PORTUGAL TELECOM SGPS SA
Form 6-K
April 05, 2012
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

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

Securities Exchange Act of 1934

For the month of March 2012

Commission File Number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of registrant as specified in its charter)

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

(Address of principal executive office)

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

Form 20-F x Form 40-F o

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

Yes o No x

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Portugal Telecom

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

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Telecommunications in Portugal

Customer segment		Revenues (Euro million)
Residential		682
Personal	> PT Comunicações 100%	768
Enterprise	> TMN 100%	982
Other		459

Telecommunications in Brazil(1)

Customer segment		Revenues (R$million, 100%)
Residential		10,501
Personal	> Oi 25.6%	8,190
Enterprise		8,470
Other		746

(1) For the 12 months ended 31 December 2011.

Other telecommunications businesses

			Revenues (Euro million)
Unitel 25% (a)(b)	> Angola	> Mobile	1,282
CTM 28% (b)	> Macao	> Wireline, mobile	356
MTC 34% (a)	> Namibia	> Mobile	159
CVT 40% (a)	> Cape Verde	> Wireline, mobile	84
Timor Telecom 41%	> East Timor	> Wireline, mobile	48
CST 51% (a)	> São Tomé e Príncipe	> Wireline, mobile	12

(a) These stakes are held by Africatel, which is controlled 75% by PT. (b) These stakes are consolidated by the equity method of accounting.

Other businesses

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

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

Call centres and telemarketing services [Contax in Brazil 44.4% and PT Contact 100%];

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01 Macroeconomic environment

1. International economic background

As in 2010, 2011 was a year clearly affected by the sovereign debt crisis distressing the Eurozone and, in a more pronounced way, the Southern European countries. The need of financial external support in Greece, in April 2010, and Ireland, in November 2010, was extended to Portugal, which requested financial external support to the European Union (EU), through the European Commission (EC) and the European Central Bank (ECB), and to the International Monetary Fund (IMF) in May 2011. The dissemination of this crisis was also clearly visible in other more peripheral economies like Belgium, Spain and Italy and, albeit to a lower extent, to economies considered core, like Austria and France. This crisis in the sovereign debt market clearly changed the market trends, increasing risk aversion across investors and reducing significantly liquidity in the credit and monetary markets.

Source: World Economic Outlook,IMF, September 2011

Europe policy setters responded by putting in place towards the end of the year clear policies promoting fiscal consolidation and budget control, while at the same time the ECB adopted a less restrictive policy, by reducing the reference interest rate (REFI) through two consecutive cuts of 25bp each in 4Q11, and by providing wide liquidity to the financial system.

The risk aversion referred to above materialised on: (1) declining yields of the so-called safe heaven countries like Germany or Switzerland the yield of the 10-year German bonds declined from 2.963% in December 2010 to 1.829% in the end of 2011; (2) increasing spreads of sovereigns perceived as riskier against the German bund the spread of the 10-year Spanish and Italian bonds against the German yield increased from 249bp and 185bp to 326bp and 520bp, respectively, and (3) depreciation of the Euro against the US dollar, -3% in full year 2011, but clearly more pronounced in 2H11 (-11%).

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Source: Bloomberg

The concerns around the sovereign debt crisis were also reflected in the equity markets, with the main European indexes showing relevant losses: DJ Euro Stoxx 50   17.1%, DAX -14.7%, CAC40 -17.0%, IBEX -13.1%, and PSI20 -27.6%. US markets were less penalised than its European equivalents, as they benefited from a more expansionary monetary policy by the Federal Reserve (FED) and better prospects for the US economy: DJones +5.5%, SPX 0.0%, and Nasdaq -1.8%. In China and Brazil, the focus of monetary authorities on the control of prices and inflation, namely in China, resulted in declining equity markets: Shanghai Composite -21.7% and Bovespa -18.1%.

