

BRASIL TELECOM HOLDING CO  
Form 20-F  
June 14, 2005

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**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

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**FORM 20-F**

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**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004  
Commission file number: 001-14477**

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**BRASIL TELECOM PARTICIPAÇÕES S.A.**

(F/K/A (TELE CENTRO SUL PARTICIPAÇÕES S.A.)

(Exact Name of Registrant as Specified in Its Charter)

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**Brazil Telecom Holding Company**  
(Translation of Registrant's Name into English)

**The Federative Republic of Brazil**  
(Jurisdiction of Incorporation or Organization)

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**SIA/Sul, ASP, Lote D, Bloco B -  
71215-000 - Setor de Indústria, Brasília, DF, Brazil**  
(Address of Principal Executive Offices)

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**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
Preferred Shares, without par value represented by American Depositary Shares*	New York Stock Exchange

\* American Depositary Shares issuable upon deposit of Preferred Shares were registered under a separate registration statement on Form F-6

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

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

**Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by this Annual Report:**

At December 31, 2004 there were outstanding:

132,550,888,203 Common Shares, without par value  
226,007,752,980 Preferred Shares, without par value

**Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.**

Yes                      No

**Indicate by check mark which financial statement item the registrant has elected to follow:**

Item 17                      Item 18

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## TABLE OF CONTENTS

	<b>Page</b>
<u>PRESENTATION OF FINANCIAL INFORMATION</u>	<u>1</u>
<u>FORWARD-LOOKING INFORMATION CONTAINED IN THIS ANNUAL REPORT</u>	<u>2</u>
<u>PART I</u>	<u>4</u>
<u>ITEM 3. Key Information</u>	<u>4</u>
<u>Selected Financial Data</u>	<u>4</u>
<u>Exchange Rates</u>	<u>7</u>
<u>Risk Factors</u>	<u>8</u>
<u>ITEM 4. Information on the Company</u>	<u>19</u>
<u>History and Development of the Company</u>	<u>19</u>
<u>Capital Expenditures</u>	<u>26</u>
<u>Business Overview</u>	<u>27</u>
<u>Regulation of the Brazilian Telecommunications Industry</u>	<u>55</u>
<u>Property, Plant and Equipment</u>	<u>62</u>
<u>Environmental and Other Regulatory Matters</u>	<u>62</u>
<u>ITEM 5. Operating and Financial Review and Prospects</u>	<u>63</u>
<u>Overview of Results of Operations</u>	<u>63</u>
<u>U.S. GAAP Reconciliation</u>	<u>68</u>
<u>Critical Accounting Policies</u>	<u>69</u>
<u>New Accounting Pronouncements</u>	<u>72</u>
<u>Results of Operations for the Years Ended December 31, 2002, 2003 and 2004</u>	<u>73</u>
<u>Liquidity and Capital Resources</u>	<u>86</u>
<u>ITEM 6. Directors, Senior Management and Employees</u>	<u>93</u>
<u>Board of Directors and Senior Management</u>	<u>93</u>
<u>Board Practices</u>	<u>96</u>
<u>Corporate Governance Practices</u>	<u>99</u>
<u>Employees</u>	<u>99</u>
<u>Share Ownership</u>	<u>100</u>
<u>ITEM 7. Major Shareholders and Related Party Transactions</u>	<u>100</u>
<u>Major Shareholders</u>	<u>100</u>
<u>Related Party Transactions</u>	<u>104</u>
<u>ITEM 8. Financial Information</u>	<u>105</u>
<u>Consolidated Statements and Other Financial Information</u>	<u>105</u>
<u>Legal Proceedings</u>	<u>105</u>
<u>Dividend Policy</u>	<u>114</u>
<u>ITEM 9. The Offer and Listing</u>	<u>116</u>

**TABLE OF CONTENTS**  
(conitnued)

		<b><u>Page</u></b>
	<u>Offer and Listing Details</u>	<u>116</u>
	<u>Markets</u>	<u>119</u>
<u>ITEM 10.</u>	<u>Additional Information</u>	<u>121</u>
	<u>Memorandum and Articles of Association</u>	<u>121</u>
	<u>Material Contracts</u>	<u>121</u>
	<u>Exchange Controls</u>	<u>125</u>
	<u>Taxation</u>	<u>126</u>
	<u>Independent Auditors</u>	<u>132</u>
	<u>Documents on Display</u>	<u>132</u>
<u>ITEM 11.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>133</u>
	<u>Quantitative Information About Market Risk</u>	<u>133</u>
<u>PART II</u>		<u>136</u>
<u>ITEM 14.</u>	<u>Material Modifications to the Rights of Security Holders and Use of Proceeds</u>	<u>136</u>
<u>ITEM 15.</u>	<u>Controls and Procedures</u>	<u>136</u>
<u>ITEM 16A.</u>	<u>Audit Committee Financial Expert</u>	<u>136</u>
<u>ITEM 16B.</u>	<u>Code of Ethics</u>	<u>136</u>
<u>ITEM 16C.</u>	<u>Principal Accountant Fees and Services</u>	<u>136</u>
<u>ITEM 16E.</u>	<u>Purchases of Equity Securities by the Issuer and Affiliated Purchasers</u>	<u>137</u>
<u>PART III</u>		<u>138</u>
<u>ITEM 17.</u>	<u>Financial Statements</u>	<u>138</u>
<u>ITEM 18.</u>	<u>Financial Statements</u>	<u>138</u>
<u>ITEM 19.</u>	<u>Exhibits</u>	<u>138</u>
Omitted items of Form 20-F are either not required in a Form 20-F filed as an annual report, not applicable or reserved.		
	<u>INDEX OF DEFINED TERMS</u>	<u>140</u>
	<u>TECHNICAL GLOSSARY</u>	<u>141</u>
	<u>SIGNATURES</u>	<u>144</u>
	<u>INDEX TO EXHIBITS</u>	<u>145</u>

## PRESENTATION OF FINANCIAL INFORMATION

In this Annual Report, Brasil Telecom Participações S.A. (previously Tele Centro Sul Participações S.A) a corporation organized under the laws of the Federative Republic of Brazil, and its subsidiaries are referred to collectively as "our company," "we", "us" or the "Registrant." References to our company's businesses and operations are references to the businesses and operations of our company on a consolidated basis for the years 2002, 2003 and 2004.

References to (i) the "*real*," "*reais*" or "R\$" are to Brazilian *reais* (plural) and the Brazilian *real* (singular) and (ii) "U.S. dollars," "dollars" or "U.S.\$" are to United States dollars. All amounts in Brazilian currencies that existed prior to the adoption of the *real* as the Brazilian currency on July 1, 1994 have been restated in *reais*. On May 31, 2005, the Commercial Market selling rate (as defined in Item 3 "Key Information Selected Financial Data Exchange Rates") was R\$2.4038 to U.S.\$1.00 as published by the Brazilian Central Bank. The exchange rate information in this Annual Report should not be construed as a representation that any such amounts have been, would have been or could be converted at this or any other exchange rate.

Our audited consolidated financial statements were prepared in conformity with generally accepted accounting principles in Brazil ("Brazilian GAAP") which are similar to the Brazilian Corporation Law (Law 6404/76, as amended by Law 10.303/01), except for the effects of the recognition of inflationary effects from January 1, 1996 to December 31, 2000, and are consistent with the rules and regulations of the Brazilian Securities and Exchange Commission (CVM *Comissão de Valores Mobiliários*), and the accounting standards issued by the Brazilian Institute of Independent Auditors (*Instituto dos Auditores Independentes do Brasil* or "IBRACON"). Investors should note that financial statements prepared in accordance with Brazilian GAAP differ from financial statements prepared in accordance with Brazilian Corporation Law in the methodology used for the recognition of inflation, among other things. See Notes 2a and 2b to our audited consolidated financial statements for (i) a summary of the principal differences between Brazilian GAAP and Brazilian Corporation Law as they relate to us and (ii) a reconciliation from Brazilian Corporation Law to Brazilian GAAP of shareholders' equity as of December 31, 2002, 2003 and 2004 and net income (loss) for each of the years ended December 31, 2002, 2003 and 2004. Brazilian GAAP when applied to us differs in certain important respects from generally accepted accounting principles in the United States ("U.S. GAAP"). See Note 33 to our audited consolidated financial statements for (i) a summary of the principal differences between Brazilian GAAP and U.S. GAAP as they relate to us and (ii) a reconciliation to U.S. GAAP of shareholders' equity as of December 31, 2003 and 2004 and net income (loss) for each of the years ended December 31, 2002, 2003 and 2004. These audited consolidated financial statements are referred to herein as the "Financial Statements."

Our audited annual consolidated financial statements as of December 31, 2002, December 31, 2003 and December 31, 2004, and for each of the two years in the period ended December 31, 2003 and December 31, 2004 prepared in accordance with Brazilian GAAP with reconciliation of shareholders' equity and income statements to U.S. GAAP, included in this Annual Report, have been audited by KPMG Auditores Independentes, in accordance with the standards of the Public Company Accounting Oversight Board as stated in their report appearing in this Annual Report.

The "Index of Defined Terms" that begins on page 140 lists the page where each defined term is defined within this document. Technical terms are defined in the Technical Glossary on page 141.

Certain figures included in this Annual Report have been subject to rounding adjustments. Accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that precede them.

## **FORWARD-LOOKING INFORMATION CONTAINED IN THIS ANNUAL REPORT**

This Annual Report contains forward-looking statements. We may also make forward-looking statements in press releases and oral statements. Forward-looking statements are not statements of historical fact and involve known and unknown risks and uncertainties. The words "anticipates," "believes," "estimates," "expects," "forecasts," "intends," "plans," "predicts," "projects," "targets" and similar words are intended to identify these forward-looking statements.

In this Annual Report, we have made forward-looking statements with respect to, but not limited to:

- our marketing strategy;
- our ability to meet our network expansion, service quality and modernization obligations;
- our market share;
- our compliance with radiation standards;
- the reduction of our labor force;
- the payment of our debt;
- the material adverse financial effect of any labor, civil or tax claims arising out of acts committed by Telebrás prior to the effective date of the breakup of Telebrás;
- the retroactive application of state value-added taxes to certain services, including installation services, rendered during the five years preceding June 30, 1998;
- the growth in the customer base and products offered by cable television services providers in our region;
- our projected capital expenditures; and
- our liquidity.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Our future results and shareholder values may differ materially from those expressed in or suggested by these forward-looking statements. Many of the factors that will determine these results and values are beyond our ability to control or predict.

Because these forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements. These factors include:

- the performance of the Brazilian economy generally;
- the levels of exchange rates between Brazilian and foreign currencies;
- the telecommunications policy of Brazil's federal government;

- the growth of the Brazilian telecommunications industry as a whole;
- the introduction of competition to the Brazilian telecommunications industry in general and in our region in particular;

- the receipt of additional, and/or the revocation of our existing, governmental approvals and licenses;
- the availability of financing;
- the emergence of new technologies and the response of our customer base to those technologies;
- acquisition by us of other companies; and
- other factors discussed under Item 3 "Key Information Risk Factors."

The reader should not place undue reliance on any forward-looking statement. Forward-looking statements speak only as of the date they are made, and we do not undertake any obligation to update them in light of new information or future developments. Neither our independent auditors, nor any other independent accountants, have compiled, examined, or performed any procedures, with respect to the prospective financial information contained herein, nor have they expressed any opinion or any other form of assurance on such information or its achievability, and assume no responsibility for, and disclaim any association with the prospective financial information.

Information included in this Report concerning Brazil, Telecom Italia International N.V. ("TII"), Techold Participações S.A. ("Techold") and Timepart Participações Ltda. ("Timepart") and other direct and indirect shareholders has been included herein based on public filings or other sources we assume to be correct but we have not independently verified such information.

**PART I****ITEM 3. Key Information****Selected Financial Data*****Background***

The selected financial information presented herein should be read in conjunction with our Financial Statements and notes, which appear elsewhere in this Annual Report. Our selected financial information is presented on a combined consolidated basis for the year 2000 and on a consolidated basis for the years 2001, 2002, 2003 and 2004.

The following paragraphs discuss some important features of the presentation of the selected financial information and our Financial Statements. These features should be considered when evaluating the selected financial information.

***Brazilian GAAP and U.S. GAAP***

Our Financial Statements are prepared in accordance with Brazilian GAAP, which differ in certain significant respects from U.S. GAAP. See Note 33 to our Financial Statements for (i) a summary of the principal differences between Brazilian GAAP and U.S. GAAP as they relate to us, and (ii) a reconciliation to U.S. GAAP of shareholders' equity as of December 31, 2003 and 2004 and net income (loss) for each of the years ended December 31, 2002, 2003 and 2004.

***Effects of Inflation***

Unless otherwise specified, all financial information included in this Annual Report for the year 2000, recognizes certain effects of inflation and is restated in constant *reais* of December 31, 2000, all in accordance with Brazilian GAAP. We used the General Market Price Index, *Índice Geral de Preços de Mercado* ("IGP-M"), published by *Fundação Getúlio Vargas* for purposes of such restatement. However, pursuant to Brazilian GAAP, our audited financial statements as of and for the years commencing after December 31, 2000, no longer recognize the effects of inflation and are not restated in constant *reais*.

***Change in Accounting Methodology******Depreciation***

See Item 4 "Information on the Company Property, plant and equipment" and Item 5 "Operating and Financial Review and Prospects Operating Results Results of Operations for the Years Ended December 31, 2002, 2003 and 2004 Cost of Services Depreciation and Amortization."

***Difference from Financial Statements Published in Brazil***

Our statutory financial statements prepared in accordance with the Brazilian Corporation Law (the "Statutory Financial Statements") are the basis for dividend and tax determinations. Our audited consolidated financial statements for the year 2000 include the effects of inflation through December 31, 2000, while our Statutory Financial Statements include the effects of inflation only through December 31, 1995. See Notes 2a and 2b to our audited consolidated financial statements for (i) a summary of the principal differences between Brazilian GAAP and Brazilian Corporation Law as they relate to us and (ii) a reconciliation from Brazilian Corporation Law to Brazilian GAAP of shareholders' equity as of December 31, 2003 and 2004 and net income (loss) for each of the years ended



December 31, 2002, 2003 and 2004. Our Statutory Financial Statements also differ from our Consolidated Financial Statements in respect of certain reclassifications, and presentation of comparative information.

**Selected Financial Information****Year ended December 31,**

<b>Income Statement Data:</b>	<b>2000<sup>(1)</sup></b>	<b>2001<sup>(2)</sup></b>	<b>2002<sup>(2)</sup></b>	<b>2003<sup>(2)</sup></b>	<b>2004</b>
	(thousands of <i>reais</i> , except per share data)				
<b><i>Brazilian GAAP:</i></b>					
Net operating revenue	4,652,184	6,158,408	7,071,368	7,915,194	9,0
Cost of services	3,768,699	4,765,593	5,143,358	5,455,019	6,1
Gross profit	883,485	1,392,815	1,928,010	2,460,175	2,9
Operating expenses:					
Selling expenses	379,235	724,507	763,346	821,627	1,0
General and administrative expenses	534,624	624,751	687,462	865,052	1,0
Other net operating expenses (income)	(56,899)	60,875	(121,181)	211,308	69,1
Operating income (loss) before net financial expenses	26,525	(17,318)	598,383	562,188	729,8
Net financial expenses	(20,480)	47,051	330,460	610,159	399,8
Operating income (loss)	47,005	(64,369)	267,923	(47,971)	330,0
Net non-operating expenses (income)	(166,753)	85,167	78,312	550,022	111,7
Employee's profit share	18,516	52,783	42,619	3,510	58,0
Income (loss) before taxes and minority interests	195,242	(202,319)	146,992	(601,503)	160,2
Income and social contribution tax benefits (expenses)	(74,386)	87,347	(916)	261,390	5,8
Income (loss) before minority interests	120,856	(114,972)	146,076	(340,113)	166,0
Minority interests	31,456	75,720	2,397	171,466	(37,9)
Net income (loss)	152,312	(39,252)	148,473	(168,647)	128,1
Number of Common Shares (millions) <sup>(3)</sup>	124,369,030	128,459,878	130,971,517	132,550,888	132,550,888
Number of Preferred Shares (millions) <sup>(3)</sup>	219,863,511	219,863,511	219,863,511	222,670,188	226,007,753

Operating Income (loss) per thousand Common Shares ( <i>reais</i> ) <sup>(3)</sup>	0.38	(0.67)	2.05	(0.36)	2.49
Net income (loss) per thousand Common Shares ( <i>reais</i> ) <sup>(3)</sup>	(1.22)	(0.32)	1.13	(1.27)	0.97
Dividends per thousand Common Shares ( <i>reais</i> ) <sup>(3)</sup>	0.34	0.38	0.55	0.54	0.70
Dividends per thousand Common Shares (U.S. dollars) <sup>(3)(4)</sup>	0.17	0.17	0.16	0.19	0.26
Dividends per thousand Preferred Shares ( <i>reais</i> ) <sup>(3)</sup>	0.34	0.38	0.55	0.54	0.70
Dividends per thousand Preferred Shares (U.S. dollars) <sup>(3)(4)</sup>	0.17	0.17	0.16	0.19	0.26

(1) Presented in constant *reais* of December 31, 2000.

(2) Pursuant to Brazilian GAAP, our audited consolidated financial statements for the years ended December 31, 2002, 2003 and 2004 no longer recognize the effects of inflation after January 1, 2001 and are not restated in constant *reais*.

(3) See Note 3s to our Consolidated Financial Statements.

(4) Dividends per thousand shares were converted into dollars at the Commercial Market selling rate of R\$1.955 per U.S. dollar on December 31, 2000, of R\$2.32 per U.S. dollar on December 31, 2001, of R\$3.5333 per U.S. dollar on December 31, 2002, of R\$2.8892 per U.S. dollar on December 31, 2003 and of R\$2.6544 per U.S. dollar on December 31, 2004, respectively.

## Selected Financial Information (continued)

Year ended December 31,

Income Statement Data  
(continued)2000<sup>(1)</sup> 2001<sup>(2)</sup> 2002<sup>(2)</sup> 2003<sup>(2)</sup> 2004<sup>(2)</sup>(thousands of *reais*, except per share data)*U.S. GAAP:*

Net income (loss)	117,722	(133,894)	279,899	(8,347)	271,444
Net income (loss) per thousand shares ( <i>reais</i> ) <sup>(5)</sup> :					
Common Shares Basic	0.35	(0.39)	0.80	(0.02)	0.76
Common Shares Diluted	0.34	(0.39)	0.80	(0.02)	0.76
Preferred Shares Basic	0.35	(0.39)	0.80	(0.02)	0.76
Preferred Shares Diluted	0.34	(0.39)	0.80	(0.02)	0.76

(5) In accordance with Statement of Financial Accounting Standards ("SFAS") 128 "Earnings Per Share," basic and diluted earnings per share have been calculated, for U.S. GAAP purposes, using the "two class method." See Note 33e to our Consolidated Financial Statements.

