

PORTUGAL TELECOM SGPS SA  
Form 20-F  
March 28, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 20-F**

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

OR

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

For the fiscal year ended December 31, 2007

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)

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**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 Prego, Investor Relations Director, Tel. +351 21 500 1701**

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

(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**

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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\*

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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, 2007, 2006 and 2005, there were no unendorsed standards effective as of and for the years ended December 31, 2007, 2006 and 2005, 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, 2007, 2006, and 2005 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 €0.6496 = US\$1.00 on March 24, 2008, and the noon buying rate on that date for Reais was R\$1.7303 = 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 and 2007 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 (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.

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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, 2006 and 2007 and the selected consolidated statement of income and cash flow data for each of the years ended December 31, 2005, 2006 and 2007 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 and 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, 2006 (the "2006 20-F"). The selected consolidated statement of income and cash flow data for the year ended December 31, 2004 was restated from that presented in the 2006 20-F in order to present PT Multimédia Serviços de Telecomunicações e Multimédia, SGPS, S.A. ("PT Multimédia") as a discontinued operation. The spin-off of PT Multimédia was completed on November 7, 2007.

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

	Year Ended December 31,			
	2004	2005	2006	2007
(EUR Millions)				
<b>Statement of Income Data:</b>				
<i>Amounts in accordance with IFRS</i>				
<b>Continuing Operations</b>				
<b>Operating revenues:</b>				
Services rendered	5,010.4	5,320.4	5,245.9	5,625.5
Sales	325.0	413.8	426.2	442.5
Other revenues	75.8	89.8	93.2	80.4
Total operating revenues	5,411.2	5,824.0	5,765.3	6,148.4
<b>Costs, expenses losses and income:</b>				
Wages and salaries	588.1	623.4	633.5	638.1
Post retirement benefits	58.8	(21.6)	(72.1)	(65.1)
Direct costs	692.9	716.3	724.9	907.3
Costs of products sold	577.8	639.5	580.6	656.1
Support services	175.0	202.3	202.1	233.6



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Marketing and publicity	136.1	164.7	138.3	147.2
Supplies and external services	716.3	872.3	928.5	945.6
Indirect taxes	118.9	165.2	175.9	201.8
Provisions and adjustments	163.2	161.6	216.6	127.0
Depreciation and amortization	883.5	1,058.7	1,130.7	1,123.1
Curtailement costs, net	165.6	314.3	19.0	275.6
Losses on disposals of fixed assets, net	7.8	(1.7)	(5.1)	(2.8)
Other costs, net	35.7	22.2	115.4	45.1
<b>Income before financial results and taxes</b>	<b>1,091.5</b>	<b>906.8</b>	<b>977.1</b>	<b>915.7</b>
Minus: Financial costs, net	230.0	50.5	118.4	(116.8)
<b>Income before taxes</b>	<b>861.5</b>	<b>856.3</b>	<b>858.6</b>	<b>1,032.5</b>
Minus: Income taxes	285.5	288.1	(21.4)	243.3
<b>Net income from continuing operations</b>	<b>576.0</b>	<b>568.2</b>	<b>880.0</b>	<b>789.2</b>
<b>Discontinued Operations</b>				
Net income from discontinued operations	149.2	120.7	74.1	45.5
<b>Net income</b>	<b>725.2</b>	<b>689.0</b>	<b>954.1</b>	<b>834.7</b>
Attributable to minority interests	102.0	35.0	87.4	92.8
Attributable to equity holders of the parent	623.2	654.0	866.8	741.9
Income before financial results and taxes per ordinary share, A share and ADS(1)	0.94	0.80	0.87	0.89
Earnings per share, A share and ADS:				
Basic(2)	0.53	0.57	0.78	0.71
Diluted(3)	0.50	0.53	0.73	0.67
Earnings per share, A share and ADS from continuing operations, net of minority interests:				
Basic(2)	0.45	0.50	0.74	0.69
Diluted(3)	0.42	0.47	0.69	0.66
Cash dividends per ordinary share, A share and ADS(4)	0.35	0.475	0.475	0.575
Share capital	1,166.5	1,128.9	395.1	30.8

- (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 and 1,025,800,000 ordinary and A shares issued as of December 31, 2007.
- (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 as a weighted average as of the date given and taking 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) The amount shown for 2007 reflects the amount proposed by the Board of Directors but not yet approved by our shareholders. Cash dividends per ordinary share, A share and ADS for the years ended December 31, 2004, 2005, 2006 and 2007 were €0.35, €0.475, €0.475 and €0.575, respectively. Cash dividends per ordinary share, A share and ADS for the years ended December 31, 2004, 2005, 2006 and 2007 were US\$0.43, US\$0.60, US\$0.64 and US\$0.85, respectively.