Source: Bloomberg

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Source: Bloomberg

The relief of global inflationary pressures in late 2011 was supported by the trend of falling prices of raw materials. The price index ThomsonReuters / JeffereisCRB index declined 8.3% in 2011 and 17.8% from its annual peak in 2 May 2011. The Brent oil price per barrel rose from USD 94.91 on 31 December 2010 to USD 106.3 on 31 December 2011, having declined 12.7% from its annual maximum achieved on 29 April 2011, reflecting more moderate expectations concerning the evolution of global demand.

Source: Bloomberg

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Source: Bloomberg

1.1. United States

In 2011 the U.S. GDP grew 1.7%, decelerating from the 3% growth observed in 2010. Notwithstanding an increasing growth rate throughout the year, with annualised GDP growth up from 0.4% in 1Q11 to 2.8% in 4Q11, annual GDP growth in 2011 stood below initial expectations, reflecting the negative impacts of external shocks on the U.S. economy. These included the effects on production resulting from the earthquake in Japan, rising oil prices and the consequences of the debt crisis in Europe, which reflected in a less buoyant investment and a contraction in public consumption. Given the absence of support from equity and housing markets that traditionally support household consumption, the growth of this aggregate resulted mainly from (1) improvements in the labour market, which created more than 1.6 million new jobs in 2011 and reduced unemployment rate from 9.1% to 8.5% of the workforce between the first and last months of the year, as well as from (2) lower savings rate, which dropped from 5.2% to 4% of income available from the beginning to the end of the year.

Source: Bloomberg

Annual inflation ended the year at 3.0%, up from 1.5% in 2010 and above the 2% target set by the US monetary authority, but with a clearly downward trend in the last quarter of 2011. In this context, the Federal Reserve (FED) continued until the end of the first half of 2011, the second program of quantitative easing (QE2), completing the acquisition of USD 600 billion long-term Treasuries and kept the fed funds target rate at historically low levels (in the range from 0% to 0.25%). The weak traction of the recovery led the Federal Reserve to adopt additional monetary policy measures in 1H11. These included (1) the decision to keep the size of its balance sheet by replacing matured securities with the acquisition of new securities, and (2) the announcement of the intention to keep reference interest rates at exceptionally low levels until at least mid-2013. Finally, the FED announced the operation *twist*, which will be in place at least until mid-2012, in which the FED will increase the maturity of its balance sheet, involving the acquisition of up to USD 400 billion in Treasuries with maturities of between 6 and 30 years, by replacing instruments with maturities of 3 years or less.

Source: Bloomberg

1.2. Economic and monetary union Eurozone

Following a significant acceleration in the beginning of 2011, as a result of a strong expansion in investment, particularly in construction investment, benefiting from favourable weather conditions, the Eurozone economy has slowed down gradually over the year, registering a contraction in activity in 4Q11. Against this backdrop, the annual GDP growth in the Eurozone stood at 1.5% in 2011, decelerating from the 1.9% registered in 2010. Notwithstanding the strong growth in Germany, the Eurozone largest economy (3% throughout the year), the performance was very heterogeneous among the various countries. In effect, Southern European economies were much weaker, with negative annual GDP growth in Greece and Portugal and subdued growth in Spain and Italy, as the sharp fiscal consolidation effort had a more restrictive effect on the activity in these economies. In effect, the deterioration of sentiment and tightening of fiscal policy was reflected in an activity contraction in 4Q11. This slowdown observed throughout the year was due to (1) fiscal consolidation efforts across the Eurozone, with the aggregate Eurozone deficit declining from 6.2% of GDP in 2010 to 4.1% in 2011; (2) deceleration of private consumption and investment against a backdrop of increasing unemployment, and more difficult access to credit, and (3) a slowdown in exports, reflecting primarily lower demand in emerging economies.