At December 31,

2000<sup>(1)</sup> 2001<sup>(2)</sup> 2002<sup>(2)</sup> 2003<sup>(2)</sup> 2004<sup>(2)</sup>(thousands of *reais*)

## Balance Sheet Data:

*Brazilian GAAP:*

Intangibles <sup>(3)</sup>	472,680	372,536	470,544	531,556	896,713
Property, plant and equipment, net <sup>(4)</sup>	11,476,414	12,231,013	11,265,991	9,579,821	9,359,958
Total assets	16,695,102	16,399,570	17,154,721	16,636,543	18,721,897
Loans and financing current portion	1,187,221	448,778	591,874	1,696,958	856,638
Loans and financing non-current portion	2,354,060	2,699,466	3,584,293	2,093,044	3,851,591
Total liabilities (including funds for capitalization and minority interests)	9,550,008	9,666,203	10,491,289	10,375,112	12,593,407

Shareholders' equity	7,145,094	6,733,367	6,663,432	6,261,431	6,128,490
<b>U.S. GAAP:</b>					
Intangibles <sup>(5)</sup>	292,898	607,509	724,160	910,511	1,420,724
Property, plant and equipment, net	11,847,183	13,186,333	11,483,967	9,883,100	9,647,334
Total assets	16,584,762	16,673,834	17,626,319	17,318,777	19,533,284
Loans and financing current portion	1,048,542	307,621	470,462	1,502,689	600,280
Loans and financing non-current portion	2,354,060	2,699,466	3,389,399	1,847,501	3,622,527
Total liabilities (including funds for capitalization and minority interests)	9,457,843	9,794,184	10,817,968	10,736,513	12,916,913
Shareholders' equity	7,126,919	6,879,650	6,808,351	6,582,264	6,616,371

- 
- (1) Presented in constant *reais* of December 31, 2000.
  - (2) Pursuant to Brazilian GAAP, our audited consolidated financial statements at December 31, 2001, 2002, 2003 and 2004 no longer recognize the effects of inflation after January 1, 2001 and are not restated in constant *reais*.
  - (3) Includes the goodwill from our acquisition of a controlling stake in CRT, which was calculated based on book value.
  - (4) Stated at indexed cost up to December 31, 2000, less accumulated depreciation. See Note 3g to our Consolidated Financial Statements.
  - (5) Intangibles under U.S. GAAP, up to 2003, include the step-up goodwill paid by Solpart Participações S.A. ("Solpart") as a consequence of the exchange of shares between companies under our common control pursuant to our merger with Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR. Intangibles under U.S. GAAP also include the goodwill from our merger with Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR and our merger with CRT at December 31, 2000, 2001, 2002, 2003 and 2004, and amounts relating to our PCS licenses at December 31, 2002, 2003, and 2004. See Note 33o to our Consolidated Financial Statements.

## Exchange Rates

Until March 14, 2005, there were two principal foreign exchange markets in Brazil: the commercial rate exchange market (the "Commercial Market") and the floating rate exchange market (the "Floating Market"). Most foreign trade and financial foreign currency exchange transactions were carried out on the Commercial Market. Purchases of foreign exchange in the Commercial Market could be carried out only through a financial institution authorized to buy and sell currency in that market. The Floating Market rate generally applied to transactions to which the Commercial Market rate did not apply.

Aside from the two mentioned principal exchange markets, there was also a market for international transfers in *reais* TIRs, which followed its own rules. Due to the enactment of Resolution 3265 of the National Monetary Council ("CMN") on March 4, 2005, the exchange markets were unified in a single market. Additional rules were issued on March 9, 2005. The market expects the new regulation to provide a more flexible environment and foster foreign investment in Brazil. The potential impact of the new rules is still uncertain. Prior to February 1, 1999, the exchange rate in each market was established independently, resulting in different rates during some periods. Since February 1, 1999, the Central Bank authorized the unification of the exchange positions of the Brazilian financial institutions in the Commercial Market and Floating Market, which led to a convergence in the pricing and liquidity of both markets. However, each market continued to have a specific regulation. Most trade and financial transactions were carried out on the Commercial Market. The foreign currencies may only be purchased through a Brazilian financial institution authorized to operate in the market. Rates are freely negotiated but may be strongly influenced by Central Bank intervention.

Under the *Real* Plan ("*Real* Plan"), on July 1, 1994, the *real* was introduced as the official unit of Brazilian currency, with each *real* having an exchange rate of R\$1.00 to U.S.\$1.00. The issuance of *reais* was initially subject to quantitative limits backed by a corresponding amount of U.S. dollars in reserves, but the government subsequently expanded those quantitative limits and allowed the *real* to float, with parity between the *real*/U.S. dollar (R\$1.00 to U.S.\$1.00) as a ceiling.

Since January 15, 1999 the *real* has been allowed to float freely. In 2000, the *real* devalued by 9.3% against the U.S. dollar to R\$1.9554. Further deterioration in the political and economic environment in 2001, in addition to the Brazilian energy crisis, resulted in the *real* devaluing by 18.7% against the U.S. dollar in that year. In the final quarter of 2001, however, the *real* appreciated by 13.1% from R\$2.6713 per U.S. \$1.00 at September 30, 2001 to R\$2.3204 per U.S.\$1.00 on December 31, 2001.

In 2002, as a reaction to political and economic uncertainties, the global economic downturn, the crisis in Argentina and the Brazilian presidential elections, the U.S. dollar appreciated by 52.3% against the *real* to R\$3.5333 per U.S.\$1.00 at December 31, 2002. The *real* recovered in 2003, appreciating by 18.2% to R\$2.8892 per U.S.\$1.00, at December 31, 2003. In 2004, the *real* appreciated by 8.1% against the U.S. dollar, quoted at R\$2.6544

per U.S.\$1.00 on December 31, 2004. We cannot assure you that the *real* will not substantially devalue again in the future. See " Risk Factors Risks Relating to Brazil."

As of May 31, 2005, the Commercial Market selling rate published by the Brazilian Central Bank was R\$2.4038 per U.S.\$1.00.

### ***Commercial Market Selling Rate for U.S. Dollars***

The following table sets forth the reported high and low Commercial Market selling rates for U.S. dollars for the months indicated.

	<b>High</b>	<b>Low</b>
December 2004	2.7867	2.6544
January 2005	2.7222	2.6248
February 2005	2.6320	2.5621
March 2005	2.7621	2.6011
April 2005	2.6598	2.5195
May 2005	2.5146	2.3784

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Source: Brazilian Central Bank

The following table sets forth the reported high and low, average and period-end Commercial Market selling rates for U.S. dollars for the annual periods indicated. The average Commercial Market selling rates represent the average of the month-end commercial market selling rates (R\$/U.S.\$) during the relevant period.

<b>For the Year Ended December 31,</b>	<b>High</b>	<b>Low</b>	<b>Average</b>	<b>Period End</b>
2000	1.985	1.723	1.835	1.955
2001	2.801	1.936	2.352	2.320
2002	3.955	2.271	2.915	3.533
2003	3.662	2.822	3.060	2.889
2004	3.205	2.654	2.926	2.654

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Source: Brazilian Central Bank

Brazilian law provides that, whenever there is a serious imbalance in Brazil's balance of payments or reliable information to foresee such an imbalance, temporary restrictions may be imposed on remittances of foreign capital abroad. We cannot assure you that these types of measures will not be taken by the Brazilian government in the future. See " Risk Factors Risks Relating to Brazil."

### **Risk Factors**

The following are risk factors that relate materially to our company and to an investment in our Preferred Shares or ADSs. Our business, results of operations or financial condition could be harmed if any of these risks materialize and, as a result, the trading price of our Preferred Shares or ADSs could decline and a holder of those securities could lose



a substantial portion or all of his investment.

***Risks Relating to Our Company***

*Regulatory developments could affect our services, including placing restrictions on the rates we charge for our services, which could adversely impact our business*

Our business, including the services that we provide and the rates that we charge, is subject to comprehensive regulation under Brazilian law. Our ability to retain our concessions is a precondition to our success,

but in light of the regulatory framework, it is possible that the terms of our concessions could be modified in an adverse manner.

Under Brazilian law, public -regime companies, like our company, must have the rates that they charge for products and services approved by Agência Nacional de Telecomunicações ("Anatel"). On June 20, 2003, Anatel enacted Resolution 341, which provides for new types of Anatel concession contracts, effective from January 1, 2006 until 2025. The new form of concession contract provides for changes in the way in which rates are set. For example, the General Price Index - Internal Availability, *Índice Geral de Preços Disponibilidade Interna* (IGP-DI), will no longer be used to determine the annual inflation-based adjustments to rates. Private -regime companies that compete with us do not require Anatel approval when setting their rates and may unilaterally determine the prices that they charge for their services. As a result, adverse changes in Brazilian telecommunications regulations and non-approval or even delays in the approval of rate changes by Anatel could adversely impact our operations and competitive position.

On May 12, 2004, the Consumer Defense Committee of the House of Representatives approved a bill of law proposing the termination of the monthly subscription fees charged for fixed-line services by the Brazilian telephone concessionaires, including Brasil Telecom S.A. The bill is still subject to the approval of other Committees within the House of Representatives, the Senate and President Lula's signature. Should this bill be approved, it will have an impact on our current rate structure and, as a result, our operations and competitive position could be adversely impacted.

*We are subject to financial covenants and other contractual provisions under our existing indebtedness. Failure to comply with these provisions could adversely affect our business and financial condition.*

The agreements that govern our debt, including our credit facilities with the National Bank for Social and Economic Development ("*Banco Nacional de Desenvolvimento Econômico e Social*" - BNDES), contain a number of significant covenants that could adversely impact our business. In particular, the terms of these agreements restrict our ability, and the ability of our subsidiaries, to incur additional debt, make capital expenditures, grant liens, pledge assets, sell, or dispose of, assets and make certain acquisitions, mergers and consolidations. Furthermore, in accordance with a number of our debt agreements, including our credit facilities with BNDES, we are required to comply with these covenants and maintain certain specified financial ratios in order to maintain the current maturity dates for these debt agreements.

During December 2004, we initiated a process of adjustment of the covenants of certain agreements with BNDES, in order to fit them to the new reality of the telecommunications sector and of our company.

In the loan agreement signed during 2004, BNDES and Brasil Telecom S.A. introduced a new mechanism pursuant to which the failure by Brasil Telecom S.A. to comply with the financial covenants, instead of giving the right to BNDES to accelerate the whole debt, gives it the right to request the retention of funds in an amount equivalent to three times the highest installment due under such agreement. If Brasil Telecom S.A., after the retention, fails again in complying with the financial covenants, then BNDES will have the right, but not the obligation, to declare the acceleration of the debt. The negotiation mentioned above includes the extension of these remedies to all BNDES agreements to which we are a party.

On December 20, 2004, the financial institutions involved in the agreement approved the changes requested by the Company and forwarded the process to BNDES. BNDES approved these changes on February 1st, 2005, with validity as from December 31, 2004. If we had not obtained the referred approval from BNDES, we would not be in compliance with the covenant related to the level of our EBITDA margin, as defined in such loans and financing contracts.

Compliance with these covenants in future periods will depend upon our financial and operating performance, which may be affected by adverse business, market and economic conditions. If we are unable to comply with these covenants, or to obtain waivers from our lenders, the maturity dates of our debt agreements may be accelerated and the terms of our debt agreements may be otherwise amended adversely. If we are unable to meet our debt service obligations or comply with our debt covenants, we could be forced to restructure or refinance our

indebtedness, seek additional equity capital or sell assets. See Item 5 "Operating and Financial Review and Prospects Liquidity and Capital Resources Indebtedness."

*Certain beneficial shareholders control a large percentage of our voting shares, and their interests may conflict with the interests of our other shareholders, including minority shareholders. Disputes among our controlling shareholders and entities that manage our controlling shareholders have had and could in the future have a material adverse effect on our management and operations.*

## CONTROL ISSUES

We are controlled by Brasil Telecom Participações S.A., which is in turn controlled by Solpart Participações S.A. ("Solpart"), the ownership of which is held by Timepart, Techold and TII. As the controlling shareholder of Brasil Telecom Participações S.A., Solpart has the power to modify our business plan, modify our dividend plan and sell our material assets. As of the date of this annual report, control of Solpart as well as certain actions taken by Solpart shareholders are the subject of a number of judicial proceedings.

On March 9, 2005, International Equity Investments Inc, as the sole shareholder of CVC/Opportunity Equity Partners LP (since renamed Citigroup Venture Capital International Brazil, LP) which holds a stake in Brasil Telecom Participações S.A. and Opportunity Zain S.A. ( Zain ), a company which integrates the controlling corporate structure of Brasil Telecom Participações S.A. and Brasil Telecom S.A. - ("CVC LP"), sent a public notice informing about the ousting of CVC/Opportunity Equity Partners, Ltd ("CVC Ltd") currently named Opportunity Equity Partners, Ltd. from the management of CVC LP, having designated as a substitute, a new company incorporated abroad, named Citigroup Venture Capital International Brazil LLC ("CVC International Brazil"). CVC LP in compliance with CVM/SEP/GEA-2 Written Notice 225/05 and the terms of CVM Instruction 358, informed us that:

- In March 2005, International Equity Investments, Inc. and the CVC LP entered into certain agreements with Investidores Institucionais Fundo de Investimento em Ações ( Investidores Institucionais FIA ), Caixa de Previdência dos Funcionários do Banco do Brasil Previ ( Previ ), Fundação dos Economistas Federais Funcef ( Funcef ) and Fundação Petrobras de Seguridade Social Petros ( Petros ), including the Shareholders Agreement of Zain, as announced in the material fact published on 03.11.05 (collectively, the Agreements ).
- The Agreements establish that the CVC LP and the Investidores Institucionais FIA, with combined shareholdings of around 90% of the voting and total capital of Zain, will conjunctly perform the corporate control of such company and Invitel S.A. ( Invitel ), a company controlled by Zain with about 68% of its voting and total capital, and in which Previ, Funcef, Petros and other non-publicly held pension entities hold nearly the totality of the remaining voting and total capital. The Agreements also establish that the parties are to attempt to disinvest, under identical terms, conjunctly and in an organized manner, their shareholdings in Zain and Invitel, companies which control, among other companies, our company, Brasil Telecom S.A. and 14 Brasil Telecom Celular S.A.
- In the context of the execution of the Agreements, Previ, Funcef and Petros signed the Put Option on Shares Issued by Zain Agreement, granting the CVC LP a put option on its Zain shares, which may be exercised in a limited period of time, but not before November 2007. If and when the CVC LP exercises its put option, a right conditioned to the occurrence of future and uncertain events, some of which are out of the control of the CVC LP, Investidores Institucionais FIA, Previ, Funcef and Petros, the exercise price is to be set to R\$1,045,941,692.43, adjusted by the variation of the IGP-DI Index + 5% p.a.. The fulfillment of the conditions to the exercise of such put option granted by Previ, Funcef and Petros does not depend or is tied to the occurrence of any operation or business involving, directly or indirectly, property or other assets owned by Zain, Invitel or any of their controlled companies, among which, our company, Brasil Telecom S.A. and 14

Brasil Telecom Celular S.A.

On April 12, 2005, Anatel issued a decision approving among other things (i) the replacement of CVC Ltd by CVC International Brazil as manager of CVC LP; (ii) Angra Partners Consultoria Empresarial e Participações Ltda. as the new manager of Investidores Institucionais FIA, one of the indirect controlling shareholders of Brasil Telecom S.A. and (iii) the changes resulting from the Zain and Futeretel S.A. Shareholders' Agreements. This decision was published in the Federal Gazette (*Diário Oficial*) on April 14, 2005. After reviewing our appeal, Anatel upheld its decision dated April 12, 2005.

On October 6, 2003, Fundação 14 de Previdência Privada ( Fundação 14 ), successor to Fundação Sistel de Seguridade Social, was prevented by the other shareholders from exercising its voting rights during the Investidores Institucionais FIA's Unitholders Meeting. At the said meeting, Banco Opportunity S.A. was ousted from the administration of Investidores Institucionais FIA. In consequence of this event, Fundação 14 brought an ordinary action before the 5th Federal Court of Rio de Janeiro against several defendants, seeking a declaration that the resolutions adopted at the Investidores Institucionais FIA's Unitholders Meeting held on October 6, 2003 were invalid. At the date of this annual report, this matter continues to be the subject of judicial proceedings. Recently, the same plaintiff brought a motion for preliminary relief before the Court as an incidental proceeding to the ordinary action against the same defendants ets of Investidores Institucionais FIA, including agreements for the sale, encumbrance and/or acquisition of interests by the fund. On April 13, 2005, a preliminary order was issued suspending the effects of any acts for the alienation or encumbrance of Investidores Institucionais FIA assets, or the acquisition of interests by the Fund until a subsequent decision, which will be issued after the defendants have submitted their arguments.

Pending the resolution of the disputes described above, our Board of Directors may be unable to act on matters of importance to us,

### ISSUES ARISING OUT OF OVERLAP OF LICENSES WITH TIM

TII is controlled by Telecom Italia S.p.A. ("Telecom Italia"). Telecom Italia acquired, through various subsidiaries now consolidated into TIM Brasil Serviços e Participações S.A., ("TIM"), authorizations to deploy personal communication service ("PCS") in the whole country, including Region II, where we provide fixed-line services. Because our company and TII were deemed to be affiliates, TIM could not exploit the PCS authorizations before January 1, 2004 unless either Telecom Italia ceased to be our affiliate or we achieved sooner our 2003 universalization targets. In order to allow TIM to exploit its PCS licenses, TII, Techold and Timepart agreed to amend the shareholders agreement dated July 19, 1998, (as amended, the "Solpart Agreement") on August 27, 2002. Following the amendment, TII was not a controlling shareholder or affiliate of our company but retained a right to reacquire such an interest under certain circumstances.