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For the Year Ended December 31,

2004	2005	2006	2007
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(EUR Millions)

**Cash Flow Data:**

*Amounts in accordance with IFRS*

Cash flows from operating activities	1,958.9	1,392.3	1,821.7	1,859.2
Cash flows from investing activities	185.5	(1,910.7)	1,136.7	235.9
Cash flows from financing activities	(1,958.2)	590.2	(3,015.4)	(1,953.6)

As of December 31,

2004	2005	2006	2007
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(EUR Millions)

**Balance Sheet Data:**

*Amounts in accordance with IFRS*

Current assets	3,972.9	6,153.7	3,998.7	3,816.3
Investments in group companies	318.3	425.6	499.1	538.1
Other investments	114.7	96.1	132.4	27.2
Tangible assets	3,936.3	4,062.0	3,942.0	3,585.4
Intangible assets	3,244.9	3,601.6	3,490.9	3,383.1
Post retirement benefits			134.1	134.1
Other non current assets	2,341.6	2,289.8	1,974.1	1,638.0
Total assets	13,928.7	16,628.8	14,171.2	13,122.2
Current liabilities	4,077.2	4,947.5	3,888.4	3,864.7
Medium and long term debt	3,899.3	5,168.6	4,467.5	4,960.7
Accrued post retirement liability	2,321.6	2,635.9	1,807.6	1,463.9
Other non current liabilities	1,376.5	1,294.7	901.7	751.1
Total liabilities	11,674.5	14,046.7	11,065.2	11,040.4
Equity excluding minority interests	1,686.5	1,828.4	2,255.2	1,338.2
Minority interests	567.6	753.7	850.8	743.6
Total equity	2,254.2	2,582.1	3,106.0	2,081.8
Total liabilities and shareholders' equity	13,928.7	16,628.8	14,171.2	13,122.2
Number of ordinary shares	1,166.5	1,128.9	1,128.9	1,025.8
Share capital(1)	1,166.5	1,128.9	395.1	30.8

(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 EuroList by 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 as certified for United States customs purposes by the Federal Reserve Bank of New York. On March 24, 2008, the Euro/U.S. dollar exchange rate was €0.6496 per US\$1.00.

Year ended December 31,	Average Rate(1)(EUR per US\$1.00)
2003	0.8763
2004	0.8014
2005	0.8064
2006	0.7898
2007	0.7248

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

Period	High	Low
	(EUR per US\$1.00)	
September 2007	0.7350	0.7033
October 2007	0.7096	0.6912
November 2007	0.6928	0.6729
December 2007	0.6972	0.6776
January 2008	0.6862	0.6722
February 2008	0.6899	0.6585
March 2008 (through March 24, 2008)	0.6336	0.6581

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 24, 2008, the Real/U.S. dollar exchange rate was R\$1.7303

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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)
2003	3.058
2004	2.915
2005	2.408
2006	2.164
2007	1.929

(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 2007	1.968	1.836
October 2007	1.829	1.739
November 2007	1.838	1.730
December 2007	1.820	1.758
January 2008	1.818	1.735
February 2008	1.766	1.667
March 2008 (through March 24, 2008)	1.739	1.667

## Risk Factors

### General Risks Relating to Our Company

#### *We may not achieve our announced shareholder remuneration goals*

In February 2007, in connection with our response to the tender offer by Sonaecom, we announced a shareholder remuneration package comprised of a €2.1 billion share buyback, a €0.475 per share dividend related to the year 2006, a €0.575 per share dividend related to years 2007 and 2008, and the spin-off of PT Multimédia Serviços de Telecomunicações e Multimédia, SGPS, S.A. ("PT Multimédia"). In 2007, we paid the dividend related to year 2006 and completed the spin-off of PT Multimédia. In addition, we acquired 103,056,500 of our own shares in September 2007 and an additional 83,204,823 of our own shares in March 2008, in each case through the physical settlement of equity swaps for those shares. We have therefore purchased shares with an aggregate value of €1.762 billion since our share buyback program was approved, equivalent to 16.5% of our share capital before the share buyback began.

The completion of the remaining shareholder remuneration goals will depend on our ability to continue to generate cash flow in our domestic businesses and assumes that we will be able to continue to streamline our operations to reduce our costs. In addition, our announced shareholder remuneration package assumes that the Real/Euro exchange rate will remain stable. The Real fluctuated significantly in relation to the Euro in recent years. See "*Risks Related to Our Brazilian Mobile Business: Macroeconomic factors in Brazil could reduce expected returns on our Brazilian investments and potentially lead to impairment charges*" and "*Fluctuations in the Real and increases in interest rates.*"

If any of the assumptions described in the preceding paragraph proves not to be the case or if any other circumstances (including any risks described in this "Risk Factors" section) impede our ability to generate cash and distributable reserves, you may not receive the full remuneration we have announced, and the price of our ordinary shares and ADSs could suffer.

#### *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;

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.

***Our recent ratings downgrades and any future 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 had four loans from the European Investment Bank ("EIB") totaling €343.2 million as of December 31, 2007 that contained a provision under which the EIB had the right to require us to provide a guarantee acceptable to the EIB in the event our ratings were downgraded to BBB/Baa2. In that circumstance, and after notice from the EIB, we would have 60 days to present an acceptable guarantee. If we failed to provide the EIB the required guarantee, the EIB would have the right to accelerate the repayment of the loans. As a result of our ratings downgrade on August 3, 2006 to BBB- by S&P, to Baa2 by Moody's and to BBB by Fitch, we negotiated with EIB revised terms and conditions for these loans. The agreement with the EIB, signed on February 23, 2007, allows us to present the guarantee mentioned above only in the case of a downgrade from the current rating (BBB- by S&P, Baa2 by Moody's and BBB by Fitch).

Our ratings downgrades could adversely affect our ability to obtain future financing to fund our operations and capital needs. The downgrades could affect the marketability of any new debt securities we may wish to issue. As part of the agreement with EIB described above, the spreads on our EIB loans increased by between 1 and 28 basis points, increasing our interest expenses. In addition, the downgrades could affect the pricing terms we are able to obtain in any new bank financing or issuance of debt securities. In addition, any further downgrade of our ratings could have even more significant effects on our ability to obtain financing and therefore on our liquidity.