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Source: World Economic Outlook,IMF, September 2011

Notwithstanding such sluggish growth, the annual average inflation rate stood at 2.7% (2.7% observed in December 2011) having increased from 1.6% in 2010 (2.2% observed in December 2010), primarily reflecting the increasing energy and food prices, whereas average core inflation in the Eurozone stood at 1.4%, relatively stable throughout the year, reflecting the absence of inflation pressures. As a result, in 2H11 the European monetary authority (ECB-European Central Bank) decreased the reference interest rate to 1.0%, through two consecutive declines of 25bp each in November and December, after having increased twice the reference interest rate in 1H11(1). Additionally, against a backdrop of lack of confidence of economic agents and low liquidity in the inter bank markets, the ECB also implemented non-conventional measures, including (1) liquidity injections in the banking system, (2) acquisition of sovereign debt securities in the secondary market, particularly of those countries in the peripheral economies, and (3) suspension of the minimum rating threshold needed for the ECB to accept Portuguese sovereign debt securities as collateral in funding operations, as it was the case for Greece and Ireland.

Source: Bloomberg

(1) ECB increased the reference interest rate in April by 25bp to 1.25% and by 25bp to 1.50% in June.

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As a result of the different economic trends and expectations in 1H11 and 2H11, as discussed above, the Euro strengthened against the US dollar in 1H11 and devalued in 2H11, having closed the year at 1.296 Euro/USD, broadly stable versus 2010 (1.337 Euro/USD), after having peaked on 4 May 2011 at 1.494.

Source: Bloomberg

2. Economic activity in PT s main geographies

2.1. Portugal

2011 was affected by a deterioration of the economic growth in Portugal and by the request for the financial external support following the deterioration of the funding conditions in the primary market and the increased risk aversion of investors in what concerns Portugal s sovereign debt. This increased risk perception was also translated into the consecutive downgrades of the Portuguese sovereign debt by the rating agencies. In effect, in 2011(2) Portugal was downgraded: (1) by 4 notches at Moody s, from A1 in 21 December 2010 to Ba2 in 5 July 2011; (2) by 3 notches at S&P from A- in 30 November 2011 to BBB- in 5 December 2011, and (3) by 6 notches at Fitch from A+ in 23 December 2010 to BB+ in 24 November 2011. As a result, the yield of the Portuguese sovereign 10-year bonds increased significantly throughout the year from 6.6% in 31 December 2010 (spread of 3.64pp against the 10-year German bonds) to 13.36% in 31 December 2011 (spread of 11.54pp against the German 10-year bonds).

Following elections in June 2011, Portugal s new government has been implementing the measures agreed as part of the Euro 78 billion financial support package agreed with the European Union / European Commission (EU/EC), the European Central Bank (ECB), and the International Monetary Fund (IMF). This financial adjustment program began to be implemented in May 2011, having already been the subject of three(3) favourable reviews by creditors officers. At the level of fiscal consolidation, the deficit fell from 9.8% of GDP in 2010 to a value near 4% of

GDP in 2011. Notwithstanding benefiting from extraordinary measures, namely the partial transfer of pension funds from

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(2) As at 15 March 2012, the local currency long term credit ratings of the Portuguese Republic were (1) Ba3 at Moody s; (2) BB at S&P, and (3) BB+ at Fitch

(3) The third quarterly review of Portugal s economic program by the EC, ECB and IMF took place in 15 to 27 February.

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banks, fiscal consolidation also results from (1) a major effort to reduce government expenditure, with a growth rate lower than budgeted, and (2) a favourable evolution of tax revenues, in line with forecast. It is expected that Portugal will achieve a primary surplus of 0.3% of GDP in 2012 and a structural deficit of 2.6% of GDP.

Source: Ministry of Finance

There has also been significant progress at the level of structural reforms in an environment of political and social stability, including changes in the labour market, reforms in the rental market and other reforms aimed at increasing competition in several markets. In the labour market significant changes have been implemented, aimed at increasing flexibility and reducing unitary costs, with clear positive impacts on competitiveness. The housing sector is also to benefit from the reforms implemented in the rental market, favouring mobility, debt reduction and absorption of the supply of housing. Finally, there are several measures aimed at increasing the competitive environment, including the privatisation program, the end of the golden shares, changes in the competition framework and a justice reform that is to introduce greater flexibility in cases of insolvency and business recovery.