Since we received certification of our compliance with the 2003 targets established by Anatel, we have begun offering national and international fixed-line services as well as mobile services. If TII were to reacquire an indirect controlling interest in our company, our company and TIM would be deemed affiliates under Brazilian telecommunications law, and our ability to offer national and international fixed-line services as well as mobile services in the same regions as TIM would be at risk of being terminated by Anatel. On January 16, 2004 Anatel issued an Act (the Anatel Decree ) pursuant to which Anatel consented to an 18 month period during which TII may reacquire an indirect controlling interest in our company, provided TII does not participate or vote in any matters related to the overlapping services offered by our company and TIM such as national and international long distance fixed-line services as well as mobile services. If, after the 18-month period (expiring July 18, 2005), our company and Telecom Italia did not reach an agreement which resolved the overlap, Anatel reserved the right to impose sanctions on any or all involved parties. Depending on Anatel's final decision, these sanctions could have a material adverse effect on our business and operations.

Additionally, ANIMEC (the Brazilian Association of Investors of Capital Markets) filed an injunction before the Conselho Administrativo de Defesa Econômica ("CADE") (Brazil's Antitrust Authority) to prevent TII from acquiring an indirect controlling interest in our company. On March 17, 2004, the injunction was granted by unanimous decision and TII appealed CADE's decision. In June 2004, CADE issued a new injunction granting TII the right to return to our control group so long as TII does not participate or vote in any matters related to the overlapping services or nominate any officers. To date, this matter remains unresolved since there is still an act of concentration on Anatel's analysis, which assembles all the demands presented by TII and/or its opponents, and that will return to CADE's analysis after Anatel's decision.

In order to eliminate the regulatory risk associated with the overlapping of licenses between TII and us and add value to our shareholders, our subsidiary 14 Brasil Telecom Celular S.A. ( BTC ) and Brasil Telecom S.A., and TII and TIM Brasil Serviços e Participações S.A. ( TIMB ), and collectively with TII the TIM Group ) entered into a Merger Agreement and a related Protocol (collectively, the Merger Agreement ) on April 28, 2005. Among other things this transaction guarantees the settlement of the overlapping of licenses and authorizations with the TIM Group so as to avoid potential sanctions and penalties to be imposed by Anatel. Pursuant to the Merger Agreement BTC will merge into TIMB and we will receive shares in the resulting TIMB company, the size of such interest to be determined based on appraisals of relative value to be performed by an international investment banking firm hired by us. In addition TIMB will surrender to Anatel and enter into preferred provider arrangements and operational agreements with our company for those services as well as other telecommunications services and products of mutual interest, which will allow us to continue to offer convergence services to our clients. The completion of the Merger is subject to the fulfillment of certain conditions precedent, including our Board of Directors and Anatel prior approvals. Despite our attempt to resolve the regulatory issue of overlapping licenses and authorizations (including those for national and international long distance services, as well as mobile services), certain indirect shareholders have filed judicial actions preventing the consummation of the Merger Agreement. The Merger is currently subject to various judicial

injunctions (see below).

Concurrently with the signing of the Merger Agreement, the Solpart Agreement was amended to restore TII to the control block of Solpart, our company, and Brasil Telecom S.A. This was implemented by a second amendment to the Solpart Agreement restoring certain rights of TII and allowing TII to restore a 38% ownership position in Solpart. As of the date of the filing of this annual report, this restoration is also being contested by judicial proceedings.

- 11 -

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As a result of entering into these various agreements, we agreed to settle existing disputes relating to TII's acts and omissions that caused material damages to our company. This agreement to settle is at the date of this annual report being contested judicially by certain indirect shareholders.

### LAWSUITS AND INJUNCTIONS AFFECTING OUR OPERATIONS

There are currently lawsuits pending seeking to block the Merger Agreement. As of the date of this filing a preliminary injunction has been issued by the Court pending further hearings preventing implementation of the Merger or the accomplishment of any extraordinary managerial act, without prior consent of the Board of Directors and approval through a general shareholders meeting. To similar effect we became aware that a preliminary injunction has been issued by the United States District Court, Southern District of New York preventing Opportunity Equity Partners, Ltd. and persons acting in concert with them from taking any action enforcing the Merger Agreement or the other agreements entered into at the same time or entering into any agreement or transaction outside the ordinary course of business involving any entity in which the CVC LP has a direct or indirect interest (this would include the Company).

We are unable to predict the outcome of these disputes, whether the Merger will be accomplished while these actions are pending and whether the overlap of licenses will be resolved without the application by Anatel of any sanctions or penalties. Our ability to offer national and international fixed-line services and/or mobile services in the same regions as TIM are at risk of being terminated by Anatel if the transactions contemplated by the Merger Agreement involving our wireless operations and the surrender by TIMB of long distance licenses are not allowed to be completed by July 18, 2005.

In addition, the disputes among the shareholders of Solpart including with respect to the ownership structure of Solpart, and management of entities which hold a stake in Brasil Telecom Participações S.A. and Zain, a company which integrates the controlling corporate structure of Brasil Telecom Participações S.A. and Brasil Telecom S.A may result in changes to our board and/or senior management.

*We face increasing competition in all segments of the Brazilian telecommunications industry, and the telecommunications industry may not continue to grow or may grow at a slower rate. This may have a material adverse effect on our market share, margins, results of operations and financial condition*

The telecommunications industry in Brazil is becoming increasingly competitive. Our public-regime fixed-line concessions are not exclusive, and Anatel could grant additional private-regime authorizations in our region. Our fixed-line services are also subject to competition from wireless service providers, however such competition is still limited by the fact that rates for wireless calls are currently much higher than rates for calls on our fixed-line network. We also face competition from wireless service providers in the low end of the market through the offer of prepaid plans by such wireless providers. To date, Telemar Norte Leste S.A. ("Telemar"), Empresa Brasileira de Telecomunicações S.A. ("Embratel"), Intelig Telecomunicações Ltda ("Intelig"), Telecomunicações de São Paulo S.A. ("Telesp"), Global Village Telecom ("GVT"), Telmex do Brasil Ltda ("Telmex"), Fonet Brasil Ltda ("Fonet"), and Novação Telecomunicações Ltda ("Novação") have been granted permission by Anatel to provide local fixed telecommunications services in the totality of our Region. Additionally, to date, TNL PCS S.A. ("Oi"), Embratel, Intelig, Telesp, GVT, Albra Telecomunicações Ltda ("Albra"), TIM Celular S.A. ("TIM"), and Easystone Telecomunicações Ltda ("Easystone") have been granted permission by Anatel to provide long distance telecommunications services in the totality of our Region. The certification of other service providers' compliance with universalization and expansion targets permits other service providers to operate in our region. Now we also have to compete in our region against competitors from outside of our region that offer fixed-line, mobile, data local and/or long distance telecommunications services throughout Brazil. Increased competition could have a material adverse effect on our market share, margins, results of operations and financial condition. Since January 2004, we have the



ability to counteract losses in market share in the local fixed-line market by providing telecommunications services in other regions.

In September 2004, we commenced offering our wireless services. Wireless services are equally competitive and we face competition in Region II from (i) a joint venture between Telefônica and Portugal Telecom (marketing under the brand name "Vivo"), (ii) Telmex, which competes against us in our region through América Móviles (marketing under the brand name "Claro"), (iii) TIM, (iv) Sercomtel Celular, and (v) CTBC Celular. Competition for wireless telecommunications customers may require us to increase our costs and marketing expenses or provide services at lower rates than those we currently expect to charge for such service. . If we are able

to complete the transactions contemplated by the Merger Agreement, then we will not be offering wireless services directly but will participate in this business through the acquisition of an equity interest in TIMB, which as of April 28, 2005, had approximately 14.6 million wireless users. The Merger Agreement also contemplates operational agreements through which we will be able to continue to offer convergence services.

Competition in data transmission services is not subject to regulatory restriction. The market is open to a great number of competitors. Increased competition in data transmission services may require us to reduce the rates we charge for data transmission services.

In addition, the Brazilian telecommunications industry is consolidating, which results in larger competitors with greater resources. There can be no assurance that increased competition in all segments of the Brazilian telecommunications industry will not have a material adverse effect on our market share, margins, results of operations and financial condition.

Our ability to continue to compete successfully will depend on the success of our marketing, financial and other resources (including our access to capital) in comparison to our competitors and on our ability to anticipate and respond to competitive factors affecting the industry, including the introduction of new services, changes in consumer preferences, changes in regulation, demographic trends, economic conditions, discount pricing strategies by competitors as well as further industry consolidation. Currently, we compete with our competitors primarily on the basis of features, pricing and customer service. However, we cannot predict exactly which factors in the future will be important in maintaining our competitive position, such as the increasing need to offer promotions, discounts and other marketing initiatives, or what expenditures will be required to develop and provide the necessary technologies, products and services to remain competitive. This may adversely affect our market share, margins, results of operations and financial condition.

In addition, we may also face increased competition due to unbundling regulations. On May 13, 2004, Anatel issued Order (*Despacho*) 172, which establishes rules for partial ("line sharing") and full unbundling of local telephone networks and requires us to make our networks available to other telecommunications service providers. This legislation limits the rate we can charge for line sharing per line for broadband speeds of up to 512kbps. Additional charges, such as co-location, are applied over the line sharing base price, increasing the total cost of the unbundled line. Anatel has not yet fixed rates for full unbundling, although we expect that these rates will be lower than the rates we currently are permitted to charge. This regulation was designed to increase competition in the local fixed-line and broadband internet access markets by making it easier for new telephone companies operating under either the public or private regime to enter these markets and for existing providers to provide new services or enter new regions, since the networks of all telecommunications service providers, including fixed-line operators such as us, will be made available at lower rates. Similarly, this legislation makes it easier for us to provide new services and enter into new regions in competition with other operators. However, operational rules for the implementation of unbundling have not yet been agreed among Brazilian telecommunications operators. These regulations are recent and as of December 31, 2004, no unbundled lines had been used by competitors in our region. We cannot assure that we can compete without suffering an adverse impact on market share, margins, results of operations or financial condition based on the implementation of unbundling.

Any economic, technological or other developments resulting in a slowdown in growth or a reduction in demand for our fixed-line or other services may harm our business and revenues. To remain competitive we must diversify further our services, and there can be no assurance that we will be successful in doing so.

*We depend on other telecommunications services providers. We may not be able to enter into favorable interconnection and unbundling agreements*

In order to receive or send calls from or to customers of other fixed-line and wireless Brazilian networks and international networks, we must interconnect with the networks of our competitors. The Brazilian General Telecommunications Law requires all telecommunications service providers to interconnect their networks with those of other providers on a non-discriminatory basis. The rates to be paid by one network operator to the other for the use of each other's network are currently regulated by Anatel.

The current interconnection model is asymmetric, with higher rates in effect for mobile interconnection than fixed-line interconnection. As a result, mobile operators generally retain more than 80% of net revenues from fixed-to-mobile calls, while fixed-line carriers, like us, usually offer this service incurring negative margins. In light of such imbalance, Anatel established that from July 2004, interconnection rates for wireless networks (the VU-M) would be freely negotiated. Nevertheless, the Brazilian network operators have not been fully successful in negotiating and reaching acceptable interconnection agreements; if telecommunications companies cannot agree on interconnection rates and conditions, Anatel may, by mediation, arbitration or intervention, establish the terms of such interconnection agreements. Our operating and financial results may be adversely affected in case we are not able to negotiate favorable interconnection agreements.

*The failure to implement the technology necessary to assess and combat fraud on our network could adversely affect our results of operations*

The fraudulent use of telecommunications networks imposes a significant cost upon service providers, who must bear the cost of services provided to fraudulent users. We suffer loss of revenue as a result of fraudulent use, and also cash costs due to our obligation to reimburse carriers for the cost of services provided to fraudulent users. During 2004, we installed a Fraud Management System to detect and prevent fraud. In addition to the system to monitor customers' usage based on their traffic behavior, we implemented a system to keep subscribers under close surveillance. The fraud system is based on a signaling network and has an interface to the call-blocking platform in order to limit revenue loss once fraudulent use has been identified.

In addition, there can be no assurance that all operators with which our network is interconnected have appropriate anti-fraud treatment in their networks. In 2001, we created a fraud management department to provide specialized customer service to customers affected by fraud. During the fiscal year 2002, several automated procedures were created and placed in various parts of our operations to detect and control possible abnormalities that could represent fraudulent activities. These controls have a preventive function, and work both pro-actively and, should a fraud occur, reactively. In 2003, we implemented controls to capture fraud events automatically, such as a non-billing mechanism for fraud-blocked terminals, a cut-off limit system for service usage, and a webpage to gather any fraud claim from the community. At the end of 2003, we created the IT Revenue Assurance Group, which develops systems to assist the revenue assurance department in fraud combating. During 2004, the Group implemented a significant number of applications to monitor and detect fraud in different areas including public telephony, bad debt, revenue chain, key performance indicators and others. These actions achieved a better level of control and mitigated the risk of loss from fraud as compared to previous years. The levels of accuracy and effectiveness of these procedures have reached the desired and expected performance for fraud control. Notwithstanding, we continue to deploy and implement the technology necessary to assess the accuracy and effectiveness of our fraud combative procedures. Should we not be able to correctly quantify and combat fraud on our network, our results of operations could be adversely affected.

In September 2004, Anatel issued Order (*Ofício*) 603, which established that fraudulent calls should not be considered for purposes of payment of interconnection rates.

*Developments in the global telecommunications industry and technology are difficult to predict, and a failure by us to respond to such developments may have a material adverse effect on our financial condition and results of operations*

All companies in the global telecommunications industry must adapt to rapid and significant changes in technology that are often difficult to anticipate. While we have been upgrading our network with technologically advanced fiber optic cable with a microwave overlay, it is possible that our network will be challenged by competition from improved or new technologies in the future. Technological changes may adversely affect our competitive position, require substantial new capital expenditures and/or require write-offs of obsolete technology.



*In the event of a natural disaster, war, significant public disturbance or for economic reasons, the Brazilian government could temporarily seize or permanently expropriate our assets, which could have a material adverse effect on our financial condition and results of operations*

The Brazilian government has the authority to temporarily seize all assets related to telecommunications concessions in the event of natural disaster, war, significant public disturbance, threats to internal peace, or for economic reasons and other reasons related to national security. In addition, the Brazilian government has the statutory right to permanently expropriate any telecommunications concession and claim any related assets for reasons of public interest. Brazilian law provides for compensation in connection with losses and damages related to temporary seizure or expropriation. However, in the event of a temporary seizure or expropriation of any of our assets there can be no assurance that the actual compensation paid would be adequate or that such payment would be timely. This would have a material adverse effect on our financial condition and results of operations.

### ***Risks Relating to Brazil***

*Brazilian political and economic conditions have a direct impact on our business and the market price of the Preferred Shares underlying the ADSs*

Substantially all of our operations and customers are located in Brazil. Accordingly, our financial condition and results of operations are substantially dependent on Brazil's economy, which has been characterized by frequent and occasionally drastic intervention by the Brazilian government and volatile economic cycles in the past. In 2004 the *real* appreciated in value by 8.1% in relation to the U.S. dollar, from R\$2.8892 per U.S. dollar on December 31, 2003 to R\$2.6544 per U.S. dollar on December 31, 2004. In 2004, the Central Bank raised Brazil's base interest rate by a total of 1.25 percentage points in an effort to stabilize the currency and decrease inflationary pressures. In the past, the Brazilian government has often changed monetary, fiscal, taxation and other policies to influence the course of Brazil's economy. We have no control over, and cannot predict, what measures or policies the Brazilian government may take in response to the current Brazilian economic situation or how Brazilian government intervention and government policies will affect the Brazilian economy and, both directly and indirectly, our operations and revenues.

Our operations, financial condition and the market price of our Preferred Shares and ADSs may be adversely affected by changes in policy involving exchange controls, tax and other matters, as well as factors such as:

- fluctuations in exchange rates;
- base interest rate fluctuations;
- inflation; and
- other political, diplomatic, social and economic developments within and outside Brazil that affect the country.

The Brazilian government may impose restrictions on capital outflow that would hinder or prevent the custodian in Brazil, or non-Brazilian holders who have exchanged ADSs for the underlying Preferred Shares, from converting the proceeds relating to the Preferred Shares into U.S. dollars and remitting those proceeds abroad. Brazilian law permits the government to impose these restrictions whenever there is a serious imbalance in Brazil's balance of payments or reasons to foresee such a serious imbalance. Although there is no current material imbalance in Brazil's balance of payments, there can be no assurance that such an imbalance will not arise in the future or that the Brazilian government will not institute more restrictive exchange control policies in the future. See Item 10 "Additional Information Taxation Brazilian Tax Considerations."

On January 1, 2003, Luiz Inácio Lula da Silva from the Labor Party took office as the new President of Brazil. Until now, the economic policies of former President Fernando Henrique Cardoso have been continued by the current administration of the Brazilian government. Although the new government has not departed

significantly from previous policies, and the *Real* appreciated 8.1% against the U.S. dollar during 2004, concerns remain about future policies of the Brazilian government. While the current administration's policies have to date not been adverse to the telecommunications industry, the uncertainty over what policies the current Brazilian government may propose or adopt in the future, may have an impact on our business and may contribute to economic uncertainty in Brazil and to heightened volatility in the Brazilian international securities markets and thus have an impact on our business.

*If Brazil experiences substantial inflation in the future, our revenues and the market price of the Preferred Shares and ADSs may be reduced*

Brazil has in the past experienced extremely high rates of inflation, with annual rates of inflation reaching as high as 2,489.1% in 1993 (according to the Brazilian National Consumer Price Index (*Índice Nacional de Preços ao Consumidor*) published by the IBGE). Inflation itself and governmental measures to combat inflation have in the past had significant negative effects on the Brazilian economy. Inflation, actions taken to combat inflation and public speculation about possible future actions have also contributed to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets. If Brazil experiences substantial inflation in the future, our costs may increase, and our gross profit may be affected to the extent that our rate increases and our net operating revenues do not keep up with the rate of inflation.

*Devaluation of the real may lead to substantial losses on our liabilities denominated in or indexed to foreign currencies and a reduction in our revenues*

The Brazilian Central Bank has periodically devalued the Brazilian currency during the last four decades. The exchange rate between the *real* and the U.S. dollar has varied significantly in recent years. For example, the *real*/U.S. dollar exchange rate fell from R\$1.9554 per U.S. dollar at December 31, 2000 to R\$3.5333 at December 31, 2002. In 2003, the *real* has strengthened against the U.S. dollar. At December 31, 2003 the *real*/U.S. dollar exchange rate was R\$2.8892 per U.S. dollar. In 2004 the *real* appreciated in value by 8.1% in relation to the U.S. dollar to R\$2.6544 per U.S. dollar.