***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 significantly 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.

**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 significantly reduced our wireline revenues and is likely to continue to adversely affect our revenues.* During 2007, approximately 30.0% of our consolidated revenues were derived from services provided by our wireline business in Portugal, as compared to 34% in 2006. 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 significant decline in our revenues from international wireline telephone services. The decrease in wireline traffic and lower tariffs resulting from competition has significantly affected our overall revenues, and we expect these factors to continue to negatively affect our revenues. See "*Item 4 Information on the Company Competition Competition Facing our Wireline Business.*"

*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.

In addition, the commercial introduction in Portugal of third-generation mobile services has heightened competition and reduced the profitability of providing third-generation services. ANACOM also intends to allow a new mobile operator in the 450 Mhz band to compete with us and other existing operators. The bidding process to choose a new operator is expected to occur in 2008.

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. At the beginning of 2008, PT Multimédia also announced that it was negotiating with Vodafone to launch an MVNO.

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 Portugal.*"

*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), including TV Cabo, a subsidiary of PT Multimédia. We believe that with competition in Internet broadband access intensifying, and with the development of existing technologies such as broadband wireless access and mobile broadband through UMTS, we may face loss of market share in the broadband market, which could result in a loss of subscribers and a loss in revenues.

In particular, PT Multimédia has significant market share in its main businesses, and we expect it to be a strong competitor of our wireline and domestic mobile businesses in television Internet access and voice telephony in the future.

In addition, in November 2005, ANACOM began a period of consultation regarding regulation of these services and issued a report on the subject in February 2006. Since then, some operators, including PT Multimédia, have launched fixed and nomadic (mobile) VoIP commercial services that compete with our services.

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In particular, PT Multimédia has significant market share in its main businesses, and we expect it to be a strong competitor of our wireline and domestic mobile businesses in Internet access and voice telephony in the future.

### *An adverse regulatory environment may negatively affect our profitability*

*Reduced interconnection rates have negatively affected our revenues for our mobile and wireline businesses and may continue to do so.* In February 2005, ANACOM declared all mobile operators to have significant market power in call termination in the mobile networks market. ANACOM has accordingly imposed price controls on interconnection rates for the termination of calls on mobile networks. In 2005, interconnection rates (both fixed-to-mobile and mobile-to-mobile) were reduced by an average of 23.5% compared with 2004 rates. In 2006, 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 October 2007, 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 proposed reductions would commence in early 2008 and reach €0.65 by October 1, 2008. Although the public consultation process ended in December 2007, ANACOM has yet to issue a final decision. If approved, this decision could have a negative impact on our cash flows.

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. Although we cannot predict the outcome of this process, if ANACOM decides to define a new market access and call origination such a decision 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 a significant 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.

*The European Commission's review of roaming charges may lead to a reduction in domestic mobile revenues* In 2007, we received approximately 6.8% of our domestic mobile revenues from incoming and outgoing roaming charges, down from 7.1% in 2006. 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 applies 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.

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In the retail market, maximum roaming charges of €0.24 per minute (for received calls) and €0.49 per minute (for outgoing calls) will apply 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 roaming charges of €0.19 per minute (for received calls) and €0.43 per minute (for outgoing calls) will apply thereafter.

Several recent statements by Viviane Reding, European Commissioner for Information Society and Media, suggest that roaming data services will also be subject to similar rules in the near future.

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. The Portuguese telecommunications regulator, ANACOM, is currently conducting a market analysis to determine the regulatory obligations that should be imposed on operators with significant market power in the provision of electronic communications pursuant to a new EU regulatory framework for electronic communications networks and services, referred to as the new European Relevant Markets Recommendation. In all but one of the 16 markets for which ANACOM has completed its analysis, the Portugal Telecom group has been found by ANACOM to have significant market power and consequently is subject to regulatory restrictions and obligations. Not all of these obligations and restrictions have been imposed on other telecommunications operators and service providers. The substantial resources we must commit to fulfill these obligations could adversely affect our ability to compete. See "*Item 4 Information on the Company Regulation Portugal.*"

*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 in 2008 that the Portuguese government announced relating to the provision of universal service. 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 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.com (this complaint was formerly against Telepac, which merged with PT.com in December 2004) 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; 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. 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, 2007, cumulative foreign currency translation adjustments related to investments in Brazil were positive €876.7 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.

In addition, the purchase and sale of foreign currency in Brazil is subject to governmental control. In the past, the Central Bank has centralized certain payments of principal on external obligations. Many factors could cause the Brazilian government to institute a more restrictive exchange control policy, including, without limitation, the extent of Brazilian foreign currency reserves, the availability of sufficient foreign exchange, the size of Brazil's debt service burden relative to the economy as a whole and political constraints to which Brazil may be subject. A more restrictive policy could affect the ability of Brazilian debtors (including Vivo) to make payments outside of Brazil to meet foreign currency-denominated obligations.

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

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

*Adverse political and economic conditions.* The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. The Brazilian government has utilized salary and price controls, currency devaluation and foreign exchange controls as tools in its previous attempts to stabilize the Brazilian economy and control inflation. Changes in the 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 1.97% against the Euro in 2006. In 2007, the Real appreciated against the Euro by 7.7%. 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. However, an increase in interest rates could negatively affect our profitability and results of operations and would increase the costs associated with financing our operations in Brazil. In addition, an increase would raise our interest costs since most of the interest on Vivo's debt is floating.