The fiscal consolidation measures and the deterioration of credit conditions contributed to a contraction in domestic demand in 2011, leading to declines in public and private consumption (around 3% in annual average terms) and investment (close to 11%). Exports of goods and services maintained, however, a solid growth (close to 7% in real terms), with an increasing proportion of sales to emerging markets in Africa, Latin America and Asia. This favourable evolution of exports mitigated the impact of the factors referred to above in the GDP evolution, declined 1.5% in 2011.

The growth of exports also contributed alongside with the continuing deleverage process that is translating into lower imports led to a significant reduction in the external deficit of 8.8% of GDP to a value near 6.5% of GDP. It is expected that this process will continue in 2012, which should lead to a further reduction to around 2% of GDP.

The stock of net external liabilities of the Portuguese economy also decreased, reaching an estimated amount near 103% of GDP, compared to a maximum of 110% of GDP observed in 2009.

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Real growth rates (%), except when indicated.	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
GDP	1.6	0.8	1.4	2,4	0.0	-2.9	1.4	-1.6
Private Consumption	2.7	1.7	1.8	2.5	1.3	-2.3	2.1	-3.9
Public Expenditure	2.4	3.4	-0.6	0.5	0.3	4.7	0.9	-3.9
Investment	3.7	-0.9	-0.6	2.1	-0.1	-13.3	-3.6	-10.7
Exports	4.1	0.2	11.6	7.5	-0.1	-10.9	8.8	7.4
Imports	7.6	2.3	7.2	5.5	2.3	-10.0	5.4	-5.5
Inflation (Consumer Price Index)	2.4	2.3	3.1	2.5	2.6	-0.8	1.4	3.7
Budget Deficit (% of GDP)*	-3.4	-5.9	-4.1	-3.1	-3.6	-10.1	-9.8	-4.0
Public Debt (% GDP)	57.6	62.8	63.9	68.3	71.6	83.0	93.3	101.6
Unemployment Rate (% of active population)	6.7	7.6	7.7	8.0	7.6	9.5	10.8	14.0
Current Accounts Deficit(% of GDP)	-6.0	-8.2	-9.1	-8.9	-11.1	-10.1	-8.8	-6.1

Sources: INE, Bank of Portugal, Ministry of Finance, European Commission, OECD, ES Research. * In 2011 assuming the efects of the integration of Banks Pension Funds

2.2. Brazil

In 2011, the Brazilian economy continued to show a solid resilient performance, notwithstanding the difficult international environment. In effect, GDP grew 3.0% in 2011, after having grown 7.5% in 2010. Growth in 2011 was driven by private consumption, which continues to be leveraged in the income redistribution and surge of the middle-income class. In effect, 2011 continued to exhibit favourable conditions in the Brazilian labour market, which recorded the lowest average historic annual unemployment rate, at 6% of the workforce, while at the same time registered an increase of 5.2% of wages in real terms.

Source: World Economic Outlook,IMF

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Source: Bloomberg

The Brazilian economy also registered a favourable evolution in terms of exports and external trade balance that reflected higher commodities prices and benefited from buoyant emerging economies and from the liquidity made available by central banks in developed economies. As a result, Brazil s 2011 trade surplus increased 47.8% y.o.y to nearly USD 30 billion, the highest since 2007, with record exports (+26.8% y.o.y to USD 256 billion) and imports (+25.7% y.o.y to USD 226 billion), clearly a sign of the dynamism of foreign trade. This soundness of fundamentals, coupled with the opportunities derived from the sporting events to be hosted in the coming years as well as the initiatives related to the necessary infrastructure will continue to drive economic opportunities and attracting foreign investment. Reflecting this performance, the BRL/USD exchange rate observed in 2011 (average of BRL/USD of 1.675 in 2011) improved versus 2010 (average of BRL/USD of 1.759 in 2010), albeit on closing prices the BRL/USD moved from 1.660 in 31 December 2010 to 1.863 in 31 December 2011.

