific indicators for the real estate market, respectively. See Notes 4 and 34 to our audited consolidated financial statements for a more detailed explanation of the assumptions used.

Recent IFRS Accounting Pronouncements

IFRIC 13 Loyalty Programs (for years beginning on or after July 1, 2008)

On June 28, 2007, the IFRIC issued IFRIC 13, *Customer Loyalty Programmes*, which addresses accounting for loyalty award credits granted by companies to their customers who buy goods or services. In accordance with this interpretation, a company must allocate some of the proceeds of the sale of the award credits as a liability, representing its obligation to provide those awards. The amount

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of proceeds allocated to the award credits is measured by reference to their fair value, that is, the amount for which the award credits could have been sold separately. A company must recognize the deferred portion of the proceeds as revenue only when it has fulfilled its obligations under the awards. We include the cost of loyalty programs at fair value under operating costs in our consolidated income statements. Therefore, the adoption of this interpretation will change the presentation of this item in our consolidated income statements. We do not believe this change will have a material impact on our consolidated financial statements.

IFRIC 16 Hedges of Net Investment in a Foreign Operation (for years beginning on or after October 1, 2008)

In July 2008, the IFRIC issued IFRIC 16, *Hedges on a Net Investment in a Foreign Operation*, which provides guidance on: (a) identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation; (b) where, within a group, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting; and (c) how an entity should determine the amounts to be reclassified from equity to profit or loss for both the hedging instrument and the hedged item. We do not expect any impact on our consolidated financial statements as a result of the adoption of this interpretation.

IAS 1 (revised) Presentation of Financial Statements (for years beginning on or after January 1, 2009)

On September 6, 2007, the IASB issued revised IAS 1, *Presentation of Financial Statements*, with the main change being the requirement that a company must present all non-owner changes in equity, or "comprehensive income," either in one statement of comprehensive income or in two statements. Comprehensive income for a period includes profit and loss plus other comprehensive income recognized in that period, whose components in the case of Portugal Telecom include primarily actuarial gains and losses, currency translation adjustments, gains and losses on remeasuring available-for-sale financial assets and the effective portion of gains and losses on hedging instruments in a cash flow hedge. Revised IAS 1 also changes the titles of financial statements (a) from "balance sheet" to "statement of financial position," (b) from "income statement" to "statement of comprehensive income" and (c) from "cash flow statement" to "statement of cash flows." The amendments to IAS 1 will only affect disclosure requirements and therefore we do not expect any significant impact on our financial statements as a result of the adoption of this revised standard.

IAS 23 (revised) Borrowing Costs (for years beginning on or after January 1, 2009)

On March 29, 2007, the IASB issued revised IAS 23, *Borrowing Costs*, which removed the option of immediately recognizing as an expense those borrowing costs that relate to assets requiring significant time to be ready for use or sale. Companies are therefore required to capitalize borrowing costs as part of the cost of such assets. Considering the nature of, and construction period for, our tangible and intangible assets, we do not expect any material impact on our consolidated financial statements as a result of the adoption of this revised standard.

IAS 32 (revised) Financial Instruments: Presentation (for years beginning on or after January 1, 2009)

In February 2008, the IASB amended IAS 32, *Financial Instruments: Presentation*, in relation to the balance sheet classification of puttable financial instruments and obligations arising only on liquidation as equity or liabilities. As a result, some financial instruments that currently meet the definition of a financial liability will be classified as equity. The amendments have detailed criteria for identifying such instruments but generally include: (1) puttable instruments that are subordinate to all other classes of instruments and where the holder is entitled to a share of the entity's net assets if there is a liquidation of the entity and (2) instruments, or components of instruments, which are subordinate to all other classes of instruments and impose an obligation to deliver to another party a share of the net assets of

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the entity only on liquidation. We are currently analyzing the date of adoption of the amendment to IAS 32 and the resulting effects on the presentation of our results of operations, financial position or cash flows.

IFRS 2 (revised) Share Based payments (for years beginning on or after January 1, 2009)

In January 2008 the IASB issued the revised standard IFRS 2, *Share Based Payment Vesting Conditions and Cancellations*. The main changes resulting from this revision are as follows: (1) vesting conditions are service and performance conditions only and (2) all cancellations, either by the entity or by employees, should receive the same accounting treatment. The adoption of this standard is not expected to have a material impact on our financial statements.

IFRS 8 Segment Reporting (for years beginning on or after January 1, 2009)

On November 30, 2006, the IASB replaced IAS 14 with IFRS 8, *Segment Reporting*, which now requires identification of operating segments based on internal reports that are regularly reviewed by a company's chief operating decisionmaker in order to allocate resources to the segment and assess performance. We are currently assessing the impact of the adoption of this standard.