*Inflation in Brazil.* Brazil has historically experienced extremely high rates of inflation. Inflation, as well as governmental measures put in place to combat inflation, have had a material adverse effect on the Brazilian economy. Since the implementation of the Real Plan in 1994, the rate of inflation has been substantially lower than in previous periods. However, inflationary pressures persist, and actions taken in an effort to curb inflation, coupled with public speculation about possible future governmental actions, have contributed to economic 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 7.9% in 2007, compared to 3.8% in 2006, 1.2% in 2005, 12.1% in 2004, 7.7% in 2003 and 26.4% in 2002. If Brazil experiences significant inflation, Vivo may be unable to increase service rates to its customers in amounts that are sufficient to cover its increasing operating costs, and its business may be adversely affected, which could in turn have an adverse effect on our results of operations.

*We could be required to record impairment charges relating to goodwill for our investment in Vivo.* Under IFRS, we are required to test our goodwill for impairment at least annually. If the carrying value of 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***

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. See "Item 4 Information on the Company 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 in the regions in which Vivo operates has also affected, and may continue to affect, its financial results by causing, among other things, a decrease in its customer growth rate, decreases in prices and increases in selling expenses.

These factors have already contributed to a negative effect on Vivo's market share and results of operations and could have a material adverse effect on our results of operations in the future. As a result of competitive pressures, for example, Vivo's market share decreased from 38.2% as of December 31, 2006 to 36.7% as of December 31, 2007.

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 2007, 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 declined significantly, primarily due to competition and increased market penetration. For example, Vivo's net additions of customers decreased 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. This change in the rate of new additions of customers negatively affected Vivo's results of operations in 2006. In 2007, Vivo had net additions of 4,430 thousand customers, including an increase of 3,693 thousand prepaid customers, but this improved trend may not continue in the future. In addition, if Vivo's rate of customer turnover were to increase significantly, its results of operations and or competitive position could be adversely affected. Several factors in addition to competitive pressures could influence Vivo's rate of acquisition of new customers and rate of customer turnover, including limited network coverage, lack of sufficient reliability of 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 for 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. The annual adjustments under these agreements may not be sufficient to cover Vivo's costs and preserve its margins from interconnections with Vivo's network. In particular, because a significant number of mobile subscribers use prepaid mobile services and generally receive more calls than they make, Vivo 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 and 483/2007, 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 and 2007 described above, our 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. Because Vivo was awarded Band J licenses in regions where it already possesses SMP licenses, the unification provision is likely to apply to Vivo. 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.

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 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.

***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. See "Item 8 Financial Information Legal Proceedings Vivo Legal Proceedings."

### **Risks Relating to Our International Investments**

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.

### **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 depository to vote the ordinary shares underlying the ADSs. For the depository to follow the voting instructions, it must receive them on or before the date specified in our voting materials. The depository 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 depository, 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 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 20<sup>th</sup> 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.

#### 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](http://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") services, through PT Comunicações; and

sales of telecommunications equipment.

In Portugal, we are the leading provider of all of these services, except for IPTV 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 (30.0% during 2007) 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;

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*

continue to roll out triple-play services through the expansion of IPTV services;

obtain economies of scale in the television business through the launch of direct-to-home ("DTH") satellite television services in 2008;

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 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; 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.

**Recent Corporate Transactions**

*Announced Acquisition of Telemig*

On August 2, 2007, Vivo signed a stock purchase agreement with Telpart Participações S.A. ("Telpart") to acquire control of Telemig Celular Participações S.A. ("Telemig") and Tele Norte Celular Participações S.A. ("Tele Norte") and 22.72% and 19.34%, respectively, of their total capital for an aggregate amount of R\$1.2 billion, subject to certain price adjustments. In addition, Vivo will acquire from Telpart certain subscription rights for R\$87 million.

Upon closing of the transaction, in accordance with Brazilian law, Vivo will launch mandatory tender offers for the acquisition of common shares held by non-controlling shareholders at 80% of the price paid for the controlling stake. The mandatory tender offers will be extended to Telemig, Telemig Celular (the mobile operator held by Telemig), Tele Norte and Amazônia Celular (the mobile operator held by Tele Norte). In addition, Vivo intends to launch voluntary tender offers for up to one-third of all classes of preferred shares held by the non-controlling shareholders in the holding and operating companies at a 25% premium to the weighted average price of the last 30 trading days up to August 1, 2007. Assuming full acceptance of all offers, Vivo will have acquired a beneficial interest of 58.2% in Telemig Celular and 54.6% in Amazônia Celular, for an aggregate consideration of approximately R\$2.9 billion (including the R\$1.2 billion amount described in the preceding paragraph and the value of the subscription rights). Telemig Celular and Amazônia Celular operate in the regions of Minas Gerais and Amazonia, respectively, and the transaction will therefore allow Vivo to increase its coverage and customer base.

The completion of the transaction is subject to shareholder approval of Telpart, Telemig, Telemig Celular, Tele Norte and Amazônia Celular, as well as to customary closing conditions. See "*Brazilian Mobile Business Acquisition of Telemig.*"

*Spin-Off of PT Multimédia*

On November 7, 2007, we completed the spin-off of PT Multimédia Serviços de Telecomunicações e Multimédia, SGPS, S.A. ("PT Multimédia"), our former multimedia business, through a distribution to our shareholders. The spin-off was approved by our shareholders on April 27, 2007, and PT Multimédia has been reflected in our financial statements as discontinued operations since that date.