Source: Bloomberg

As a result of the economic strength, both internal and external, inflation closed the year at 6.5%, in line with the maximum threshold defined for inflation. Notwithstanding this, the Brazilian Central Bank reverted the trend of tightening monetary policy and decreased the SELIC reference rate from its peak of 12.5% in July and August 2011 to 11.0% in December 2011 (as compared to 10.75% in December 2010). Meanwhile, since the end of 2011, the SELIC rate was decreased further twice to 9.75%, reflecting a continued expansionary policy and a focus of monetary authority on the defence of economic activity.

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Source: Bloomberg

2.3. Africa

African economies have rebounded quickly following the slowdown caused by the global recession. In 2010, Africa s average economic growth amounted to 4.9%, up from 3.1% in 2009 and in 2011 it is expected a growth around 3.7%. Particularly, the Sub-Saharan Africa is showing solid macroeconomic performance, with many economies already growing at rates close to their pre-crisis averages. The global slowdown has not significantly affected the region thus far, but downside risks have risen, namely increasing inflation and exposure to commodity price swings.

2.3.1. Angola

The intensification of economic activity growth in Angola during 2011, which is expected to have grown 3.7%(4), was primarily driven by better performance of the oil sector, leveraged on the recovery of oil prices and its global demand, with Angola consolidating its position as the second largest producer in sub-Saharan Africa, having increased volumes throughout 2011: 1.8 million barrels per day in December 2011, which compares to an average of 1.7 million barrels per day in 2011.

Beyond the oil sector, Angola s economy also performed well as investments in infrastructure continued to progress at a swift pace and in diversified areas, including roads, railways, housing and other national recovery projects. These factors continued to lead external investment in Angola, and the country is now of the bigger receivers of foreign investment in Africa.

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(4) IMF estimate 24 January 2012

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Source: World Economic Outlook,IMF

On the credit front Angola also registered a good evolution in 2011, as the country sovereign rating has been upgraded at the three main rating agencies: (1) S&P, from B+ to BB- with stable outlook; (2) Moody s, from B1 to Ba3 with stable outlook, and (3) Fitch, from B+ to BB- with stable outlook. These upgrades clearly confirm the confidence that is being steadily built in the country.

On the currency front, since the Angolan authorities decided to abandon the peg against the US dollar after an initial devaluation, the kwanza has been broadly stable against the USD. In 2011 it has fluctuated in the range USD / AOA 92-95, and actually valued against the Euro. The price inflation remained high throughout 2011 with average annual inflation having increased at circa 15%, primarily conditioned by prices of food and beverages. This performance of food prices also continued to be underpinned by the difficulties at the level of logistics and distribution capabilities. At the level of monetary policy, the National Bank of Angola considering the need to promote national economic growth reduced in April the discount rate from 25% to 20%, having remained at this level until the end of the year, and the re-discount rate decreased by 5 percentage points from 30% to 25%.

Source: Bloomberg

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2.3.2. Namibia

Following a 0.7% contraction in 2009, the Namibian economy grew by 4.2% in 2010 and 3.6% (5) in 2011, leveraging on (1) a rapid recovery in diamond and uranium mining activities; (2) sustained improvement in global demand for mineral products, and (3) credit extension. In effect, the IMF expects Namibia to grow faster in 2012 at 4.2%, while the fiscal deficit to gross domestic product (GDP) ratio should shrink to 4.7% from 8.9% (estimated for 2011). The average consumer inflation rate is forecast to ease to 5.5% from 5.7%.

Source: World Economic Outlook,IMF

Unemployment and income inequality are high(6). Against this backdrop, fiscal policies expanded significantly with the government introducing a new program, in last years, aimed at increasing long-term growth and reducing unemployment by: (1) increasing infrastructure spending; (2) creating and temporary jobs within the public sector, and (3) introducing new measures targeted on the sectors of agriculture, tourism, transport, and housing and sanitation. The Bank of Namibia has maintained its policy rate at 6% since December 2010, 50 basis points above that of the South African Reserve Bank. Conditions in the banking sector have improved as the economy recovers, and supervision of the rapidly growing sector of non-bank financial institutions is being strengthened.