A significant amount of our financial assets and liabilities are denominated in or indexed to foreign currencies, primarily U.S. dollars. When the Brazilian currency is devalued, we incur losses on our liabilities denominated in or indexed to foreign currencies, such as our U.S. dollar-denominated long-term debt and foreign currency loans, and experience gains on our monetary assets denominated in or indexed to foreign currencies, as the liabilities and assets are translated into *reais*. If devaluation occurs when the value of such liabilities significantly exceeds the value of such assets, including any financial instruments entered into for hedging purposes, we could incur significant reduction in our revenues, even if their value has not changed in their original currency. This could adversely affect our ability to meet certain of our payment obligations.

*We are subject to delays and delinquency on accounts receivable*

Our business is affected by customers' ability to pay their bills. If the Brazilian economy worsens because of, among other factors:

- the level of economic activity;
- inflation;
- devaluation of the *real*; or



- an increase in domestic interest rates,

a greater portion of our customers may not be able to pay their bills, which would increase our bad debts and provisions for doubtful accounts. Strict regulation from Anatel prevents us from implementing certain policies that could have the effect of reducing delinquency, such as service restrictions or limitations on the types of services provided based on a subscriber's credit record. Losses from accounts receivable reached R\$410.3 million in 2004,

against R\$298.0 million in 2003, increasing in percentage of gross revenues terms, from 2.7% in 2003 to 3.2% in 2004. However, if economic conditions worsen in Brazil or if we are unable to implement policies to limit subscriber delinquencies or otherwise select our customers, persistent subscriber delinquencies and bad debt can adversely affect our financial results. See "Item 5. Operating and Financial Review and Prospects Critical Accounting Policies and Estimates Provision for Doubtful Accounts."

*Any increase in taxes levied on the telecommunications sector could affect the results of our operations. Tax reform will be gradually implemented in the following years.*

Increases in Brazil's already high level of taxation could adversely affect our profitability. Increases in taxes for the telecommunications sector usually result in higher tariffs for our customers. High tariff levels generally result in lower levels of usage of our services and, therefore, lower net sales. Lower net sales result in lower margins because a significant portion of our costs are fixed and thus do not vary substantially based on the level of usage of our network or our services. There can be no assurance that the Brazilian government will not increase current tax levels, at state and/or federal levels, and that this will not adversely impact our business.

In December 2003, the Federal Senate approved part of the tax reform bill that had been under discussion for eight months. The text approved by the Senate was consolidated in Constitutional Amendment 42, enacted on December 19, 2003. Constitutional Amendment 42 is already in force, and provides for an extension on the assessment of the Provisional Contribution of Financial Transfers (*Contribuição Provisória sobre Movimentação Financeira - "CPMF"*), the assessment of *Programa de Integração Social* ("PIS"); and *Contribuição para Financiamento da Seguridade Social* ("COFINS") taxes on import transactions, and the assessment of COFINS under a non-cumulative regime.

Some important issues originally provided for in the tax reform bill relate to: (i) harmonization of ICMS tax rules, which would be governed by a single federal legislation applicable to all states; (ii) equalization of ICMS rates; and (iii) limitations on granting tax incentives. If approved, such measures shall be gradually adopted in 2005 and 2007. The delay in the approval and implementation of the tax reforms bill may negatively affect the Brazilian economy and capital markets. For a further discussion of the impact of taxation on our business, see "Item 10. Additional Information Taxation."

*The proposed changes in Brazilian labor law may affect labor relations*

In April 2003, the Lower House reopened the discussions regarding the changes in the Brazilian Labor Law (*Consolidação das Leis do Trabalho*, or CLT). A revision of union relations in Brazil is also being discussed. It is not clear whether the proposed changes, if approved by the Congress, would impact our business in the future.

*It may be difficult to effect service of process upon, or to enforce foreign judgments upon us, our directors and our officers*

We are organized under the laws of Brazil, and all of our directors and officers reside outside the United States. In addition, a substantial portion of our assets, and most or all of the assets of our directors and officers are located in Brazil. As a result, it may be difficult for an ADS holder to effect service of process within the United States or other jurisdictions outside of Brazil upon our company or such persons, or to enforce against them judgments of courts in the United States, predicated upon the civil liability provisions of the federal securities or other laws of the United States.

***Risks Associated with Our Preferred Shares or American Depositary Shares***

*Holding Preferred Shares in ADS form may subject the holder to several risks and may jeopardize certain rights relating to voting, dividends and distributions, and preemptive rights, among others, that such holder would otherwise enjoy as a holder of Preferred Shares*

- In the limited circumstances where holders of Preferred Shares are able to vote, an ADS holder will be able to exercise voting rights with respect to the Preferred Shares represented by ADSs only in

accordance with the provisions of the deposit agreement relating to the ADSs. There are practical limitations upon and ADS holder's ability to exercise voting rights due to the additional procedural steps involved in communicating with such holders. See Item 7 "Major Shareholders and Related Party Transactions Major Shareholders" and Item 10 "Additional Information Memorandum and Articles of Association Voting Rights."

- If an ADS holder is a resident of the United States, it may not be able to exercise preemptive rights, or exercise other types of rights, with respect to our Preferred Shares. An ADS holder's ability to exercise preemptive rights is not assured unless a registration statement is effective with respect to those rights or an exemption from the registration requirements of the U.S. Securities Act of 1933, as amended (the "Securities Act"), is available. We are not obligated to file a registration statement relating to preemptive rights with respect to our Preferred Shares. Moreover, there can be no assurance that we will file any such registration statement. If a registration statement is not filed and an exemption from registration does not exist, Citibank, N.A., as depositary (the "Depositary"), will attempt to sell the preemptive rights, and the ADS holder will be entitled to receive its share of the proceeds of the sale. However, the preemptive rights will expire if the Depositary cannot sell them. For a more complete description of preemptive rights with respect to our Preferred Shares, see Item 10 "Additional Information Memorandum and Articles of Association."
- Payments of cash dividends and distributions, if any, will be made in Brazilian currency to Banco Itaú S.A., as custodian for the ADS holders' Preferred Shares, on behalf of the Depositary, which will then convert such proceeds into U.S. dollars and will cause such U.S. dollars to be delivered to the Depositary for distribution to such ADS holders. Holders of ADSs could be adversely affected by devaluations of the Brazilian currency that may occur due to delays in, or a refusal to grant any, required government approval for conversions of Brazilian currency payments and remittances abroad in connection with the Preferred Shares underlying our ADSs. See Item 10 "Additional Information Memorandum and Articles of Association Dividends."
- We may agree with the Depositary to modify the deposit agreement at any time without the ADS holders' consent. We undertake to give holders of ADSs 30 days' prior notice of any modifications that would materially prejudice any of their substantial rights under the deposit agreement. ADS holders will be bound by the modifications to the deposit agreement if such holders continue to hold ADSs after the modifications to the deposit agreement become effective.

*Holder of ADSs may have fewer and less well-defined shareholders' rights than in the United States*

Our corporate affairs are governed by our Bylaws and Brazilian Corporation Law, which may differ from the legal principles that would apply if we were incorporated in a jurisdiction in the United States. Under Brazilian Corporation Law, the holders of our Preferred Shares and our ADSs may have fewer and less well defined rights to protect their interests relative to actions taken by our board of directors or the holders of our Common Shares than under the laws of other jurisdictions outside Brazil.

Restrictions on insider trading and price manipulation, rules and policies against self-dealing and regarding the preservation of shareholder interests may not be as detailed, well-established and enforced in Brazil as in the United States, potentially disadvantaging the holders of our Preferred Shares and/or ADSs. For example, when compared to Delaware corporation law, Brazilian Corporation Law and practice has less detailed and well-established rules, and judicial precedents relating to the review of management decisions involving duty of care and duty of loyalty standards in the context of corporate restructurings, transactions with related parties, and sale-of-business transactions. In addition, shareholders in Brazilian companies must hold at least 5.0% of the outstanding share capital of a corporation in order to have standing to bring shareholders' derivative suits, and shareholders in Brazilian companies ordinarily do not have standing to bring class action suits.



*The relative volatility and illiquidity of the Brazilian securities markets may substantially limit an ADS holder's ability to sell the Preferred Shares underlying the ADSs at the price and time desired*

Brazilian investments, such as investments in our securities, are subject to economic and political risks, including, among others:

- changes in the regulatory, tax, economic and political environment; and
- restrictions on foreign investment and on repatriation of capital invested, that may affect the ability of investors to receive payment, in whole or in part, in respect of their investments.

The Brazilian securities markets are substantially smaller, less liquid, more concentrated and more volatile than major U.S. and European securities markets, and are not as highly regulated or supervised as these markets. The relatively small capitalization and the illiquidity of the Brazilian equity markets may substantially limit an ADS holder's ability to sell the Preferred Shares underlying the ADSs.

*Developments in other countries may affect the Brazilian economy, and the market price of the Preferred Shares and the ADSs*

The securities of Brazilian issuers have been influenced by economic and market conditions in other countries, especially other emerging market countries. Since the end of 1997, and in particular during 2001 and 2002, the international financial markets have experienced significant volatility as a result of economic problems in various emerging market countries. Investors subsequently have had a heightened risk perception for investments in such markets. As a result, in some periods, Brazil has experienced a significant outflow of U.S. dollars and Brazilian companies have faced higher costs for raising funds, both domestically and abroad, and have been impeded from accessing international capital markets. We cannot assure investors that international capital markets will remain open to Brazilian companies, including Brasil Telecom S.A., or that prevailing interest rates in these markets will be advantageous to us and our ability to obtain additional financing on acceptable terms or at all. As a consequence, the market value of our securities may be adversely affected by these or other events outside of Brazil. See Item 9 "The Offer and Listing Offer and Listing Details." There can be no assurances that future events elsewhere, especially in emerging market countries, will not have an adverse effect on the market value of our Preferred Shares and our ADSs.

*Changes in Brazilian tax laws may have an impact on the taxes applicable to the disposition of the ADSs*

According to Law 10,833, enacted on December 29, 2003, the disposition of assets located in Brazil by non-residents of Brazil, whether to other non-residents of Brazil or Brazilian residents and whether made within or outside Brazil is subject to taxation in Brazil. Considering the general and unclear scope of Law 10,833 and the absence of judicial guidance in respect thereof, we are unable to predict how the scope of Law 10,833 would be interpreted in the courts of Brazil.

#### **ITEM 4. Information on the Company**

##### **History and Development of the Company**

We are one of the fixed-line telecommunications companies that resulted from the breakup and privatization of Telebrás by the Brazilian Federal Government in 1998. We are an amalgamation of the following operating companies formerly controlled by *Telebrás: Telecomunicações de Santa Catarina S.A. Telesc ("Telesc"), Telecomunicações de Goiás S.A. Telegoiás ("Telegoiás"), Telecomunicações de Brasília S.A. Telebrasília ("Telebrasília"), Telecomunicações do Mato Grosso S.A. Telemat ("Telemat"), Telecomunicações do Mato Grosso do*

*Sul S.A. Telems ("Telems"), Telecomunicações de Rondônia S.A. Teleron ("Teleron"), Telecomunicações do Acre S.A. Teleacre ("Teleacre"), Companhia Telefônica Melhoramento e Resistência*

CTMR ("CTMR"), and our predecessor, *Telecomunicações do Paraná S.A. Telepar* ("Telepar") and CRT, a company formerly controlled by Telefônica S.A. and acquired by us in July 2000.

Our principal executive office is located at SIA/Sul, ASP, Lote D, Bloco B 71215-000 *Setor de Indústria e Abastecimento*, Brasília, DF, Brazil, and our telephone number is (55-61) 415-1140. Our agent in the United States is CT Corporation System, located at 111 Eighth Avenue, 13th floor, New York, New York 10011.

### ***Historical Background***

Prior to the incorporation of Telebrás in 1972, there were more than 900 telecommunications companies operating throughout Brazil. Between 1972 and 1975, Telebrás acquired almost all the other telephone companies in Brazil and thus came to have a monopoly over the provision of public telecommunications services in almost all areas of the country. Beginning in 1995, the Federal Government undertook a comprehensive reform of Brazil's telecommunications regulatory system. In July 1997, Brazil's National Congress approved the *Lei Geral de Telecomunicações* (the "General Telecommunications Law," and together with the regulations, decrees, orders and plans on telecommunications issued by Brazil's Executive Branch, the "Telecommunications Regulations"), which provided for the establishment of a new regulatory framework, the introduction of competition and the privatization of Telebrás.

The General Telecommunications Law established Anatel as the regulator of the telecommunications industry in Brazil. Anatel is administratively independent from the Brazilian Government and financially autonomous. Anatel is required to report on its activities to the Ministry of Communications and to the Brazilian Congress on an annual basis. In addition, any proposed regulation of Anatel is subject to a period of public comment, including public hearings. Anatel's decisions may be challenged in the Brazilian courts. Among its functions are the following:

- to propose the implementation or elimination of services in the public regime;
- to manage the spectrum of radio frequency and the use of orbits;
- to settle conflicts of interest among the companies that render telecommunications services;
- to protect and defend the users' rights;
- to prevent, control and impose penalties of the economic order, in the telecommunications industry;
- to impose restrictions, limits or conditions on corporate groups in obtaining or transferring the concessions, permissions and authorizations, in order to ensure a competitive environment; and
- to establish the rate structure for each kind of service rendered in the public regime.

On January 30, 1998, in preparation for the restructuring and privatization of Telebrás, the cellular telecommunications operations of Telebrás' operating subsidiaries were spun off into separate companies. On May 22, 1998, Telebrás was restructured to form, in addition to Telebrás, 12 new holding companies by means of a procedure under Brazilian Corporation Law called *cisão*, or split-up. These new holding companies were allocated virtually all the assets and liabilities of Telebrás, including the shares held by Telebrás in its operating companies. The split-up of Telebrás into 12 new holding companies is referred to herein as the "breakup of Telebrás."

These holding companies, together with their respective subsidiaries, consisted of (i) eight cellular service providers, each operating in one of the regions into which Brazil has been divided for purposes of cellular



telecommunications services in the frequency range formerly used by each of the former operating companies of Telebrás, (ii) three regional fixed-line service providers, each providing local and intraregional long-distance service in one of the three regions into which Brazil has been divided for purposes of fixed-line telecommunications, and (iii) Embratel, which provides domestic (including intraregional and interregional) long-distance telephone service and international telephone service throughout Brazil.

Set forth below are maps of Brazil showing the locations of the fixed-line, long-distance regions and cellular regions into which the country was split-up following the breakup of Telebrás:

*Brasil Telecom Participações S.A* is one of the three holding companies providing local and long-distance services in Brazil. See Item 7 "Major Shareholders and Related Party Transactions Major Shareholders." In the breakup of Telebrás, Brasil Telecom Participações S.A. was allocated all the share capital held by Telebrás in Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre, CTMR and Telepar, our predecessor; companies which provided fixed-line telecommunications service in the northern, western, central and southern

regions of Brazil. See " Business Overview Our Region." In July 1998, the Federal Government sold all its voting shares of these holding companies, including the shares it held in Brasil Telecom Participações S.A. to private sector buyers. The sale of all of the Federal Government's voting shares in the holding companies to private sector buyers is referred to herein as the "privatization of Telebrás." As a result of the merger of Telepar, Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre, CTMR and CRT, ultimately turning into our subsidiary Brasil Telecom S.A., we became the leading local and intraregional fixed-line telecommunications service provider in our region. The only other relevant fixed-line telecommunications service provider in our region is Global Village Telecom (Sercomtel and CTBC also operate partially in our region but we do not service the same cities). For intraregional long-distance telecommunications services, Intelig and Embratel, among others, are providers that are authorized to provide long-distance services in our region.

The other major telecommunications operators which were created as a result of the privatization of Telebrás are: Telemar which is our mirror telecommunications service provider in Region I, Telesp which is our mirror telecommunications service provider in Region III, and, Embratel which provides domestic and international long-distance service throughout Brazil. We, Telemar, Telesp, and Embratel all operate pursuant to public concessions granted by Anatel.

Since the privatization of Telebrás, Anatel has continued to implement regulations which further its policy of promoting competition and quality of service in the Brazilian telecommunications market place. As part of this policy initiative, Anatel has allowed new private competitors into the Brazilian market to compete directly against us. In addition, Anatel required us and the other public concession service providers to meet certain quality and universalization targets before we could compete in other service providers' market areas. On January 19, 2004, we received certification by Anatel that we have accomplished our universalization targets. Accordingly, we are now authorized to offer local fixed and domestic and international long-distance telephone services, originated inside or outside our region as well as mobile services in our region. The certification of other service providers' compliance with universalization and expansion targets permits other service providers to operate in our region.

### *History of Our Company*

The following bullet points briefly illustrate the history of our company:

- November 27, 1963: Telepar was incorporated as a corporation under the laws of Brazil.
- June 5, 1975: The control of our company was transferred to the Brazilian government and we became a subsidiary of Telebrás.
- May 22, 1998: Restructuring of Telebrás System, with the creation of Tele Centro Sul Participações S.A. (currently Brasil Telecom Participações S.A.), a holding company of Telesc, Telepar, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR.
- July 29, 1998: Solpart acquired Tele Centro Sul Participações S.A. (currently Brasil Telecom Participações S.A.), from the Brazilian government in the privatization process of Telebrás.
- February 28, 2000: The concessionaires Telesc, Telepar, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR, controlled by Tele Centro Sul Participações S.A., currently Brasil Telecom Participações S.A., were reorganized and merged into Telepar and became a single company.
- April 28, 2000: We changed our corporate name from Tele Centro Sul Participações S.A to Brasil Telecom Participações S.A. and our subsidiary changed its corporate name from Telecomunicações do Paraná

S.A.-Telepar to Brasil Telecom S.A.

- July 5, 2000: Brasil Telecom Participações S.A.'s ADSs were listed on the New York Stock Exchange and started trading under new symbol "BRP."