As a result of the application of withholding tax and the mechanics for paying cash in lieu of fractional shares, we initially retained 25.7 million shares of PT Multimédia, representing 8.3% of its share capital. By November 13, 2007, we had disposed of this interest to buyers who committed to holding those PT Multimédia shares for a six-month period from November 7, 2007. We no longer retain any interest in PT Multimédia.

**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 and IPTV 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, 2005, 2006 and 2007:

	Year Ended December 31,		
	2005	2006	2007
	(€ millions)		
<b>Wireline Business:</b>			
Retail	1,318.8	1,173.5	1,023.2
Wholesale	457.7	464.2	486.9
Data and Corporate	244.9	250.5	265.6
Directories	120.4	108.9	98.0
Sales	34.2	32.8	40.5
Other	37.7	41.9	48.1
	2,213.6	2,071.8	1,962.4
<b>Domestic Mobile Business:</b>			
Services	1,403.6	1,363.2	1,393.1
Sales	146.3	129.7	141.8
Other	7.1	9.4	8.1
	1,557.1	1,502.4	1,542.9
<b>Brazilian Mobile Business:</b>			
Services	1,737.8	1,789.8	2,157.2
Sales	233.8	254.8	258.1
Other	65.3	60.2	47.7
	2,036.9	2,104.7	2,463.0
<b>Other Businesses</b>	244.8	281.4	377.3
<b>Eliminations in consolidation</b>	(228.4)	(195.0)	(197.2)
<b>Total consolidated operating revenues</b>	5,824.0	5,765.3	6,148.4

### Our Businesses

#### Wireline Business

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

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

wholesale, including leased lines, interconnection services, unbundled access to our local loops, 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 communications, leased lines to major clients, network managing and outsourcing; and

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

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

telecommunications network from the Portuguese government. Since then, PT Comunicações has owned the basic telecommunications network.

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.

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

#### *Fixed Line Network*

We had approximately 4,176 million telephone and asymmetric digital subscriber line ("ADSL") access lines in service at December 31, 2007, 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, 2007, we had 714 thousand ADSL lines, of which 652 thousand were attributable to our ADSL retail business (which is operated by PT.com), and 3,010 thousand PSTN/ISDN lines. In the third quarter of 2007, we launched IPTV services, totaling 21 thousand new lines at the end of 2007. The following table shows the number of our main lines by category.

	As of December 31,				
	2003	2004	2005	2006	2007
Fixed line main lines in service (thousands)					
Traditional main lines	3,224	3,165	3,011	2,590	2,312
ISDN main line equivalents	813	783	758	727	699
ADSL	188	420	637	749	714
TV					21
Unbundled local loop (ULL)		9	72	196	291
Wholesale line rental (WLR)				142	140
Total	4,225	4,377	4,478	4,404	4,177
PSTN/ISDN fixed line main lines per 100 inhabitants	41.2	40.6	40.5	40.4	38.3
Public pay phones (thousands)	41.4	47.3	57.8	65.7	61.7

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 38.8 fixed line main lines at the end of 2007.

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 2007, PT Comunicações was providing approximately 1,034 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 2007, we had 224,490 subscribers to the basic-rate ISDN service and 7,483 subscribers to the primary-rate ISDN service. By the end of 2007, ISDN lines represented 23.2% of our total equivalent fixed line main lines, as compared with 21.9% 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 2006 and 2007, 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.

#### **ADSL Customers**

**(Thousands)**

We had 0.2 billing complaints per 1,000 bills and 11.7 reported faults per 100 main lines in the year ended December 31, 2007. The percentage of faults repaired in less than 12 working hours was

77.4% in 2007, compared with 77.7% in 2006. 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.

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,

	2003		2004		2005		2006		2007	
	Millions of minutes	%	Millions of minutes	%	Millions of minutes	%	Millions of minutes	%	Millions of minutes	%
Retail	7,947	43.5	7,250	44.0	6,400	43.2	5,575	41.5	5,218	41.7
Wholesale	10,308	56.5	9,229	36.0	8,418	56.8	7,867	58.5	7,284	58.3
Total	18,255	100.0	16,479	100.0	14,818	100.0	13,442	100.0	12,502	100.0

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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 2006 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 2007.

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 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.

### *Retail*

*Fixed Line Telephone Services.* We provide public fixed line telephone services in Portugal to retail customers, primarily through our subsidiary PT Comunicações. This business area provided €1,023.2 million and €1,173.5 million during 2007 and 2006, 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 €488.4 million and €568.1 million to our wireline operating revenues during 2007 and 2006, 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, 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. The chart below illustrates changes in our prices and fees from 2003 through 2007. All prices are in Euros and exclude VAT.

#### Fixed Fees for Fixed Line Telephone Services(1)

	As of December 31,				
	2003	2004	2005	2006	2007
Installation fee	71.83	71.83	71.83	71.83	71.83
Line rental per month					
Residential	12.3	12.66	12.66	12.66	12.66
Business			12.98	13.35	14.40

(1) Amounts rounded to nearest hundredth.

*Traffic.* Traffic contributed €352.7 million and €425.1 million to our wireline operating revenues during 2007 and 2006, respectively. Measured in minutes, total fixed line traffic decreased by 7% in 2007 compared with 2006. The decrease was primarily due to the continuing effects of the trend toward use of mobile services instead of fixed line services and the migration of Internet users to ADSL.