The IMF said the economic outlook appears promising, although facing important downside risks, including (1) a fragile external climate that poses risks for commodity demand and prices, and (2) upward pressures on prices of non-tradable services against a backdrop of expansionary fiscal stance. These risks could weaken efforts to strengthen Namibia s external competitiveness and economic diversification. However, there are good prospects for further investment and growth in the natural resource sector, and ongoing growth is expected in such areas as construction, manufacturing, and services.

2.3.3. Cape Verde

GDP growth is maintaining resilience, despite the economic and financial exposure of the archipelago, to some European countries, in which the financial debt crisis has been a major cause of the current turmoil.

(5) IMF estimate in January 2012 World Economic Outlook.

(6) 2008 Labour Force Survey, IMF. Unemployment rate using the expanded measure stands at 51.2% and the narrow measure, which only includes those who have looked for work in the past few weeks before the survey stands at 37.6%

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Macroeconomic performance in Cape Verde is solid but has weakened in 2011. GDP growth is projected to have slowed to about 5% in 2011 (down from 5.4% in 2010), reflecting the negative external environment due to the adverse and yet to be resolved European economic and financial conditions. Notwithstanding this slowdown in growth momentum, tourism and public investments have been underpinning economic activity. Turism activity has been positively influenced by the turbulence in some countries in the Middle East and Northern Africa. On another hand, consumer price inflation rose to 4.5% in 2011 (end of period, up from 2.1% in 2010), reflecting global food and fuel price shocks. Core inflation remains restrained.

The fiscal target for calendar year 2011 was met, as tax revenues held up well, notwithstanding certain shortfalls in nontax, and the spending execution was held below the budget. Fiscal overall deficit including grants stood at CVE 15 billion, or 9.9% of GDP.

Source: World Economic Outlook,IMF

Monetary conditions began tightening after mid-2011 as the BCV adopted a more restrictive monetary stance by (1) broadening and raising reserve requirements; (2) restarting open market operations to absorb escudo, and (3) raising intervention interest rates. The exchange rate is pegged against the Euro.

2.3.3. São Tomé & Príncipe

São Tomé & Príncipe s economy is gradually recovering after a marked slowdown in 2009 that reflected a decline in foreign direct investment as a result of the global financial crisis. GDP growth is estimated to have rebounded to nearly 5% in 2011 as externally financed projects helped drive activities in construction, trade, tourism, and agriculture. Growth momentum is expected to increase as exploratory drilling for oil continues. The public authorities expect oil production to start in 2015. Inflation has declined substantially since 2008 but still remains high (2011: 12.0% end of period and 12.4% average of period). The exchange rate is pegged against the Euro, since January 2010.

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Source: World Economic Outlook,IMF

2.4. Other geographies

2.4.1. East Timor (Timor-Leste)

In 2011, growth is estimated to have remained strong at about 10% on the back of government spending. Inflation in Dili remained high, having increased to 13.4% in December 2011, due to high food prices, a weak U.S. dollar, and strong demand from rising government spending.

The government launched its Strategic Development Plan targeted at transforming Timor-Leste into an upper-middle-income country by 2030 by increasing public investment to improve the country infrastructures. Against this backdrop, capital expenditure increased in 2011: total government spending is estimated to have risen to USD 1.2 billion, from USD 0.8 billion in 2010. Owing to rising petroleum revenue, however, the overall fiscal balance is expected to have continued to record a large surplus of 50 percent of GDP in 2011, and the Petroleum Fund to have risen to about USD 9 billion. Most of the Petroleum Fund is invested in US government bonds. The current account surplus is estimated to have remained large at over 50 percent of GDP in 2011 due to high oil revenue.

Given the buoyant petroleum demand and rising prices, the outlook for economic growth and poverty reduction is promising.

Source: World Economic Outlook,IMF

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02 Regulatory background

Portugal

Number Portability. Pursuant to the transposition, on September, of the new regulatory framework for the electronic communications sector, on 28 October 2011, ANACOM launched a public consultation on the regulation project amending the Number Portability Regulation. The changes proposed by ANACOM focus mainly on the need to ensure implementation of number portability (fixed and mobile) within 1 working day and reinforcement of subscribers rights within number portability.