- 22 -

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- July 31, 2000: Brasil Telecom S.A acquired 98.8% of the corporate capital of TBS Participações S.A. ("TBS"), a company controlled by Telefônica, which held 85.2% of the voting capital of CRT, representing 31.6% of the total share capital of CRT, for approximately R\$1,500.0 million. CRT was the leading fixed-line telecommunications service company in the state of Rio Grande do Sul. The acquisition of CRT was financed partly through the use of Brasil Telecom S.A own cash reserves, as well as through the domestic placement of commercial paper of approximately R\$900.0 million.
- December 28, 2000: TBS was merged into CRT, and immediately afterwards CRT was merged with and into Brasil Telecom S.A. Pursuant to our merger with CRT, minority shareholders of CRT were given the right to exchange their CRT shares for Preferred Shares and Common Shares of Brasil Telecom S.A. The exchange of shares was made based on the market value of Brasil Telecom S.A's shares compared to those of CRT.
- November 1, 2001: BrT Serviços de Internet S.A. ("BrTSi"), a wholly-owned subsidiary of our company, acquired 15.4% of the total capital stock of iBest Holding Corporation, for approximately R\$10.0 million.
- November 16, 2001: Brasil Telecom S.A listed ADSs evidencing its Preferred Shares on the New York Stock Exchange.
- December 5, 2001: Brasil Telecom S.A acquired 19.9% of the capital stock of Vant, a leading corporate data solutions provider, for R\$3.9 million from AESCOM Sul Ltda. and Luiz Cruz Schneider together with an option to purchase the remaining 80.1% after certification by Anatel of compliance with the 2003 targets stipulated in our concession contracts.
- May 9, 2002: Brasil Telecom Participações S.A. and Brasil Telecom S.A joined the Special Corporate Governance Level 1 of the São Paulo Stock Exchange ("BOVESPA").
- June 3, 2002: Brasil Telecom Participações S.A.'s shares listed on BOVESPA and started trading under new symbols: "BRTP" for Common Shares and "BRTP4" for Preferred Shares. Brasil Telecom S.A shares listed on BOVESPA and started trading under new symbols: "BRTO3" for Common Shares and "BRTO4" for Preferred Shares.
- December 18, 2002: Brasil Telecom S.A acquired licenses for the personal communications system ("PCS") for R\$191.5 million through the auction held on November 19, 2002. The minimum price was R\$182.9 million and Brasil Telecom S.A paid a premium of 3.6%.
- February 18, 2003: Brasil Telecom S.A announced the acquisition of 19.9% of the capital of MTH Venturas do Brasil Ltda. ("MTH"), a company that holds 99.99% of the capital of MetroRED Telecomunicações Ltda. ("MetroRED"), for U.S.\$17.0 million together with an option to purchase the remaining 80.1% of the capital of MTH for U.S.\$51.0 million after certification by Anatel of compliance with the 2003 targets stipulated in our concession contracts.
- June 11, 2003: Brasil Telecom S.A acquired, through BrTSi, the entire submarine fiber-optic cable system from GlobeNet Communications Group Ltd. for U.S.\$46.8 million. A total of U.S.\$27.6 million was paid on June 11, 2003, with the remaining U.S.\$19.2 million payable within 18 months of the first installment.
- June 26, 2003: Brasil Telecom S.A acquired the remaining capital of iBest Holding Corporation for U.S.\$36.0 million.

- January 19, 2004: Anatel certified that we had met our universalization targets and authorized us to provide interregional long-distance services throughout Brazil and international long-distance services, also from any point in the country. We also received authorization to offer local services outside our original concession area and to offer mobile services in our region.

- March 17, 2004: CADE issued a provisory decision determining that TII, one of our former controlling shareholders, could not return to Brasil Telecom's block of control.
- May 13, 2004: Brasil Telecom S.A purchased the remaining 80.1% of the capital of MTH for U.S.\$51.0 million which was only possible once we received certification of our compliance with the 2003 targets stipulated by Anatel in our concession contracts.
- May 13, 2004: Brasil Telecom S.A purchased the remaining 80.1% capital of Vant for R\$15.6 million which was only possible once we received certification of our compliance with the 2003 targets stipulated by Anatel in our concession contracts.
- September 27, 2004: Brasil Telecom S.A began offering wireless telecommunications services through our subsidiary 14 Brasil Telecom Celular S.A., under the brand name "Brasil Telecom GSM".
- November 24, 2004: Brasil Telecom S.A. concluded the acquisition of approximately 63% of iG's capital stock, for U.S.\$104.9 million. Considering that we already held, indirectly, 10% of iG's total capital, both companies now hold approximately 73% of the total capital of iG.
- April 28, 2005: Brasil Telecom S.A. entered into an agreement with TIM providing for the merger into TIMB of our subsidiary through which we provide wireless services. TIMB agreed to surrender their overlapping long distance licenses and to use us as a preferred provider for national and international long distance services as well as for other telecommunications services and products. TII returned to our control group. (See Risk Factors - Risks Relating to Our Company for a discussion of current obstacles to these transactions.)

### ***Organizational structure***

Brasil Telecom Participações S.A. is structured as a holding company, and conducts substantially all of its operations through its only and wholly owned subsidiary Brasil Telecom S.A. Brasil Telecom S.A. currently has four subsidiaries, BrT Serviços de Internet S.A., 14 Brasil Telecom Celular S.A., Vant Telecomunicações S.A. and MTH Ventures do Brasil Ltda., and Brasil Telecom S.A. is subdivided into eleven operational branches, Tocantins, Goiás, Acre, Rondônia, Mato Grosso, Mato Grosso do Sul, Paraná, Santa Catarina, Rio Grande do Sul, Pelotas and the Federal District. For information on our shareholding structure, please see Item 7 "Major Shareholders and Related Party Transactions - Major Shareholders." The following chart sets forth a summary of our organizational structure, including the percentage of total capital held in each of our indirect significant subsidiaries as of December 31, 2004. All of our indirect significant subsidiaries are organized and existing under the laws of the Federative Republic of Brazil, except for Brasil Telecom Subsea Cable Systems (Bermuda) Ltd. incorporated under the laws of Bermuda, Brasil Telecom of America Inc. incorporated under the laws of the United States of America, Brasil Telecom de Venezuela S.A. incorporated under the laws of Venezuela, and Internet Group (Cayman) Limited and iBest Holding Corporation, incorporated under the laws of the Cayman Islands.

*BrT Serviços de Internet S.A.*

We formed BrTSi in October 2001. Through BrTSi, we provide broadband internet services through our internet service provider ("ISP") BrTurbo and data center services. BrTSi is also the parent company of our free internet service providers iG and iBest.

*iBest*

In November 2001, BrTSi acquired 15.4% of iBest Holding Corporation for approximately R\$10.0 million. iBest Holding Corporation controlled iBest S.A. ("iBest"), a free internet service provider and important brand name. On June 26, 2003, we acquired through our wholly owned subsidiary, BrTSi, the remaining capital of iBest Holding Corporation for U.S.\$36.0 million, consolidating our 100% ownership of iBest. The iBest Group was composed by the following main entities: (i) iBest Holding Corporation; (ii) iBest S.A.; (iii) Febraio S.A.; and (iv) Freelance S.A. On May 31st, 2004, a corporate reorganization of the iBest Group was concluded, and Freelance fully incorporated Febraio S.A., iBest S.A. and its subsidiary Mail BR Comunicações Ltda. Freelance S.A. became the owner of iBest's trademark, and is now the operating company of the Group.

*iG*

In November 2004, we concluded the acquisition of approximately 63% of iG's capital stock, for U.S.\$104.9 million. Considering that Brasil Telecom Participações S.A. already held, indirectly, 10% of iG's total capital, both companies now hold approximately 73% of the total capital of iG. iG is the leading dial-up internet service provider in Brazil. The acquisition of iG made us the largest internet company in Latin America.

*Grupo BrT Cabos Submarinos (Submarine Fiber-Optic Cable System)*



On June 11, 2003, Brasil Telecom S.A. acquired the entire submarine fiber-optic cable system from GlobeNet Communications Group Ltd which we now refer to as Grupo BrT Cabos Submarinos (former GlobeNet), for U.S.\$46.8 million. A total of U.S.\$27.6 million was paid on June 11, 2003, with the remaining U.S.\$19.2 million payable within 18 months of the first installment. As of December 31<sup>st</sup>, 2004 there was an outstanding balance of U.S.\$12.0 million to be paid until April 30, 2005. Grupo BrT Cabos Submarinos is formed by five operating subsidiaries: Brasil Telecom Cabos Submarinos (Holding) Ltda., Brasil Telecom Cabos Submarinos Ltda., Brasil Telecom of America, Inc., Brasil Telecom Subsea Cable Systems (Bermuda) Ltd. and Brasil Telecom de Venezuela, S.A. These companies own and operate the Grupo BrT Cabos Submarinos fiber optic

cable system that connects the United States, Bermudas, Brazil and Venezuela. Brasil Telecom of America, Inc. is headquartered in Boca Raton, Florida, and coordinates all Grupo BrT Cabos Submarinos's activities and supports the commercial activities of the group in the international market. Grupo BrT Cabos Submarinos is also the parent company of iG, our internet service provider.

#### *14 Brasil Telecom Celular S.A*

14 Brasil Telecom Celular S.A. ("Brasil Telecom GSM") is Brasil Telecom S.A.'s mobile telephony services subsidiary, which became operational on September 27, 2004. Brasil Telecom GSM offers wireless telecommunications services using Global System for Mobile Communications ("GSM") technology under the brand name "Brasil Telecom GSM". See " Business Overview Wireless Services." Brasil Telecom S.A. has entered into the Merger Agreement with TIMB, pursuant to which we have agreed to merge Brasil Telecom GSM into TIMB in return for an ownership interest in TIMB, the size of such interest to be determined based on appraisals of relative value to be performed by an international investment banking firm hired by us. (See Risk Factors - Risks Relating to Our Company for a discussion of current obstacles to these transactions)

#### *Vant Telecomunicações S.A.*

On May 13, 2004, Brasil Telecom S.A. exercised its option to purchase for R\$15.6 million the remaining 80.1% of the capital of Vant, giving Brasil Telecom S.A 99.99% of the capital of Vant. This purchase was made possible once we received certification by Anatel of our compliance with our 2003 universalization targets. Vant offers internet protocol as well as other products to the corporate market throughout Brazil.

#### *MetroRED Telecomunicações Ltda.*

On May 13, 2004, Brasil Telecom S.A exercised its option to purchase for U.S.\$51.0 million the remaining 80.1% of the capital of MTH, giving Brasil Telecom S.A 99.99% of the capital of MTH. This purchase was made possible once we received certification by Anatel of our compliance with our 2003 universalization targets. MetroRED is a leading local fiber optic network provider, with 343 kilometers of local network in São Paulo, Rio de Janeiro and Belo Horizonte, and a 1,600 kilometer long-distance network linking these three metropolitan areas as well as an internet solutions data center in São Paulo which will provide internet support to our customers. As part of the acquisition, we also integrated a management team with expertise in these markets.

### **Capital Expenditures**

The following table sets forth our capital expenditures on plant expansion and modernization for each of the years ended December 31, 2002, 2003 and 2004.

	<b>Year ended December 31,</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
	(millions of <i>reais</i> )		
Conventional Telephony	416.5	302.8	179.7
Data Network	231.3	264.9	300.0
Network Operation	372.8	251.6	270.2
Information Technology	366.8	210.1	216.1
Other <sup>(1)</sup>	618.5	651.4	725.7

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Total	Fixed Telephony	2,005.9	1,680.8	1,691.7
Total	Mobile Telephony	-	109.2	1,175.7
Total capital expenditures		2,005.9	1,790.0	2,867.4

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(1) These investments include the acquisition of PCS licenses, the acquisition of Grupo BrT Cabos Submarinos, MetroRED, iBest, Vant and IG, and investments to replace plant equipment and other fixed assets generally without altering the capacity of the assets replaced and certain investments in operational and technical support such as telecommunications management network systems and expansion projects.

Our capital expenditures increased approximately 60.2% to R\$2,867.4 million in the year ended December 31, 2004, from R\$1,790.0 million for the corresponding period in 2003. Of our total capital expenditures, R\$1,215.6 million relate to fixed telephony and internet operations, R\$1,175.7 million to mobile telephony operations and R\$476.1 million to acquisitions. The capital expenditures on the expansion and modernization of our fixed telephony operations consist mainly of updating technology and upgrading capacity in relation to our transmission backbone, switching centers, data network and intelligent network.

#### *Expected Capital Expenditures on Plant Expansion and Modernization*

We currently expect to invest approximately R\$2,166.0 million in the expansion and modernization of our network during the fiscal year 2005, which includes investments of approximately R\$398.0 million in our mobile telephone network. Considering that Brasil Telecom S.A. has entered into a Merger Agreement, investments in our mobile telephone network are subject to change. See *Risk Factors - Risks Relating to Our Company* for a discussion of current obstacles to these transactions. Of our total expected capital expenditures, R\$500.0 million relate to targets established by Anatel and required under the terms and conditions of our concessions. This amount may be revised by our board of directors once ongoing negotiations with Anatel come to an end. See Item 5 "Operating and Financial Review and Prospects *Liquidity and Capital Resources Capital Expenditures.*"

#### *Acquisition of PCS Licenses*

As part of our strategy of providing integrated solutions to our clients, we acquired PCS licenses for R\$191.5 million, at an auction held on November 19, 2002.

On December 18, 2002, we paid the equivalent of 10.0% of the total bid amount at auction. The remaining 90.0% was to be paid in six equal installments annually, respectively due 36, 48, 60, 72, 84 and 96 months after the date of the signing of the term of authorization. These installments will be monthly adjusted by the IGP-DI index plus 1.0% interest rate over the indexed amount calculated from the term execution date. If we are able to complete the transactions contemplated by the Merger Agreement, then we do not expect to make payments other than those incurred by the time of the accomplishment of the Agreement.

#### **Business Overview**

We provide fixed-line telecommunications services in Region II under concessions which we assumed from each of Telepar, Telesc, Telegoiás, Telebrasil, Telemat, Telems, Teleron, Teleacre, CTMR and CRT for each of the states in our region. These concessions were granted by the Brazilian government to us and to each of these companies as a result of the privatization process. Until January 2004, these concessions authorized us to provide local and intrastate fixed-line telecommunications services in nine states located in the northern, western, central and southern regions of Brazil and in the Federal District. These concession areas constitute our region. See " *Our region.*" As a result of these original concessions, we are the leading provider of local fixed-line telecommunications services and intraregional fixed-line telecommunications services in our region. Local fixed-line telecommunications services include all calls that originate and terminate within a single local area, as well as, installation, monthly subscription, public telephones and supplemental local services. Intrastate fixed-line telecommunications services include all calls between local areas within a state. Since January 2004 we have been able to offer interregional and international long-distance telecommunications services. We also provide a variety of data transmission services through various technologies and means of access. Since 1999, we have invested in data transmission capacity in response to the growing demand in Brazil for data, images and text transmission services, mainly for corporate networks and corporate and residential Internet access.

Our business, including the service we provide and the rates we charge, is subject to comprehensive regulation by Anatel, an independent regulatory agency, under the General Telecommunications Law and various administrative enactments thereunder. The licenses and concessions under which we operate our fixed-line services imposed certain universalization, expansion and modernization targets on us. On January 19, 2004, we received certification by Anatel that we have accomplished our universalization targets established for December 31, 2003. Accordingly, we were authorized to offer local fixed and domestic and international long-distance telephone services, originated inside or outside our region. We also acquired a license to provide mobile telephone services in our region.

- 27 -

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Our main competitors are Embratel, Intelig, Global Village Telecom, Telesp, Telemar, TIM, Claro, Vivo, Companhia de Telecomunicações do Brasil Central ("CTBC Telecom") and *Sercomtel Telecomunicações S.A.* ("Sercomtel").

### ***Our Strategy***

Our goal is to become a leading provider of integrated telecommunications services in Brazil and in the Latin American countries that we can reach with our international infrastructure. We intend to achieve this goal by maintaining our strong position in the local and long distance markets while at the same time enhancing our existing services and developing new services which complement our existing products and services, as well as by implementing the following key strategies:

#### *Offer interregional and international long-distance services*

We intend to increase our market share in our business of providing long-distance service. Since January 22, 2004 we have begun offering interregional and international long distance services and started competing directly with other regional operators which currently provide such services. By offering interregional and international long-distance services, we expect to be able to offer our existing corporate and residential clients more competitive and integrated plans and capture market share. We intend to leverage the strength of the "Brasil Telecom" brand in Region II and to solidify Brasil Telecom S.A. as the carrier of choice through advertising campaigns that promote the use of our carrier selection code "14" and the synergies across our growing portfolio of integrated services, including wireless, data and long-distance services nationwide. Our ability to offer national and international fixed-line services and/or mobile services in the same regions as TIM are at risk of being terminated by Anatel if the transactions contemplated by the Merger Agreement involving our wireless operations and the surrender by TIMB of long distance licenses are not allowed to be completed by July 18, 2005. See Item 3 "Key Information Risk Factors Risks relating to our company Certain beneficial shareholders control a large percentage of our voting shares, and their interests may conflict with the interests of our other shareholders, including minority shareholders. Disputes among our controlling shareholders and entities that manage our controlling shareholders have had and could in the future have a material adverse effect on our management and operations."

#### *Strengthen our wireless telecommunications services*

Since September 27, 2004 we have begun offering wireless telecommunications services using Global System for Mobile Communications ("GSM") technology through our subsidiary, 14 Brasil Telecom Celular S.A., and under the brand name "Brasil Telecom GSM". With the introduction of wireless services, we are the only company in Region II to offer both wireline and wireless services and we expect to leverage this to increase our brand awareness and overall market share. We are able to offer competitive wireless service plans due, among other things, to the attractive prices paid for our licenses and the favorable terms available to us from our equipment vendors. We also intend to realize the synergies between our wireline and wireless operations by marketing to our existing client database, using our existing wireline sales channels, providing integrated packages and sharing infrastructure and operational systems. We also intend to develop new mobile products and services for the corporate market. If we are able to complete the transactions contemplated by the Merger Agreement, then we will not be offering wireless services directly but will participate in this business through the acquisition of an equity interest in TIMB, which as of April 28, 2005, had approximately 14.6 million wireless users. The Merger Agreement also contemplates operational agreements through which we will be able to continue to offer convergence services.

#### *Continue to integrate and acquire high technology network infrastructure in order to position ourselves as a market leader in the Brazilian corporate market*

Our acquisition in June 2003 of Grupo BrT Cabos Submarinos, our submarine fiber optic cable system, and our acquisition in May 13, 2004 of MetroRED, our local fiber-optic network, and Vant, provided us with a state-of-the-art broadband infrastructure as well as local network capacity. These networks consist of a 22,000 kilometer submarine fiber optic system connecting us to Latin America and the United States, as well as 343 kilometers of local and 1,600 kilometers of long-distance fiber-optic lines in Brazil, allowing us to expand geographically to three

principal corporate markets outside our region São Paulo, Rio de Janeiro and Belo Horizonte. In addition, through MetroRED we obtained an internet data center in São Paulo that will host various internet services. We have integrated these networks and this center into our existing network and business and to use this capacity to meet the growing demands for our network and data transmission services in order to become the market leader in both residential and corporate network and data transmission services.