*Domestic.* Domestic traffic contributed €306.1 million and €372.7 million to our wireline business's operating revenues in 2007 and 2006, 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 2006, domestic prices decreased an estimated 0.45% over the course of 2007 in nominal, annualized terms. See "*Regulation-Portugal Pricing of Wireline Services.*"

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The chart below illustrates changes in our prices from 2003 through 2007. The call prices from 2003 through 2007 are for a three-minute call at peak rates in 2007 constant prices. All prices are in Euros and exclude VAT.

### Principal Prices for Domestic Fixed Line Telephone Services(1)

	As of December 31,				
	2003	2004	2005	2006	2007
<b>Local call prices</b>					
Residential	0.12	0.13	0.12	0.12	0.12
Business			0.13	0.13	0.13
<b>Regional call prices</b>					
Residential	0.21	0.16	0.12	0.12	0.12
Business			0.13	0.13	0.13
<b>National call prices</b>					
Residential	0.29	0.20	0.19	0.19	0.19
Business			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, 2007.

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

	As of December 31, 2007		
	EU Average(1)	EU Average(2)	Portugal
<b>Local call prices:</b>			
Residential	0.037	0.038	0.041
Business	0.036	0.037	0.042
<b>National call prices:</b>			
Residential	0.061	0.068	0.065
Business	0.055	0.061	0.063

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

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

To increase 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, although traffic increased in 2005 as a result of growth in traffic from prepaid international calling cards.

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 2007 decreased by a weighted average of approximately 4.1% for incoming traffic and 1.05% for outgoing traffic compared to the end of 2006.

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 2003 and the end of 2007, international traffic has remained broadly the same in real terms.

The table below shows changes in retail prices for our international fixed line telephone services to selected destinations since 2003. The prices for 2003 through 2007 are peak rate prices per minute on the basis of a three-minute call, set at 2007 constant prices. They are in Euros and exclude VAT.

#### Selected Prices for the International Services(1)

	As of December 31,				
	2003	2004	2005	2006	2007
EU(2)	0.27	0.27	0.27	0.27	0.27
Other European countries(3)	0.61	0.61	0.61	0.61	0.61
United States	0.28	0.28	0.28	0.28	0.28
Canada	0.28	0.28	0.28	0.28	0.28
Brazil	0.57	0.57	0.57	0.57	0.57

(1) Euro amounts rounded to nearest hundredth.

(2) Including Switzerland.

(3) Excluding Norway and Iceland.

*ADSL Services and ISPs.* According to ANACOM, we are the leader in providing Internet access in Portugal. As of December 31, 2007, we had approximately 652 thousand ADSL retail customers, which represented an overall decrease of 4.8% over the previous year. The decrease was, in part, due to a database cleanup in which we eliminated 103 thousand inactive prepaid broadband customers from our database.

We also offer dial-up paid and free Internet access services. In 2007, revenues from ADSL services grew 2.9% to €175.1 million, more than offsetting a decline in dial-up revenues from €10.2 million to €4.9 million as increasing numbers of people switched to broadband service.

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*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 2,407 customers for our ASP business as of December 31, 2007.

*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 the second quarter of 2007, we announced the soft launch of IPTV services. Our triple-play offer includes 42 pay TV channels (of which 10 are à la carte), broadband access of up to 8MB and unlimited fixed-to-fixed calls. In addition, customers can buy premium channels, such as SportTV (a premium sports channel) and premium movie channels. The service is provided using ADSL 2+ and is available for up to two televisions per home. We were the first operator in Portugal to introduce HDTV and have the most extensive VOD offer in the market. The service is being initially rolled out in Lisbon and Oporto.

### *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 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 €486.9 million and €464.2 million to our wireline operating revenues in 2007 and 2006, respectively.

*Traffic.* Interconnection and narrowband Internet access traffic comprised about 45% of our wholesale business in terms of revenues in 2007. The service providers who purchase interconnection services include fixed and mobile network operators, voice and data communications

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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 2007, from January 1 to March 25, interconnection rates per minute for call termination included local rates equal to €0.0061, single

tandem rates equal to €0.0091 and double tandem rates equal to €0.0141, each based on a three-minute call made during peak hours. From March 26, 2007 onward, interconnection rates per minute for call termination included local transit rates equal to €0.0056, single tandem rates equal to €0.0082 and double tandem rates equal to €0.0127, 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 7.4% in 2007 compared with 2006 and 6.5% in 2006 compared with 2005. This decrease was primarily due to a decrease in dial-up Internet traffic, which was partially compensated for by increases in termination traffic and international incoming traffic.

*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 17.1% in nominal terms in 2007 compared with 2006, due to our introduction of capacity-based interconnection offers and ANACOM's decision to lower interconnection rates, and by 7.8% in 2006 compared with 2005. International interconnection revenue per minute for wholesale operators' outgoing traffic declined 4.1% in nominal terms in 2007 compared with 2006, and by 21.6% in 2006 compared with 2005. 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:

digital leased lines;

broadband data and IP/MPLS Ethernet solutions;

networking and systems integration solutions;

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

interactive systems and related applications;

outsourcing of telecommunications application systems;

security and disaster recovery solutions;

consultancy services;

Web design and site management;

fixed line and mobile convergence services;

business-to-business e-commerce;

housing and hosting solutions, including application service provider, or ASP, and enterprise resource planning, or ERP; and

telephone services using Internet protocol.

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We are the leading supplier of the full range of these services in Portugal. Data and corporate operating revenues contributed €265.6 million and €250.5 million to our wireline operating revenues in 2007 and 2006, respectively.