IFRIC 18 Transfer of Assets from Customers (as from 1 July 2009)

In January 2009, the IFRIC issued IFRIC 18, *Transfer of Assets from Customers*, which clarifies the requirements for agreements in which an entity receives from a customer an item of property, plant and equipment (or cash which is used only for its construction or acquisition) that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services. We do not expect any impact on our consolidated financial statements as a result of the adoption of this interpretation.

IAS 27 (revised) Consolidated and Separate financial statements (for years beginning on or after July 1, 2009)

In January 2008, the IASB published the revised standard IAS 27, *Consolidated and Separate Financial Statements*. The main changes resulting from the revision of IAS 27 are as follows: (1) changes in a parent's ownership interest in a subsidiary that do not result in the loss of control are accounted for exclusively within equity, (2) if a parent loses control of a subsidiary it must derecognize the related consolidated assets and liabilities and (3) when losses attributed to the minority shareholders exceed the minority's interests in the subsidiary's equity, these losses must be allocated to the non-controlling interests even if this results in a deficit balance. We are currently analyzing the impact of the adoption of the amendments to IAS 27.

IAS 28 (revised) Investments in Associates (for years beginning on or after July 1, 2009)

In January 2008, the IASB published the revised standard IAS 28, *Investments in Associates*. The main change resulting from the revision of IAS 28 is as follows: if an investor loses significant influence over an associate, it derecognises that associate and recognises in profit or loss the difference between the sum of the proceeds received and any retained interest, and the carrying amount of the investment in the associate at the date significant influence is lost. We are currently analyzing the impact of the adoption of the amendments to IAS 28.

IAS 31 (revised) Interests in Joint Ventures (for years beginning on or after July 1, 2009)

In January 2008, the IASB published the revised standard IAS 31, *Consolidated and Separate Financial Statements*. Following this revision, the standard provides exemptions from application of proportionate consolidation or the equity method similar to those provided for certain parents not

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preparing consolidated financial statements. We are currently analyzing the impact of the adoption of the amendments to IAS 31.

IFRIC 17 Distribution of Non-Cash Assets to Owners (for years beginning on or after July 1, 2009)

In November 2008, the IFRIC issued IFRIC 17, *Distribution of Non-Cash Assets to Owners*, which clarifies that: (a) a dividend payable should be recognized when the dividend is appropriately authorized and is no longer at the discretion of the entity; (b) an entity should measure the dividend payable at the fair value of the net assets to be distributed; and (c) an entity should recognize the difference between the dividend paid and the carrying amount of the net assets distributed in profit or loss. We do not expect any impact on our consolidated financial statements as a result of the adoption of this interpretation.

IAS 39 (revised) Financial Instruments: Recognition and Measurement (for years beginning on or after July 1, 2009)

In July 2008, the IASB issued an amendment to IAS 39, *Financial Instruments: Recognition and Measurement*, which specifies that an entity may designate an option as a hedge of changes in the cash flows or in the fair value of a hedge item above or below a specified price or other variable. We are currently analyzing the impact of the adoption of the amendment to IAS 39.

IFRS 3 (revised) Business Combinations (for years beginning on or after July 1, 2009)

In January 2008, the IASB published the revised standard IFRS 3, *Business Combinations*. The main changes resulting from the revision of IFRS 3 are as follows: (1) there is the option of measuring non-controlling interests at fair value or at the proportionate share of the identifiable net assets, (2) in a business combination achieved in stages, the acquirer must remeasure its previously held equity interest at the date it obtains control, and goodwill is then computed as the difference between the remeasured carrying amount plus consideration transferred for the acquisition of the new shares, minus the acquired net assets, (3) transaction costs must be recognized as expenses, (4) for changes in contingent consideration classified as a liability at the acquisition date, goodwill cannot be subsequently remeasured and (5) effects from the settlement of relationships existing prior to the business combination are not part of the exchange for the acquiree.

Results of Operations

Our results reflect the changing patterns in our business described above in " *Overview*." The key changes over the course of 2006, 2007 and 2008 include:

increasing revenues from Brazilian mobile services;

decreasing wireline telephone service revenues, partially offset by increased in pay-TV revenues; and

a high level of workforce reduction program costs in 2006, 2007 and 2008, as we focus on increasing the efficiency of our wireline business.

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The following tables set forth the contribution to our consolidated operating revenues of each of our major business lines, as well as our major consolidated operating costs and expenses, for the years ended December 31, 2006, 2007 and 2008.