*Develop integrated voice, data and multimedia services for residential and corporate clients*

We intend to offer voice, data and multimedia products and services through our existing distribution channels as well as through new mobile phone stores. Our strategy is to provide a one-stop shopping environment for both residential and corporate clients, satisfying all of their local, long distance, mobile, network and data transmission service needs. We intend to maximize synergies and increase client loyalty by providing value-added services and to attract new clients and maintain existing clients by offering competitively priced products. We also intend to provide integrated customer service which will allow us to improve our service quality as well as increase our sales.

*Evaluation of possible participation in consolidation of Brazilian telecommunications industry*

The Brazilian telecommunications industry has experienced and may continue to experience consolidation. We continue to evaluate potential consolidation opportunities in Brazil, which may include acquisitions or other methods of participation designed to increase our market share or to improve our efficiency.

***Our Services***

The fixed-line telecommunications services that we offer to our customers consist of (i) local services, including all calls that originate and terminate within a single local area in the region, as well as, installation, monthly subscription, measured services, public telephones and supplemental local services, (ii) intraregional long-distance services which include intrastate (calls between local areas within a state in our region) and interstate (calls between states in our region), (iii) interregional and international long-distance services, (iv) network services, including interconnection, leasing of facilities and fixed-to-mobile services, (v) data transmission services, (vi) wireless services and (vii) other services. On January 19, 2004, Anatel certified our compliance with universalization targets which enabled us to provide mobile services in our region and interregional and international long-distance services in all regions.

The following table sets forth our revenue by type of service for the indicated years. Our rates for each category of service are discussed below under " Rates." Trends and events affecting our operating revenue are discussed under Item 5 "Operating and Financial Review and Prospects."

	<b>Year ended December 31,</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
	(millions of <i>reais</i> )		
Local services	6,255	6,900	7,371
Intraregional (Intrastate and Interstate) long-distance service	1,748	1,923	2,394
Interregional and International long-distance service	1	1	249



Network services	1,021	1,051	970
Data transmission	505	766	1,069
Mobile Services	-	-	88
Other	310	437	622
Gross operating revenues	9,840	11,077	12,763
Taxes and discounts	(2,769)	(3,162)	(3,698)
Net operating revenues	7,071	7,915	9,065

### *Local Services*

We are the leading provider of local telecommunications services in our region with an estimated 95.0% market share. In local fixed-line services, our main competitor is Global Village Telecom. Global Village Telecom is an independent service provider operating under an authorization from Anatel. As of December 31, 2004, we had approximately 9.5 million lines in service. We own and operate public telephones throughout our region. At December 31, 2004, we had approximately 295.9 thousand public telephones and a ratio of public telephones / 100 lines installed equal to 2.76 which meets Anatel's service targets. We also provide a variety of other supplemental local services that include voice mail, call waiting, call forwarding, conferencing, speed dialing and caller ID.

To date, numerous companies have permission by Anatel to provide local fixed telecommunications services in our region. Our fixed-line services are also subject to competition from wireless service providers. See Item 3 "Key Information Risk Factors Risks Relating to the Brazilian Telecommunications Industry We face increasing competition in the Brazilian telecommunications industry which may have a material adverse effect on our market share, results of operations and financial condition." We have also been authorized to provide local fixed telecommunications services outside our region, however as of May 31, 2005, we have not done so.

### *Intraregional (intrastate and interstate) long-distance service*

Calls from one local area in a region to another local area in the same region are referred to as "intraregional long-distance" calls. Intraregional long-distance service includes intrastate long-distance calls (calls within a given state in a region) and interstate long-distance calls (calls between states in a region). Prior to merging into us, each of Telepar, Telesc, Telegoiás, Telebrasil, Telemat, Telems, Teleron, Teleacre, CTMR and CRT was the exclusive provider of intrastate long-distance service in its state. As a result we became and still are the leading provider of intrastate fixed-line telecommunications services in our region with a 90.3% intrastate market share and an estimated 79.5% interstate market share in 2004. Until July 1999, Embratel was the exclusive provider of interstate long-distance service.

Pursuant to Anatel regulations, callers are able to choose a service provider for each long distance call by selecting a carrier selection code that identifies the carrier. Until July 6, 2003, this was permitted only for calls made from fixed-line phones. Since such date, mobile callers can also choose a service provider by selecting a carrier selection code. Our carrier selection code is "14".

As of July 1999, Embratel and Intelig were authorized to provide intrastate long-distance services within the states in our region, and we were authorized to begin to provide interstate long-distance services between the states in our region. See " Competition." As a result we have been expanding our network to provide interstate long-distance service in our region to compete against Embratel, and Embratel and Intelig have been expanding their networks to provide intrastate long-distance service to compete against us. Until we complete this expansion, we may lease transmission facilities from other carriers to complete interstate long-distance calls between states in our region. To date, numerous companies have permission by Anatel to provide intraregional long distance telecommunications services in our region. See Item 3 "Key Information Risk Factors Risks Relating to the Brazilian Telecommunications Industry We face increasing competition in the Brazilian telecommunications industry which may have a material adverse effect on our market share, results of operations and financial condition."

### *Interregional and International Service*

Historically, under Anatel rules, regional fixed-line companies, such as us, generally were not permitted to offer interregional or international long-distance services until December 31, 2003 (the date designed to correspond with the certification of our universalization targets by Anatel). As a result of Anatel having certified our compliance with

universalization targets, on January 19, 2004, we began offering interregional long-distance and international long-distance services. Interregional long-distance services consist of calls between locations within Brazil. International long-distance services consist of calls between different regions within Brazil and a location outside of Brazil. In order to provide these services, we have entered into interconnection agreements with Telemar and Telesp and we will also make use of the cable network we acquired through the Grupo BrT Cabos Submarinos acquisition (linking Brazil with the United States, Bermuda and Venezuela) and through the MetroRED acquisition

(providing network facilities in São Paulo, Rio de Janeiro and Belo Horizonte). Our market share for these services have increased rapidly throughout 2004 and reached 35.6% and 23.8% in the interregional and international segments in our Region, respectively. To date, numerous companies have permission by Anatel to provide interregional and international long distance telecommunications services in our region. See Item 3 "Key Information Risk Factors Risks Relating to the Brazilian Telecommunications Industry We face increasing competition in the Brazilian telecommunications industry which may have a material adverse effect on our market share, results of operations and financial condition." We also expect to benefit from the preferred provider status that pursuant to the Merger Agreement TIMB has agreed to give our long distance services as well as other telecommunications services and products. If the transactions contemplated by the Merger Agreement involving our wireless operations and the surrender by TIMB of long distance licenses are not allowed to be completed by July 18, 2005, our ability to offer national and international long distance services and/or mobile services in the same regions as TIM would be at risk of being terminated by Anatel. See "Risk Factors Certain Beneficial Shareholders Control "

### *Network Services*

Our Network services consist of interconnection, lease of facilities and fixed-to-mobile services.

#### Interconnection services

Interconnection services consist of the use of our network by other telecommunications providers in order to:

- receive calls that originate on our network;
- complete calls that terminate on our network; and
- connect switching stations to our network.

Use of our interconnection services has grown substantially since they were introduced in 1998, as a result of:

- the spin-off of the cellular telecommunications businesses of each of Telepar, Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR;
- the breakup of Telebrás; and
- the advent of competition in the telecommunications sector in Brazil.

Telecommunications service providers are required to provide interconnection services on a nondiscriminatory basis. Subject to certain requirements, they are free to negotiate the terms of their interconnection agreements, but if the parties fail to reach an agreement, Anatel will arbitrate the controversy and establish the terms and conditions of interconnection. See " History and Development of the Company Regulation of the Brazilian Telecommunications Industry Obligations of Telecommunications Companies Interconnection" and " Rate Regulation." The terms of our interconnection services, particularly the pricing and technical requirements of these services, may affect our results of operations, competitive environment and capital expenditure requirements.

We provide interconnection services to long-distance providers, such as Embratel, Intelig, Global Village Telecom, "espelinhos", small private regime operators, and certain operators of trunking services. We also provide interconnection services to the cellular service providers that were spun off from each of Telepar, Telesc, Telegoiás, Telebrasília, Telemat, Telems, Teleron, Teleacre and CTMR as well as all Band B, D and E cellular service providers in our region.



### Lease of Facilities

Other telecommunications service providers, particularly cellular service providers, lease trunk lines from our company for use within their own network, which are used for bulk transmission of voice and data messages. Large corporate customers lease lines from our company for use in private networks connecting different corporate sites. We also lease our telecommunications facilities to Embratel and Intelig in order to provide access to our network.

### Fixed-to-Mobile Services

Fixed-to-mobile services consist of calls that originate in a fixed-line telephone and terminate on a mobile or cellular device. The cellular base rate per-minute charges are generally VC-1 (Communication Value 1) for local calls, VC-2 (Communication Value 2) for calls outside the cellular subscriber's registration area but inside the region where the respective cellular provider provides service, and VC-3 (Communication Value 3) for calls outside the subscriber's registration area and outside the region where the respective cellular provider provides service. The use of our fixed-to-mobile services has increased significantly in the past five years as the penetration rate of mobile services in our region has increased. We are the leading operator in the inter-city fixed-to-mobile services segment in our Region and reached, in 2004, the market share of 82.7% and 56.6% for interregional calls in VC-2 and VC-3 areas, respectively.

### Data Transmission Services

We provide a variety of data transmission services through various technologies and means of access. Since 1999, we have invested in data transmission capacity in response to the growing demand in Brazil for data, images and text transmission services, mainly for corporate networks and corporate and residential Internet access.

The primary data product that we offer to both residential and corporate clients is Turbo, our broadband access service based on Asymmetric Digital Subscriber Line (ADSL) technology. Turbo is an important product because it acts as a primary access or last mile for other services which we offer, such as BrTurbo, our broadband internet service provider for residential clients and corporations. In addition Turbo provides us with a platform to offer new value-added services that increase the average revenue per user, such as "TvFone" and "Turbo Video" which was launched in October 2004. TvFone allows point-to-point videoconferences, over ADSL technology with more than 600kbps, using regular TV and telephone sets. Turbo Video is a video on demand service over PC, offered by BrTurbo, that allows the delivery of high-quality streams to its customers. We intend to continue to invest in our broadband business in order to better serve the expected increase in demand for this type of service, particularly in the Internet access market.

In addition to ADSL, we offer various data transmission services that are designed specifically for corporate clients such as:

- Asynchronous Transfer Mode ("ATM") and Frame Relay a broadband switching service and data transmission service for corporations;
- Dedicated Internet Protocol ("Dedicated IP") a leased line which functions as a dedicated gate for access to internet backbone typically used by internet service providers;
- Digital Dedicated Line Service ("SLDD") a newly introduced leased dedicated line service which offers wider band width than Dedicated IP;

- Dial up internet access a remote dial up internet access which we market under the name "DialNet". DialNet is used primarily by corporate internet service providers to provide remote access to corporate networks; and
- virtual private networks based on internet protocol a new product which we market to corporate clients under the "Vetor" brand name. The virtual private network offered by Vetor allows companies

to consolidate and organize their data communications services and improve the quality of such services through a virtual private network, which we create for each client using our data transmission infrastructure.

#### MetroRED

On May 13, 2004, we purchased the remaining 80.1% stake giving us 99.99% of the capital share of MTH, the parent company of MetroRED. MetroRED established its Brazilian branch in August 1997, beginning its commercial operations in December 1998 by providing private digital telecommunications network to the corporate segment.

Through MetroRED we provide our corporate data transmission services through local fiber optic networks in the São Paulo, Rio de Janeiro and Belo Horizonte markets. MetroRED has 343 km of metropolitan network in São Paulo, Rio de Janeiro and Belo Horizonte, and 1,600 km of long-distance network connecting these three cities. In addition to its private network, MetroRED also has an Internet solution center of 3,790 square meters, which offers data center services and support such as co-location and hosting among others. As part of the acquisition, we acquired a management team with expertise in these markets. Currently, MetroRED has 648 clients in Brazil.

MetroRED plays a key role in our strategy to expand outside Region II, due to its excellent positioning in the key data service markets (São Paulo, Rio de Janeiro and Belo Horizonte) as well as its highly qualified executive team. With a technologically advanced data network which complements our existing networks, MetroRED gives us direct access to main corporate clients in Brazil to whom we can offer national as well as international services, through Grupo BrT Cabos Submarinos's infrastructure. The integration process of MetroRED with our other services, carried out throughout 2004, captured many synergies, not only on sales opportunities but also in reduction of general and administrative, and information technology costs. According to a study we conducted in 2002, approximately 80.0% of the interregional long-distance traffic originating in our region terminates in the three states where MetroRED has its network. By using MetroRED's infrastructure, we realize savings, as we do not have to use third parties' infrastructure to complete these calls. The integration of MetroRED with our existing services also increases our competitiveness in the other Regions, furthering our strategy of expanding beyond Region II.

#### Vant

On May 13, 2004, we purchased the remaining 80.1% stake giving us 99.99% of the share capital of Vant. Founded on October 1999, Vant was the first telecom company in Brazil to offer 100.0% of its services over the TCP/IP network technology. Through Vant we offer Dedicated IP and other products to the corporate market throughout Brazil. The Vant acquisition is expanding our corporate solutions services to the other two regions where we were not active. As MetroRED, Vant had its processes integrated with our other services throughout 2004, capturing synergies.

#### Grupo BrT Cabos Submarinos

We offer bandwidth and interconnectivity to our clients through Grupo BrT Cabos Submarinos (former GlobeNet). Grupo BrT Cabos Submarinos was formed in 1998 to provide fiber-optic communications services in the United States and internationally between the United States and South America. Grupo BrT Cabos Submarinos's system is composed of two armored submarine cable rings, representing approximately 22,000 kilometers of high quality fiber-optic cable, linking Brazil to the United States, passing through Venezuela and the Bermuda Islands, with an installed capacity of 80Gbps, with the potential to increase to 1,360Gbps.

The infrastructure offered by Grupo BrT Cabos Submarinos assists us particularly in the expansion of our corporate data transmission services, allowing us to offer integrated services to national and international corporate clients which includes data communications (Internet and corporate) between Brazil and the USA. In addition, we can reduce our voice and data interconnections costs.



During 2004, Grupo BrT Cabos Submarinos reduced operational costs, renegotiated contracts and developed new businesses in Venezuela, the Caribbean, United States, Brazil, and other Mercosur countries. These

- 33 -

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efforts allowed Grupo BrT Cabos Submarinos to finish the year ended on December 31, 2004 generating positive cash flows and EBITDA.

Additionally, Grupo BrT Cabos Submarinos gave us the necessary autonomy to carry our international voice and data traffic (including IP traffic), reducing interconnection and transport costs. In 2004, we saved approximately U.S.\$8.0 million in international capacity rental expenses and we expect to save approximately U.S.\$16.0 million in 2005.

### *Internet Services*

In October 2001, we formed BrTSi (a wholly owned subsidiary) which provides internet services through BrTurbo, iBest, and iG, and data communications services through Grupo BrT Cabos Submarinos.

#### *BrTurbo*

We offer broadband Internet services through BrTurbo, our broadband Internet service provider, based on ADSL technology. We created BrTurbo in 2002 as a broadband ISP to offer competitively priced broadband access and internet content. BrTurbo's content includes live transmission of news, entertainment channels, video channels with on-demand feature films and documentaries and an exclusive on-line games channel. In November 2002, BrTurbo launched TurboMeeting service, which allows two-line video-conferences.

In 2002, we developed BrTurbo Empresas, a line of services aimed at corporate clients, particularly small and medium-sized companies and home offices. As part of these services, we launched a portal which offers space for backup and storage of information, e-mail account, publication of Internet sites and hosting services. In March 2004, BrTurbo Empresas started offering a number of new products including Web Presence, Enterprise Webmail, Video Conference and BrTurbo VIP.

The BrTurbo portal was redesigned in 2004 and its new platform brought technical and visual improvements, offering better navigability and interactivity. BrTSi also established new partnerships for the restructuring and content management of BrTurbo. In October 2004, we launched Turbo Video, a new video-on-demand service allowing clients to rent movies on-line. We also extended the offer of the BrTurbo Asas Wi-Fi service, which we launched in December 2003, to offer internet to subscribers who occasionally need access while in transit. In order to expand our nation-wide Wi-Fi network we have established partnerships with other players and invested in our own infra-structure.

#### *iBest*

iBest was created in 1999 to develop commercially the "Prêmio iBest" brand name, an Internet award instituted in 1995 that quickly became a national reference for Internet awards in Brazil. In December 2001, iBest extended its activities in the Internet market by providing free dial up Internet access. The acquisition of iBest in June 2003, was a significant step in our Internet strategy.

iBest is an important traffic generator (incoming calls), which increases minutes of use and balances our traffic exchange with other networks in our Region. Traffic drain occurs when a competitor offers free internet services to customers in our region. Because the interconnection regime in Brazil requires us to pay an interconnection fee to the service provider who completes a call originating from our network, free internet increases the traffic in only one direction which generates this interconnection revenue for the service provider. Without a matching increase in traffic in the other direction, the continued traffic imbalance will result in increasing costs for us. Through iBest, we have been able to minimize the risk of traffic drain by stimulating the use of iBest through dial up access, thereby

increasing incoming traffic to our network.

We intend to leverage iBest's large customer base by targeting sales of broadband services (ADSL) to iBest's dial up customers. In addition to ADSL, we can also offer integrated services such as voice (local and long-distance), data and internet to iBest's customers, making iBest an important sales channel for us and allowing us to protect an important customer base from our competition.

### iG

We also offer internet services through iG which Brasil Telecom S.A. acquired in November 2004. iG was the first Brazilian portal to offer free internet access. Over the past years, the business model of iG has developed significantly and the portal started to generate revenues streams through advertising, e-commerce, broadband access, content commercialization, traffic generation, and other paid services such as connection accelerator, telephone customer support, premium email, hosting services, among others. iG is considered the largest dial-up internet service provider in Brazil with a market share of more than 30.0% of dial-up internet minutes. Additionally, iG is the largest wireless content portal of the country. iG has more than 3 million active internet users and 7.7 million active email accounts.

The acquisition of iG consolidates our existing leading position in the ISP market and strengthens our position in Regions I and III. Together, iG, iBest and BrTurbo serve approximately 5 million clients, which make us the largest internet service provider in Latin America and one of the 15 largest providers worldwide.

### *Other Services*

We provide telecommunications services beyond local, long distance, network and data transmission services including value-added services (900, call forwarding, voice mail, caller ID, call waiting, directory inquiry voice service) and advertising on public telephone cards. However, in accordance with our concessions, we are prohibited from providing cable television services, but we may lease our network to providers of such services.