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

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

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

We provide a range of broadband solutions to corporate customers. The type of solution depends on the type (voice, data or image), volume, priority level and stability of information flow required by our customers. We also provide reporting services targeted to special customers to control service level agreements and the overall performance of the network. In addition, we provide outsourced corporate network services for our customers. For example, we operate and manage the SIBS network, as well as the corporate networks of our strategic partners Caixa Geral de Depósitos, Banco Espírito Santo and 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 ADS. 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.

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

We also offer services focused on the integrated management of networks ranging from local area networks ("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 €98.0 million and €108.9 million in 2007 and 2006, 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 €40.5 million and €32.8 million in 2007 and 2006, respectively, including the sale of handsets, modems and other telecommunications equipment.

#### **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.

Operating revenues from TMN amounted to €1,542.9 million in 2007 compared to €1,502.4 million in 2006. At December 31, 2007, there were approximately 126.9 active mobile telephone cards per 100

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Portuguese inhabitants according to ANACOM. The table below provides statistical information relating to TMN.

	As of December 31,				
	2003	2004	2005	2006	2007
<b><i>TMN-Portugal</i></b>					
Number of subscribers (thousands)(1)	4,887	5,053	5,312	5,704	6,261
Subscriber growth per annum (%)	10	3	5	7	10
Number of subscribers per 100 inhabitants (including competitors' subscribers)(2)	89.8	95	108.7	115.7	126.9
Estimated market share by number of subscribers (%) (3)	48.7	48.8	46.4	46.7	46.5
Number of employees	1,109	1,133	1,184	1,140	1,144

(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 2007, TMN's UMTS population coverage was approximately 87%, and its geographic coverage was about 51%, or 3,985 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 in partnership with Lusomundo Cinemas, a subsidiary of PT Multimédia.

TMN paid spectrum fees in 2006 and 2007 of €26 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 €114.2 million in 2006 and €118.2 million in 2007 in building out its third-generation network and services. In 2007, the investments made by TMN in connection with UMTS represented approximately 60% of its total capital expenditures in 2007, excluding investments in the Portuguese information society associated with the UMTS license.

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During 2007, TMN introduced the following new products and services in Portugal:

"Office Box PME," a new voice and data offer targeting small and medium businesses and small home offices that includes mobile and fixed voice services, broadband, and Internet and e-mail services;

"Internetnotelemóvel," a new mobile Internet service based on a flat rate for unlimited use of the Internet and e-mail access through mobile handsets; and

"kitados," a new set of pricing plans launched to address the youth segment that allows customers to make unlimited on-net calls after the first minute at night ("kit noite"), on weekends ("kit fim de semana") or to a selected number ("kit par").

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 an 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. In 2007, TMN and PT Wi-Fi agreed to extend the portfolio of Wi-Fi services provided by TMN.

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.

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, 2007, TMN had approximately 6.3 million subscribers, representing an increase of 9.8% from December 31, 2006. At December 31, 2007, TMN's subscribers represented 46.5% of the total mobile subscribers in Portugal.

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During 2007, TMN's share of new mobile subscribers (net additions) was 45.5% according to ANACOM.

In addition to the increase in the number of subscribers, mobile usage grew during 2007. TMN's voice traffic in terms of minutes grew by 8.7% to 8,477 billion minutes in 2007, compared to 7,802 billion minutes in 2006. Average monthly usage per subscriber increased by 0.3% to 120.6 minutes in 2007, compared to 120.3 minutes in 2006, primarily due to the growth in originated traffic.

In terms of traffic from data transmission services, SMS increased by 50.0% during 2007 and there were an average of 83.0 SMS messages per month per user in 2007, 38.5% more than the average of 59.9 SMS messages per month per user in 2006. Traffic from WAP services supported by GPRS and UMTS networks increased by 262% in 2007.

### *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 90.1%, 9.2% and 0.7%, respectively, of TMN's revenues in 2007 and approximately 90.2%, 8.6% and 1.2%, respectively, of TMN's revenues in 2006. Monthly subscription fees range from €12.4 (+Perto; Plano; Extra 100) to €41.3 (Extra 500), 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. Further reductions in interconnection charges are expected should ANACOM issue a decision to that effect in 2008. In October 2007, ANACOM issued a draft decision that was submitted for the public consultation process, proposing significant further reductions in the mobile termination rates. These reductions have had, and are expected to continue to have, a significant impact on TMN's interconnection revenues and consequently its earnings.

### *Products and Marketing*

TMN offers a variety of innovative products. It was the first operator in the world to offer pre-paid services, and its prepaid and discount products are popular. We estimate that at the end of 2007, approximately 76% 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 34.6% increase in the number of postpaid subscribers in 2007 as a result of a promotional campaign aimed at stimulating a switch from prepaid to postpaid services and also as a result of continued marketing efforts directed at corporations and in the middle and high-end segment of the market.

TMN markets its services through more than 2,400 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 2007, TMN's digital network had 4,234 GSM base stations, including 53 base stations added during 2007, and 2,760 UMTS B nodes,

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including 533 B nodes added during 2007. As of December 31, 2007, these GSM base stations covered more than 98% of continental Portugal and 99% of the Portuguese population, and the UMTS B nodes covered approximately 51% of continental Portugal and 87% 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 2007, TMN had entered into GSM roaming agreements with a total of 387 operators (in 206 countries or regions), 197 GPRS roaming agreements (in 130 countries or regions) and 84 3G roaming agreements (in 50 countries or regions).