	Year Ended December 31,							
	2006			2007			2008	
	EUR	% of	%	EUR	% of	%	EUR	% of
	Millions	Operating	Increase	Millions	Operating	Increase	Millions	Operating
		Revenues	of Item		Revenues	of Item		Revenues
Continuing Operations								
Operating revenues:								
Wireline business	1,953.0	33.9%	(5.6)%	1,843.5	30.0%	(2.1)%	1,805.6	26.8%
Retail	1,170.6	20.3%	(12.7)%	1,022.5	16.6%	(6.9)%	952.3	14.1%
Wholesale	368.7	6.4%	5.9%	390.4	6.3%	(0.9)%	386.8	5.7%
Data and corporate	242.7	4.2%	6.3%	258.1	4.2%	8.3%	279.5	4.2%
Directories	108.9	1.9%	(9.9)%	98.0	1.6%	(8.0)%	90.2	1.3%
Sales	32.1	0.6%	24.8%	40.1	0.7%	26.1%	50.5	0.8%
Other	29.9	0.5%	15.4%	34.5	0.6%	34.3%	46.4	0.7%
Domestic mobile business	1,426.2	24.7%	2.7%	1,464.6	23.8%	3.8%	1,520.3	22.6%
Services	1,290.8	22.4%	2.4%	1,321.7	21.5%	3.2%	1,363.8	20.3%
Sales	126.0	2.2%	7.3%	135.3	2.2%	9.8%	148.5	2.2%
Other	9.4	0.2%	(18.7)%	7.6	0.1%	4.7%	8.0	0.1%
Brazilian mobile business	2,104.7	36.5%	17.0%	2,462.9	40.1%	23.4%	3,039.3	45.1%
Services	1,789.8	31.0%	20.5%	2,157.2	35.1%	24.0%	2,676.0	39.7%
Sales	254.8	4.4%	1.3%	258.1	4.2%	13.7%	293.3	4.4%
Other	60.2	1.0%	(20.8)%	47.7	0.8%	46.9%	70.0	1.0%
Other businesses	281.4	4.9%	34.1%	377.3	6.1%	(2.2)%	369.2	5.5%
Services	261.8	4.5%	38.5%	362.5	5.9%	(3.8)%	348.8	5.2%
Sales	13.3	0.2%	(32.2)%	9.0	0.1%	80.4%	16.3	0.2%
Other	6.3	0.1%	(8.1)%	5.8	0.1%	(28.8)%	4.1	0.1%
Total operating revenues	5,765.3	100.0%	6.6%	6,148.4	100.0%	9.5%	6,734.3	100.0%
Costs, expenses, losses and income:								
Wages and salaries	633.5	11.0%	0.7%	638.1	10.4%	(3.4)%	616.6	9.2%
Post retirement benefits	(72.1)	(1.3)%	(9.8)%	(65.1)	(1.1)%	(168.8)%	44.8	0.7%
Direct costs	724.9	12.6%	25.2%	907.3	14.8%	19.8%	1,086.9	16.1%
Costs of products sold	580.6	10.1%	13.0%	656.1	10.7%	18.6%	778.5	11.6%
Marketing and publicity	138.3	2.4%	6.5%	147.2	2.4%	19.7%	176.3	2.6%
Supplies and external services	1,130.6	19.6%	4.3%	1,179.2	19.2%	4.3%	1,229.9	18.3%
Indirect taxes	175.9	3.1%	14.7%	201.8	3.3%	15.7%	233.6	3.5%
Provisions and adjustments	216.6	3.8%	(41.4)%	127.0	2.1%	(1.7)%	124.8	1.9%
Depreciation and amortization	1,130.7	19.6%	(0.7)%	1,123.1	18.3%	12.9%	1,268.3	18.8%
Curtailment costs, net	19.0	0.3%	1,353.5%	275.6	4.5%	(63.7)%	100.0	1.5%
Losses on disposals of fixed assets, net	(5.1)	(0.1)%	(45.7)%	(2.8)	0.0%	596.2%	(19.5)	(0.3)%
Other costs, net	115.4	2.0%	(60.9)%	45.1	0.7%	(33.5)%	30.0	0.4%
Income before financial results and taxes	977.1	16.9%	(6.3)%	915.7	14.9%	16.2%	1,064.1	15.8%
Net interest expense	220.1	3.8%	(10.3)%	197.4	3.2%	38.0%	272.4	4.0%
Net foreign currency exchange losses (gains)	(4.5)	(0.1)%	(378.2)%	12.4	0.2%	(31.6)%	8.5	0.1%
Net gains on financial assets and other investments	(18.3)	(0.3)%	1,257.0%	(248.8)	(4.0)%	(92.2)%	(19.3)	(0.3)%
Equity in earnings of affiliated companies, net	(130.6)	(2.3)%	(3.4)%	(126.1)	(2.1)%	35.6%	(171.0)	(2.5)%
Net other financial expenses	51.8	0.9%	(6.7)%	48.3	0.8%	(19.5)%	38.9	0.6%
Income before taxes	858.6	14.9%	20.3%	1,032.5	16.8%	(9.5)%	934.6	