### *Wireless Services*

As a result of our universalization targets certification by Anatel on January 19, 2004 and in furtherance of our business strategy to provide integrated telecommunications services both in our region and throughout Brazil, we started to offer wireless telephony services in our region using the PCS wireless license we obtained on December 18, 2002. Our license to provide wireless service is valid for fifteen years and may be renewed for another fifteen years.

All the prerequisites for the launch of the operations of Brasil Telecom GSM were met in 2004, including the authorizations for the rendering of mobile services conferred by Anatel on January 19, 2004, the acquisition and installation of network equipment and the integration of mobile telephony with other products of the Brasil Telecom Group.

As a result of the launch of its mobile operations, Brasil Telecom S.A. became the largest integrated telecommunications carrier in Region II, offering its clients a complete range of services, including fixed telephony, broadband and narrowband services, free internet, data transmission and mobile telephony.

The full launch of operations to the general public was on September 27, 2004, with the announcement of the advantages of convergence (The Only One, Bonus Every Month, Friends at All Times, Talk for Less and Boomerang 14) and a launch promotion, the Pula-Pula.

Brasil Telecom GSM started its operations with 18,000 post-paid clients, derived from the "Our Mobile" ("*Nosso Celular*") plan, which was created in January 2004 and targeted our employees and their relatives and friends.

### Convergence Products

Bonus Every Month (*Bônus Todo Mês*): allows clients to designate any Brasil Telecom S.A. fixed-line number to earn up to 200 minutes per month, equivalent to 50 pulses, in free local calls to any fixed-line number.

Boomerang 14 (*Bumerangue 14*): allows Brasil Telecom GSM clients to earn credits from long distance calls made using the carrier selection code 14 ("CSC 14"). Clients can then use their credits to make free local calls from their mobile phone to any Brasil Telecom S.A. fixed or mobile number.

- 35 -

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Friends at All Times (*Amigos Toda Hora*): allows Brasil Telecom GSM post-paid clients to designate up to 14 numbers to speak to at a reduced rate of only R\$0.10 (excluding taxes) per minute, at any time. The designated numbers may be fixed-line numbers of any operator or Brasil Telecom GSM mobile numbers. Brasil Telecom GSM pre-paid clients can elect seven numbers, one of which may be a fixed-line number.

The Only One (*Único*): a pre-paid service that merges mobile, fixed-line and payphone services. Clients buy credits for their pre-paid mobiles, but also have the option to use the same credits to make phone calls from fixed-line or payphones. The client simply calls a toll free number and identifies the number to be called. The cost of the call is deducted from the pre-paid credits, and the rate charged is cheaper than the pre-paid one. Brasil Telecom GSM is also the only operator to offer SMS credits every time a calling card is purchased, regardless of the face value of the card.

Talk For Less (*Fale por Menos*): allows Brasil Telecom GSM customers to pay less for calls from a Brasil Telecom S.A. fixed-line number to a Brasil Telecom GSM mobile number. Calling mobile numbers from other operators is at least 60% more expensive, regardless of the time. This promotion was valid from October 1, 2004 to March 31, 2005.

#### Launch Promotion

The Pula-Pula promotion is an offer used to promote the launch and positioning of Brasil Telecom GSM in the mobile telephony market.

In the post-paid Pula-Pula, the amount billed in one month is deducted from the following month's bill, while in the pre-paid Pula-Pula the amount of minutes received in one month is credited as talk time in the following month, provided the customer buys credit at least once every month. The Pula-Pula promotion is guaranteed until 2010 for all clients who acquired their Brasil Telecom GSM phone by December 2004.

We extended the Pula-Pula promotion, guaranteeing similar benefits until 2009 ("Pula-Pula de Verão" summer promotion) for mobile phones activated from January 1, 2005 to February 8, 2005, and until 2008 (the "Pula-Pula 2008" promotion) for mobile phones activated between April 1, 2005 and May 8, 2005.

#### Flagship Stores One-stop-shop

Our 16 flagship stores were created with an innovative concept in mind, the one-stop-shop. In our stores, clients have access to the entire portfolio of products and services of the Brasil Telecom Group (fixed-line, ADSL, mobile, free internet installation CDs, intelligent services, alternative bundles of DLD and ILD rates, accessories, modems and even personal computers). This initiative meets the needs of the clients and capitalizes on the competitive advantages of an integrated telephony operation. The majority of our flagship stores are located in the main shopping centers of Region II.

#### Real Time Customer Retention

With our convergence offers and the Pula-Pula promotion, Brasil Telecom GSM became the first company in Brazil to offer a Real Time Customer Retention program, eliminating the need for our clients to subscribe to a program, earn points, view catalogs, and request prizes. After acquiring a Brasil Telecom GSM mobile phone, our clients can immediately enjoy the benefits of our convergence offers and the Pula-Pula promotion.

#### Roaming

The use of Brasil Telecom GSM phones is not restricted to Region II. Our clients have countrywide coverage through roaming agreements. Brasil Telecom GSM's preferred roaming partners are Oi and TIM in Regions I and III, respectively. As a result of an agreement between Brasil Telecom GSM and Oi, our clients do not pay for roaming charges and can benefit from advantageous rates when using their phones in Oi's authorization area, comprising the 3 south-eastern states (Minas Gerais, Rio de Janeiro, and Espírito Santo), the 4 northern states (Amazonas, Amapá, Pará, and Roraima) and the 9 states in the northeast of Brazil (Bahia, Sergipe, Alagoas, Pernambuco, Paraíba, Rio Grande do Norte, Ceará, Piauí, and Maranhão).

### Products and Services

Brasil Telecom GSM offers three types of plans: post-paid, pre-paid and control (a plan where clients establish a pre-determined monthly rate and buy pre-paid credits if they wish to make extra calls). Besides voice services, Brasil Telecom GSM clients can also take advantage of value-added services, including data communications via GPRS and new services previously not offered by other carriers. An example is the Mobile Banking service, the result of a partnership between Brasil Telecom GSM and Banco do Brasil that allows clients to access account balances and statements, and make transfers, among other services.

### Clients

At the end of 2004, Brasil Telecom GSM had 622,300 clients, which represented a 3.2% market-share gained in only three months of operations. 33.1% of the clients were post paid, a percentage which is above the market average.

### Coverage

The Brasil Telecom GSM network covers 626 localities and 81.2% of the population of the states of Region II. Around 2,000 new towers were implemented during 2004. In 2005, new investments are expected to further broaden our coverage and increase the number of localities covered as well as the main highways that link the regions, enabling our clients to fully benefit from the mobility concept.

### Integration

The Brasil Telecom GSM sales team works in partnership with the Brasil Telecom S.A's commercial business area to offer all the group's product portfolio and address the necessities of clients within Region II.

### Points of Sales

In December 2004, Brasil Telecom GSM had 2,109 points of sale, including 16 flagship stores, 48 kiosks, 800 exclusive authorized dealers and non-exclusive authorized sales agents, and 1,300 pre-paid card resellers among the main retailers.

### ***Our Region***

Until January 2004, we were authorized by our original concessions to provide fixed-line telecommunications service only in nine states of Brazil located in the western, central and southern regions of Brazil, and in the Federal District, as listed in the chart below, excluding small areas in the States of Goiás, Mato Grosso do Sul and Paraná, which we refer to as our region. We have a unique advantage in this region as we inherited the telecommunications business in this region upon privatization of Telebrás. Since we received certification that we had met our universalization targets, we are now authorized to provide interregional long-distance services throughout Brazil and international long-distance services, also from any point in the country. We also received authorization to offer local services out of our original concession area and to offer wireless services in our region. Our primary source of revenues continues to come from operations in our region.

The states in our region cover an area of approximately 2.85 million square kilometers, representing 33.5% of the country's total area and generating 26.1% of Brazil's Gross Domestic Product ("GDP"). The estimated population of our region was approximately 41.5 million, representing 23.5% of the population of Brazil. Our region has four metropolitan areas with populations in excess of one million inhabitants, including Brasilia, the capital of Brazil.





The following table sets forth certain key economic data for the states in our region.

<b>State</b>	<b>Population (millions)<sup>(1)</sup></b>	<b>Population per square kilometer<sup>(1)</sup></b>	<b>Percentage of Brazil's GDP for 2002<sup>(1)</sup></b>	<b>Per capita income (R\$) for 2002<sup>(1)</sup></b>
Paraná	9.9	49.59	6.05	8,241
Santa Catarina	5.6	58.63	3.85	9,272
Distrito Federal	2.2	375.78	2.65	16,361
Tocantins	1.2	4.36	0.26	2,931
Mato Grosso	2.6	2.92	1.33	6,773
Mato Grosso do Sul	2.2	6.06	1.14	7,092
Rondônia	1.5	6.33	0.54	4,843
Rio Grande do Sul	10.5	37.23	7.76	9,958
Acre	0.6	3.86	0.17	3,833
Goiás	5.3	15.54	2.33	5,921

<sup>(1)</sup> Source: Instituto Brasileiro de Geografia e Estatística - IBGE ("IBGE") pursuant to the 2002 Regional Accounts of Brazil.

Set forth below is a map of Brazil showing the location of our region.

Our business, financial condition, results of operations and prospects depend on the performance of the Brazilian economy and the economy of our region, in particular.



**Seasonality**

Our main activity, which is to provide fixed-line telecommunications services, is generally not affected by seasonal variations.

**Targets Established by Anatel Applicable to Us**

We are required to achieve certain targets established by Anatel and required under the terms and conditions of our concessions, in connection with the quality and universalization of our services.

**Quality Targets**

We are required, pursuant to the Telecommunications Regulations and our concession contracts, to meet certain service quality targets relating to call completion rates, repair requests, rate of response to repair requests, operator response periods and other aspects of our telecommunications services. Noncompliance with these quality targets can result in certain fines. See " History and Development of the Company Regulation of the Brazilian Telecommunications Industry Obligations of Telecommunications Companies Quality of Service General Plan on Quality."

The following table indicates the individual performance of each of our concessions in accomplishing their respective quality of service obligations as of December 31, 2004.

**Quality Performance of Services measured on December 31, 2004**

	Teleacre	Teleron	Telemat	Telegoías	Tele-brasília	Telems	Telepar	Telesc	CRT	Pelotas	Target
Rate of completed originated local calls Morning	70.35	70.29	70.37	70.43	70.13	71.60	71.61	71.24	71.27	71.42	70.0
Rate of completed originated local calls Afternoon	70.75	70.19	70.93	70.14	70.21	72.51	71.60	70.86	71.01	71.31	70.0
Rate of completed originated local calls Night .....	72.74	70.36	71.80	70.75	70.34	71.61	70.42	70.45	70.07	70.71	70.0
Rate of completed originated DLD calls Morning	73.09	70.32	71.55	71.10	70.28	71.17	73.34	73.05	70.80	72.56	70.0
Rate of completed originated DLD calls Afternoon	70.17	70.89	72.39	71.92	71.39	70.80	73.33	72.83	70.62	70.89	70.0
Rate of completed originated DLD	72.78	70.91	73.02	72.24	70.28	70.72	71.30	70.26	70.48	70.14	70.0

calls Night												
Rate of amount of repair requests per 100 accesses in service	Integral	1.09	1.20	1.27	1.39	1.27	1.20	1.35	1.78	1.30	1.35	2.0
Rate of amount of repair requests per 100 public telephones	Integral	4.15	5.72	9.49	9.97	9.98	8.84	6.80	6.30	5.87	3.94	10.0
Response rate for user telephones of the STFC within 10 seconds	Morning	99.32	99.68	99.36	99.46	99.85	99.35	99.76	99.88	99.88	100	94.0
Response rate for user telephones of the STFC within 10 seconds	Afternoon	98.03	99.11	99.24	99.30	99.79	98.89	99.64	99.50	99.68	99.46	94.0
Response rate for user telephones of the STFC within 10 seconds	Night	99.31	99.59	99.50	99.57	99.91	99.57	99.87	99.60	99.71	99.70	94.0
Amounts of bills with complaints of errors in every 1,000 bills issued local mode		1.91	1.94	1.96	1.94	1.98	1.94	1.93	1.95	1.97	1.93	2.0

**Quality Performance of Services measured on December 31, 2004**

	<b>Teleacre</b>	<b>Teleron</b>	<b>Telemat</b>	<b>Telegoías</b>	<b>Tele-brasília</b>	<b>Telems</b>	<b>Telepar</b>	<b>Telesc</b>	<b>CRT</b>	<b>Pelotas</b>	<b>Target</b>	
Amounts of bills with complaints of errors in every 1,000 bills issued												
DLD mode	1.64	1.88	1.72	1.76	1.59	1.74	1.80	1.55	1.23	1.69	2.0	
Rate of claimed inaccurate bills with credit issued (for each 100 bills) for the local mode	Integral	100	100	100	100	100	100	100	100	100	97.0	
Rate of originated DLD calls not completed due to traffic jam												
Morning	3.26	1.39	1.78	1.74	2.57	1.72	1.64	1.80	1.27	1.52	4.0	
Rate of originated DLD calls not completed due to traffic jam												
Afternoon	3.90	1.91	2.24	1.84	2.54	2.06	1.86	1.60	1.52	1.76	4.0	
Rate of originated DLD calls not completed due to traffic jam	Night	1.81	1.70	1.68	1.75	2.91	1.58	1.59	1.76	1.89	1.98	4.0
Rate of originated local calls not completed due to traffic jam												
Morning	3.09	0.57	1.27	1.03	1.55	1.26	0.59	1.19	0.58	0.48	4.0	
Rate of originated local calls not completed due to traffic jam												
Afternoon	0.75	0.70	1.03	2.27	2.84	1.14	0.70	1.54	0.86	0.40	4.0	
Rate of originated local calls not completed due to traffic jam	Night	1.14	2.06	1.23	2.06	1.38	2.30	0.77	1.90	2.53	0.69	4.0
Response rate to repair requests made by residential users in up to 24 hours	99.60	98.91	99.72	99.49	99.25	99.84	99.53	99.30	99.09	99.47	97.0	

Integral												
Response rate to repair requests made by non-residential users in up to 8 hours	Integral	97.67	97.39	98.83	99.07	98.76	99.62	99.07	97.54	97.75	100	97.0
Response rate to repair requests made for public telephones in up to 8 hours	Integral	98.19	97.95	99.63	99.13	97.99	99.13	98.55	99.15	98.00	100	97.0
Response rate to address change requests from residential users in up to 3 business days	Integral	100	99.78	99.84	99.79	99.81	99.91	99.90	99.92	99.35	99.40	97.0
Response rate to address change requests from non residential users in up to 24 hours	Integral	100	97.22	100	99.20	99.42	100	99.22	99.45	97.78	100	97.0

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*Universalization Network Expansion*

We are also required under the Telecommunications Regulations and our concessions to meet certain targets relating to network expansion and modernization. See " History and Development of the Company Regulation of the Brazilian Telecommunications Industry Obligations of Telecommunications Companies Network Expansion General Plan on Universal Service."

During 2004, all our universalization targets of the General Plan on Universal Service were met.

The table below indicates certain of our obligations relating to the expansion of our network in 2004 and our performance in accomplishing those obligations as of December 31, 2004.

Table of Contents

	<b>Targets at December 31, 2004</b>	<b>Company status at December 31, 2004</b>
Fixed-line service available to all communities larger than  (inhabitants)	600	Obligation met
At least one public phone available to all communities  larger than (inhabitants)	300	Obligation met
Maximum waiting time for installation of a line (weeks) <sup>(1)</sup> .	2	Obligation met
Minimum number of public telephones in service (thousands)	216	296
Minimum number of public telephones (per 1,000 inhabitants)	7.5	8.3
Minimum public telephones as a percentage of fixed-lines.	2.5	2.8

(1) Applies only to areas where fixed-line service is fully available.

***Our Rates***

For basic plans, our concessions establish a mechanism of annual rate adjustment, based on rate baskets and the use of the IGP-DI price index. Two rate baskets are defined, one for local services (local basket) and one for long-distance services (DLD basket). The rates for the provision of services through payphones and the rates for address change are treated separately.

The adjustment index considers the IGP-DI price index variation, discounting the pre-established productivity factor in the Concession Contract. Within each basket, the rates have a cap price, which can be adjusted up to a percentage above the established index (up to 9.0% higher for the local basket and up to 5.0% higher for the DLD basket). However, the application of a higher index to one of the items in the basket will require a balancing of the remaining items so as not to exceed the established limit for such basket.

The local basket includes activation fees (activation of the terminal), basic subscriptions and local pulse, and represents the weighted average of these rates. The national long-distance basket includes all different prices for calls, which vary according to the distance and the time of connection.

On the adjustment dates for the local and DLD baskets, the rate adjustments for network use are also approved. These rates apply when our networks are used by other telecommunications carriers.

The maximum adjustment indexes allowed for the baskets within the period of 1999 to 2004 are as follows:

	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Local Basket	7.9%	14.2%	10.4%	8.3%	16.0%	6.89%
DLD Basket	5.4%	11.9%	7.7%	4.9%	12.5%	3.20%



On June 30, 2004, Anatel authorized an increase in rates based on the IGP-DI index, in connection with local and long distance services and network usage, as provided for in our concession contract. These rate increases were equal to an average of 6.9% on local services and 3.2% on domestic long distance services. The maximum rate for the international long distance Basic Plan was increased by 8.0% .

On July 1, 2004, the Superior Court of Brazil ("STJ") suspended the preliminary injunction that stipulated the IPCA index (*Índice de Preços ao Consumidor Amplo*) as a substitute of the IGP-DI index in concession contracts as the base for rate adjustments in 2003, determining that rates were to be adjusted based on the IGP-DI index, as foreseen by concession contracts.

Fixed-line telephony service providers, in negotiation with Anatel, agreed to apply the rate adjustment in two installments, effective on September 01, 2004 and on November 01, 2004, as shown below:

Service Plan	Average Rate Adjustment on Sep 01, 2004	Average Rate Adjustment on Nov 01, 2004	Total Average Rate Adjustment
Local Basic	4.35%	4.17%	8.52%
Domestic Long Distance Basic	4.78%	4.56%	9.34%
Local Network Usage Rate	5.46%	5.18%	10.64%
Intercity Network Usage Rate	5.46%	5.18%	10.64%

*Local Rates*

Our revenue from local services derives from fees charged for service access, service availability, service usage and change of address.

An activation fee is applied for service access and consists solely of a charge paid when terminals are activated.

The monthly subscription charge is the amount paid for the availability of fixed switched telephone service, regardless of utilization. There are three types of monthly subscriptions, depending on the category of the terminal, which can be residential, non-residential or trunk. Payment of this charge includes 100 free pulses per month for residential clients and 90 free pulses per month for remaining clients (non-residential and trunk). Any pulses in excess of such amounts are billed to the customer as a measured service.