### *Equipment Sales*

TMN sells mobile phones and related equipment in Portugal. Equipment sales contributed €141.8 million, €129.7 million and €146.3 million to TMN's operating revenues in 2007, 2006 and 2005, 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. In 2007, TMN recorded a license cost of €233 million, corresponding to the present value of the contributions related to those information society initiatives that are not in the ordinary course of its business. 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. We believe these initiatives should increase PC and broadband penetration in Portugal, strengthening TMN's position in this key market segment.

### **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 33,484 thousand customers at December 31, 2007. We hold 50% of Vivo, which is a joint venture with Telefónica. The joint venture operates in 19 states in Brazil and in the Federal District of Brasília, which produced more than 83.1% of Brazil's GDP. Vivo had an estimated market share of approximately 36.7% in its areas of operation and 27.7% in Brazil at December 31, 2007. We believe that the joint venture facilitates our ability to serve our Brazilian subscribers on a seamless basis throughout Brazil.

### *History and Organizational Structure*

Until 2002, our mobile operations in Brazil, a country with a population of about 177 million people, had been active only in the states of São Paulo, Paraná and Santa Catarina. In January 2001, we entered into a strategic agreement with Telefónica Móviles (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 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."

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The diagram below presents the simplified ownership structure of Vivo as of December 31, 2007:

As of December 31, 2007, Brasilcel held 88.85% of the common shares of Vivo Participações, 47.76% of its preferred shares and 62.77% of its total share capital.

### *Acquisition of Telemig*

On August 2, 2007, Vivo signed a stock purchase agreement with Telpart Participações S.A. ("Telpart") to acquire control of Telemig Celular Participações S.A. ("Telemig") and Tele Norte Celular Participações S.A. ("Tele Norte") and 22.72% and 19.34%, respectively, of their total capital for an aggregate amount of R\$1.2 billion, subject to certain price adjustments. In addition, Vivo will acquire from Telpart certain subscription rights for R\$87 million.

Upon closing of the transaction, in accordance with Brazilian law, Vivo will launch mandatory tender offers for the acquisition of common shares held by non-controlling shareholders at 80% of the price paid for the controlling stake. The mandatory tender offers will be extended to Telemig, Telemig Celular (the mobile operator held by Telemig), Tele Norte and Amazônia Celular (the mobile operator held by Tele Norte). In addition, Vivo intends to launch voluntary tender offers for up to one-third of all classes of preferred shares held by the non-controlling shareholders in the holding and operating companies at a 25% premium to the weighted average price of the last 30 trading days up to August 1, 2007. Assuming full acceptance of all offers, Vivo will have acquired a beneficial interest of 58.2% in Telemig Celular and 54.6% in Amazônia Celular, for an aggregate consideration of approximately R\$2.9 billion (including the R\$1.2 billion amount described in the preceding paragraph and the value of the subscription rights). Telemig Celular and Amazônia Celular operate in the regions of Minas Gerais and Amazonia, respectively, and the transaction will therefore allow Vivo to increase its coverage and customer base.

On August 21, 2007, Vivo's shareholders approved the stock purchase agreement mentioned above. On November 6, 2007, ANATEL approved Telemig's acquisition by Vivo pursuant to Action (*Ato*) No. 68,401.

On December 20, 2007, Vivo announced that it signed a stock purchase agreement with Telemar, a Brazilian telecommunications company unrelated to either Telpart or Vivo, for the sale of all of the Tele Norte shares it was acquiring from Telpart under the stock purchase agreement dated August 2, 2007, in order to facilitate its acquisition of the shares of Telemig. Vivo decided to sell the Tele Norte shares in order to address an ANATEL concern regarding the acquisition. As a result, on March 5,

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2008, pursuant to Action (*Ato*) No. 1,261, ANATEL approved the transfer of shares of Tele Norte Participações to Vivo Participações and the subsequent transfer of those shares to Telemar.

The completion of the transaction is subject to shareholder approval of Telpart, Telemig, Telemig Celular, Tele Norte and Amazônia Celular, as well as to customary closing conditions.

### *Regions*

Vivo provides mobile telecommunications services on the A and B Band frequencies in 19 Brazilian states in addition to the federal district, representing a total of approximately 7.3 million square kilometers, or 85.6% of the Brazilian territory. This area includes more than 135.2 million people, representing 73.6% of Brazil's population (183.8 million people), and 212 municipalities with a population in excess of 100,000 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.

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	At December 31, 2007			Last Available IBGE Data		
	Frequency Range Band	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	39,838	21.7%	727,052	33.9%	17,997
Paraná state	A, L and J	10,279	5.6%	126,621	5.9%	12,339
Santa Catarina state	A, L and J	5,868	3.2%	85,295	4.0%	14,539
Goiás state	A, L and J	5,644	3.1%	50,536	2.4%	8,992
Tocantins state	A, L and J	1,248	0.7%	9,083	0.4%	6,957
Mato Grosso state	A, L and J	2,854	1.6%	37,466	1.7%	13,365
Mato Grosso do Sul state	A, L and J	2,265	1.2%	21,641	1.0%	9,557
Rondônia state	A, L and J	1,454	0.8%	12,902	0.6%	8,408
Acre state	A, L and J	653	0.4%	4,481	0.2%	6,692
Amapá state	B and J	585	0.3%	4,366	0.2%	7,344
Amazonas state	B and J	3,167	1.7%	33,359	1.6%	10,320
Maranhão state	B and J	6,117	3.3%	25,325		