Since November 1, 2004, the date of the last rate adjustment, average monthly subscription charges (net of taxes) have been R\$25.54 for residential customers, R\$36.71 for non-residential customers, and R\$24.47 for trunk customers.

Users of measured service pay for local calls depending on usage, which is measured in pulses. Pulses occur system wide every four minutes for local calls. These system-wide pulses are recorded independently of when the individual calls are actually made. In addition to system-wide pulses, the system records one pulse for every call when the call is connected. After the first pulse, only system-wide pulses are used in determining the charge for a call. As a result, the time between the first and the second (system-wide) pulse may vary. For example, for a call being charged using four-minute pulse increments, the time between the first pulse and the second (system-wide) pulse may vary between one second and four minutes.

Local call charges for calls made on weekdays between 6:00 a.m. and 12:00 a.m. and on Saturdays between 6:00 a.m. and 2:00 p.m., are determined by multiplying the number of pulses by the charge per pulse. For calls being made any weekday and on Saturdays between midnight and 6:00 a.m., on Saturdays between 2:00 p.m. and midnight and all day on Sundays and holidays, a caller is charged for only one pulse regardless of the duration of the call.

Since the last rate adjustment, on November 1, 2004, the average pulse charge (net of taxes) has been of R\$0.10294.

The following table sets forth selected information regarding our subscription charges and measured service charges for local telephone services for the periods indicated.

	<b>Year ended December 31,</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
Average rates for local telephone service <sup>(1)</sup> :		<i>(reais)</i>	
Monthly subscription:			
Residential	18.92	22.18	25.54
Commercial	24.80	29.08	36.71
Measured service (per local pulse)	0.07624	0.08938	0.10294

---

(1) Average rates, net of taxes.

Since the date of the last rate adjustment, which occurred on November 1, 2004, we charge an activation fee for a new line, net of taxes, between R\$3.47 and R\$73.42 (depending on the state) and a fee of R\$78.46, net of taxes, when a subscriber changes his/her address.

#### *Domestic Long-Distance Rates*

Domestic long-distance calls between fixed-line telephones are measured by the duration of the call and registered in the telephone bill call by call. The value per minute is defined by the distance involved (rate degrees from one to four), the day of the week and the time of the call. The measurement is based on a rate unit of one tenth of a minute (six seconds) and the minimum billable time is one minute.

The following table sets forth selected information regarding our domestic long-distance rates during the periods indicated.

	<b>Year ended December 31,</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
Domestic long-distance rates <sup>(1)</sup> :		<i>(reais)</i>	
0 to 50 km	0.50	0.59	0.62
50 to 100 km	0.73	0.82	0.90
100 to 300 km	0.85	0.95	1.05
Over 300 km	1.12	1.15	1.13

---

(1) Average rates for a domestic long-distance call (interstate), three minutes in duration between the hours of 9 a.m. and noon and 2 p.m. and 6 p.m. (peak hours) on weekdays, net of taxes.

#### *Network Usage Charges*

The network usage rates, responsible for a large part of our interconnection revenue, are applied in the following situations:

- in DLD calls originating and terminating at our network, executed with the use of the selection code of other providers;
- in calls terminating at our network, originating from networks of mobile carriers; and
- in local fixed-fixed type calls made between two local telephony carriers at the same location. In this case, interconnection revenue must be of the local carrier that configures a volume of traffic receipt

above 55.0% of the total volume of minutes between the two networks. The revenue will be calculated over whatever exceeds this limit.

The Local Network Usage Rate (*Tarifa de Uso de Rede Local* - TU-RL) is applied when third parties use our local network to complete their calls. When third parties use our long-distance network the Intercity Network Usage Rate (*Tarifa de Uso de Rede Interurbana* - TU-RIU) is applied.

The following table sets forth the average per-minute rates that we charged for network services during the indicated years.

	<b>Year ended December 31,</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
		<i>(reais)<sup>(1)</sup></i>	
Network usage rate (local)	0.0512	0.05284	0.05248
Network usage rate (long-distance)	0.0860	0.09681	0.11083

---

(1) Net of taxes.

As of the date of the last rate adjustment, on November 1, 2004, network usage rates for local and long-distance services were approximately R\$0.05248 and R\$0.11083, respectively. The adjustment of rates for network usage in 2004, considering the indexes authorized by Anatel on June 30, 2004 and adding the differences in connection with the 2003 rate adjustment, which were suspended by the STJ and were applied in September and November 2004 after a new court ruling, was of approximately -0.7% for the Local Network Usage Rate and 14.5% for the Intercity Network Usage Rate.

Our revenue from network services also includes payments from other telecommunications service providers arranged on a contractual basis to use part of our network. Other telecommunications service providers, such as providers of trunking and paging services, may use our network to connect a central switching station to our network. Some mobile service providers use our network to connect mobile central switching stations to the mobile radio base stations. We also lease transmission lines, certain infrastructure and other equipment to other providers of telecommunications services.

#### *Fixed-Mobile Rates*

Wireless telecommunications services in Brazil, unlike in North America, are offered on a "calling party pays" basis. Under this policy, a cellular service subscriber generally pays cellular usage charges only for calls made by the cellular service subscriber and not for calls received. In addition, a subscriber pays roaming charges on calls made or received outside his or her home registration area. Calls received by a cellular service subscriber are paid for by the party that places the call in accordance with a rate based on cellular per-minute charges. For example, a fixed-line service customer pays a rate based on cellular per-minute charges for calls made to a cellular service subscriber. The cellular base rate per-minute charges are generally VC-1 (Communication Value 1) for local calls, VC-2 (Communication Value 2) for calls outside the cellular subscriber's registration area but inside the region where the respective cellular provider provides service, and VC-3 (Communication Value 3) for calls outside the subscriber's registration area and outside the region where the respective cellular provider provides service.

We charge our fixed-line service customers per-minute charges based on either VC-1, VC-2, or VC-3 rates when a fixed-line service customer calls a cellular subscriber. In turn, we pay the cellular service provider a mobile network

usage charge for such calls. For local calls, the VC-1 is applied, and for national long-distance calls, the VC-2 and VC-3 rates are applied.

The criteria for measurement of these calls are defined in the Concession Contract and have the following rules:

- Rating unit: six seconds (one tenth of a minute);

- Billable Minimum: 30 seconds; and
- Billable Calls: only calls with duration of more than three seconds are billed.

Like the local and DLD basket rates, rates for calls involving mobile telephones are set in the Concession Contract and are adjusted annually based on IGP-DI price index, after approval by Anatel. The month of reference for the adjustment is February.

During the same month, the values for mobile network use (VU-M) are also readjusted and are used to determine the amount that the fixed-line carriers will have to pay per minute, after the execution of calls of the fixed-mobile type, whether in local range or in national long-distance range.

Since July 6, 2003, by determination of Anatel, mobile telephone customers can choose, via the carrier selection code, the DLD carrier they prefer to complete their calls, following the same system adopted by the fixed telephony sector. With the introduction of this new system, the DLD carriers began to take part in this new market.

In February 2004, the VU-M was readjusted, on average, by 9.2% in our concession area and the VC-1, VC-2 and VC-3 rates were adjusted by 7.0% .

On April 7, 2005, Anatel announced that the VC-1 rate was to be adjusted by 7.99%, pending the approval of Anatel's board of directors. Also according to the announcement, Anatel expects mobile and fixed-line operators to reach an agreement regarding the VU-M rate. Anatel did not approve the adjustments for the VC-2 or VC-3 rates.

The following table sets forth the average per-minute rates that we charged for fixed to mobile services during the indicated years.

	<b>Year ended December 31,</b>		
	<b>2002 <sup>(1)</sup></b>	<b>2003</b>	<b>2004</b>
		<i>(reais)</i>	
VC-1	0.335	0.414	0.443
VC-2	0.694	0.847	0.906
VC-3	0.764	0.932	0.997

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(1) Net of taxes.

#### *Data Transmission Rates*

The majority of revenue from data transmission services is generated by monthly line rental charges for private leased circuits. The balance consists mainly of nominal charges for access to the data transmission network and measured service charges based on the amount of data transmitted. The following table sets forth selected information about our average monthly line rental charges for private leased circuits during the indicated years.

**Year ended December 31,**

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	<b>2002</b>	<b>2003</b>	<b>2004</b>
		<i>(reais)</i>	
Average rates for monthly line rental per leased circuit:			
Local circuit			
4.8 Kbps	254.75	302.00	302.00
9.6 Kbps	254.75	302.00	302.00
64Kbps	523.74	586.00	586.00
2Mbps	6,635.45	6,636.00	6,636.00
Long-distance circuit <sup>(1)</sup>			
4.8 Kbps	1,094.93	1,303.00	1,303.00
9.6 Kbps	1,094.93	1,303.00	1,303.00
64Kbps	2,961.79	3,317.00	3,317.00

- 45 -

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	<b>Year ended December 31,</b>		
	<b>2002</b>	<b>2003</b>	<b>2004</b>
		<i>(reais)</i>	
2Mbps	37,565.23	37,566.00	37,566.00

(1) Average of rates, net of taxes, assuming a transmission distance between 300 and 500 kilometers and a three-year contract.

The table below sets forth the rates that we charged for ADSL services. These costs do not include the fees normally paid by customers to their Internet service providers.

<b>Residential Plans</b>	<b>Downstream/Upstream Speed</b>	<b>Monthly Subscription<sup>(1)</sup></b>
<i>Turbo Lite</i>	Up to 150 Kbps/Up to 64 Kbps	49.90 <sup>(2)</sup>
<i>Turbo 300</i>	Up to 300 Kbps/Up to 150 Kbps	79.90
<i>Turbo 600</i>	Up to 600 Kbps/Up to 300 Kbps	99.00
<i>Mega Turbo</i>	Up to 1.0 Mbps/Up to 300 Kbps	199.00
<b>Corporate Plans</b>	<b>Downstream/Upstream Speed</b>	<b>Monthly Subscription<sup>(1)</sup></b>
<i>Rápido</i>	Up to 400 Kbps/Up to 200 Kbps	119.90
<i>Super Rápido</i>	Up to 800 Kbps/Up to 400 Kbps	253.12
<i>Profissional</i>	Up to 1.5 Mbps/Up to 256 Kbps	593.44

(1) Monthly rates in *reais*, including taxes.

(2) Monthly value for 50 hours of Internet access. Additional hours are charged R\$ 2,95 per hour.

#### *Wireless Rates*

Our authorization establishes a price-cap mechanism of annual rate adjustment, based on the IGP-DI price index for basic and alternative plans. The price-cap is a weighted average price for the services offered in our Basic Plan, including monthly subscription and particular roaming charges, such as toll per call and local minute-basis tariffs.

However, tariffs and prices for value-added services, such as data communications services, are not subject to regulation and can be defined on a competitive basis. Such services are offered as pay-per-use or volume-based packages.

The Basic Plan follows a post-paid system, whereby clients pay a monthly charge for the availability of mobile services, regardless of utilization. In addition to this charge, subscribers are charged for the utilization of voice and data services.

The following table sets forth selected information about the average charges for our Basic Plan in 2004:

#### **Year ended December 31, 2004**

Average rates for the Basic Plan <sup>(1)</sup> :	<i>(reais)</i>
Activation	0.00
Monthly Subscription	27.74
Local calls to fixed-line numbers	0.4138
Local calls to Brasil Telecom GSM mobiles	0.4138
Local calls to other wireless operators	0.4138

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(1) Average rates, net of taxes.

As of May 31, 2005 we also offered our wireless clients three different types of alternative plans, the *Brasil Conta Plan*, the *Brasil Controle Plan* and the *Brasil Cartão Plan*.

The *Brasil Cartão Plan* follows a pre-paid system, whereby our clients purchase credits in advance for the availability of mobile services. We offer reduced rates for either nighttime or daytime calls, with the *Brasil Cartão Noturno Plan* and the *Brasil Cartão Diurno Plan*, respectively, or charge a single tariff regardless of the time of the call, with the *Brasil Cartão Simples Plan*.

The *Brasil Conta Plan* follows a post-paid system, whereby clients pay a monthly charge for a given package of inclusive minutes. Any minutes used in excess of such amounts are billed to the customer according to the selected package, so that packages with a greater amount of inclusive minutes are generally charged a lower tariff. We offer 14 different packages of monthly inclusive minutes ranging from 50 to 2000 minutes. If subscribers do not use the total amount of inclusive minutes in any given month, the balance is brought forward to the following month.

The *Brasil Controle Plan* has characteristics of both pre- and post-paid systems. Clients pay a fixed monthly charge for the availability of mobile services, regardless of utilization. Payment of this charge includes cash credits of equal amount. Once all credits have been used, subscribers may purchase extra pre-paid credits. Tariffs charged for the plan are the same, regardless of whether the credit is post- or pre-paid. If subscribers do not use the total amount of cash credits in any given month, the balance is brought forward to the following month.

### ***Taxes on Telecommunications Services***

The cost of telecommunications services in Brazil includes a variety of taxes. The principal tax is a state value-added tax, the *Imposto sobre Circulação de Mercadorias e Serviços* ("ICMS"), which Brazilian states impose at varying rates on telecommunications services. The current average ICMS tax rate for telecommunications services is 25.0%. However, the ICMS tax rate varies between states. In the State of Acre, for example, the ICMS tax rate is 25.0%, while in the State of Mato Grosso the ICMS tax rate is 30.0%. In the State of Mato Grosso do Sul, the ICMS tax rate is 27.0%. In the State of Goiás, the ICMS tax rate is 26.0%.

The telecommunications tax burden also includes four other federal taxes, the *Programa de Integração Social*; ("PIS") and *Contribuição para Financiamento da Seguridade Social* ("COFINS") which are the two social contribution taxes based on our gross revenues and the Universal Telecommunications Service Fund ("FUST") and the Fund for Technical Development of Brazilian Telecommunications ("FUNTTEL").

PIS is applied at a 0.65% rate and COFINS is applied at a 3.0% rate for telecommunications services. Since December 2002, we have been subject to a 1.65% PIS rate for services other than telecommunications services and may be entitled to PIS credits calculated on our costs and expenses to offset the PIS due on those services. Since February 2004, we have been subject to a 7.6% COFINS rate for services other than telecommunications services and may be entitled to COFINS credits calculated on our costs and expenses to offset the COFINS due on those services.

The FUST and FUNTTEL are imposed on certain telecommunications services at the rates of 1.0% and 0.5%, respectively, of gross operating revenues net of certain deductions. See Item 10 "Additional Information Taxation Brazilian Tax Considerations Other Brazilian Taxes."

In 2004, taxes on telecommunications services represented approximately 28.0% of our annual operating revenues.

### ***Billing and Collection***

We send each customer of local services, long-distance services and other services a monthly bill covering all the services provided during the prior period. We group our customers into six different monthly cycles with six different payment dates. The telephone bill itemizes long-distance calls, calls made to cellular telecommunications networks, 300, 500 and 800 services and other services such as call waiting, voice mail and call forwarding.



For interregional and international long-distance services, customers either receive separate monthly bills from each company they use for long-distance calls or a combined bill issued by us. Customers make payments under agreements with various banks or other alternative agents by direct payment to a bank or an alternative agent, or by allowing their checking account to be debited.

Pursuant to Brazilian law, subscribers must receive a bill at least five days before the due date. When a payment is not made by the due date, we must send the customer, 15 days after the due date, a notice informing the customer of the right to contest the debt and if payment is not made within 30 days after the due date, all outgoing service will be suspended, and the customer will only be able to receive incoming calls. If payment is not made within 45 days after the due date, we send another notice informing the customer that if payment is not made within 60 days after the due date, all services will be suspended, the contract will be cancelled and the customer's failure to pay will be reported to a credit protection agency.

The following table sets forth information about our accounts receivable for the year ended on December 31, 2004. For the discussion of provisions for past due accounts, See Item 5 "Operating and Financial Review and Prospects Operating Results."

**At and for the year ended December 31,**

	<b>2004</b>
Due	64.5%
Past due 01 to 30 days	16.4%
Past due 31 to 60 days	5.7%
Past due 61 to 90 days	3.7%
Past due 91 to 120 days	2.7%
Past due More than 120 days	7.0%

***Network and Facilities***

*General*

The network is the combination of the physical and logical infrastructure which provides telecommunications services, whether it is voice, data and/or image.

*Network Expansion*

Voice Network

During 2004, we installed 50,700 lines. As a result, as of December 31, 2004, our plant consisted of approximately 10.7 million installed lines, of which 9.5 million were in service. Of the lines in service at that time, approximately 67.8% were residential lines, 18.0% were commercial lines, 3.1% were public telephone lines and 11.1% were other. Long-distance transmission is provided by a fiber-optic cable network and by microwave links.

At the end of 2003, we had 9.8 million lines in service and the telephone density reached 23.4 lines in service per 100 inhabitants. At December 31, 2004, we had 9.5 million lines in service and the telephone density was 22.4 lines in service per 100 inhabitants.

The following table sets forth combined information about our network for the periods indicated.

	<b>At the year ended December 31,</b>	
	<b>2003</b>	<b>2004</b>
Installed lines (millions)	10.7	10.7
Lines in service (millions)	9.8	9.5
Average lines in service for year ended (millions)	9.7	9.7
Lines in service per 100 inhabitants	23.4	22.4
Percentage of installed lines connected to digital exchanges	99.0	99.7
Number of public telephones (thousands)	296.3	295.9

## Data Networks

At the end of 2004 we had 620,406 ADSL installed ports and 535,457 accesses in service, which represents 253,557 new ADSL accesses added in 2004. This represents an 89.9% growth from the 281,900 accesses in service in 2003, and a growth in the ratio of active customers to 86.3% in 2004 compared to 81.4% in 2003. During 2004 we also increased the number of cities with ADSL services from 323 to 1,117.

	Year ended December 31,		
	2003	2004	% Change
<b>ADSL</b>			
Installed Ports	346,233	620,406	79.2
Accesses in Service	281,900	535,457	89.9

ATM, Frame Relay, and Dedicated IP, expanded by 5.7% in 2004 compared to 2003. As of December 31, 2004, we had installed 10,829 ATM, Frame Relay or Dedicated IP ports, in 87 cities. The DialNet service increased from 150,174 ports installed at the end of 2003, to 192,236 ports installed in 239 cities at the end of 2004, representing an increase of 28.0 %.

	Year ended December 31,		
	2003	2004	% Change
DialNet	150,174	192,236	28.0
ATM/Frame Relay/ Dedicated IP	10,245	10,829	5.7

The ratio of active customers in the several data communications networks are in the following table:

	Aggregate value until December 2004		
	Total number of ports	Total ports in service	Utilization rate (%)