The document was subject to public consultation until 14 December 2011. A final decision of ANACOM is now pending.

Digital Terrestrial Television. PT Comunicações has carried out the fulfilment of all obligations imposed under the licence awarded by ANACOM, having successfully concluded the process of channel update, in accordance with ANACOM s determination of 4 April 2011, wherein ANACOM approved the final decision regarding the switch of channel 67 (838-846MHz) consigned to PT Comunicações for the mainland, by channel 56 (750-758MHz), within the scope of provision of the digital terrestrial television service (DTT).

PT Comunicações is especting for the criteria, by means of a governmental ordinance, of compensation of the costs it has incurred within the process of hte aforementioned channel switch associated with MUX A.

On 24 March 2011, ANACOM issued a decision on the granting of subsidies for the purchase of DTT equipments by citizens with special needs, population groups with low incomes and institutions with a certain social relevance. PT Comunicações is granting subsidies in accordance with this decision.

On 31March 2011, ANACOM approved the Information and Promotion Plan to fulfil by PT Comunicações, within the scope of the DTT process. PT Comunicações has carried out the television campaign it was bound to (ceased on November 2011) which was followed by the television campaign promoted by ANACOM.

On 7 April 2011, ANACOM decided on the reimbursement procedures regarding the costs of instalation and equipmentsincurred populations resident in areas covered with complementary means (DTH). PT Comunicações is also fully fulfiling this decision.

Within the context of preparing migration to DTT, during 2011, three pilots were carried out in Alenquer, Nazaré and Santarém.

Wholesale Reference Offers. By determination of 20 October 2011, ANACOM approved a project decision on the procedures to be carried out in order to evaluate quality of service within wholesale reference offers.

This project decision determines that PT Comunicações shall amend the several reference offers that establish deadlines for repairs (local loop unbundling, leased lines, Ethernet accesses, bitstream and wholesale line rental)

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within 30 business days after notification of ANACOM s final decision, in accordance with several criteria. In said determination, ANACOM also has determined to PTC to send to the regulator information on service failures within the local loop unbundling reference offer, since January 2011, as well as on the measures already adopted, or envisaged, in the context of said offer, to minimize service failures generally associated to months with more rainfall.

The project decision was subject to public consultation until 19 December 2011, and is pending ANACOM s final decision.

Leased Lines Reference Offer (ORCA) and Ethernet Accesses Reference Offer (ORCE). On 17 November 2011, ANACOM approved its project decision on the leased lines reference offer (ORCA) and the Ethernet Accesses Reference Offer. ANACOM is proposing to determine, among others, to PT Comunicações to decrease, in the ORCA, the price of all components included in its pricing list (including CAM lines) for 2 Mbps, 34 Mbps and 155 Mbps lines, in 35%, 40% and 45%, respectively.

This decision project was submitted to a preliminary hearing and to a public consultation, ANACOM having established a term of 20 business days for submission of contributions, which ended on 30 December 2011; the project is now pending for a final decision by ANACOM.

RIO and RIAO 2011. On 22 December 2011, PT Comunicações published new versions of the Interconnection Reference Offer (RIO) and the Reference Internet Access Offer (RIAO). The modifications did not include price changes.

Wholesale market for voice call termination on individual mobile networks. On 1 April 2011, ANACOM submitted to Public Consultation the text about the Methodological Definition concerning the Development and Implementation of a Mobile Termination Cost Model. The option was for a pure LRIC bottom-up model, developed in collaboration with Analysis Mason. The consultation closed on 13 May and the corresponding report was approved on 1 July. ANACOM gave indication that a new consultation would follow, this time about the implementation of the LRIC model and, consequently, the definition of a new glide path applicable to mobile termination rates (MTRs).

On 3 October 2011, ANACOM approved the Draft Decision on the Price Control Obligation, within the market of Voice Call Termination on Mobile Networks. In this Draft Decision, ANACOM incorporated its understanding derived from the Consultation of April and the cost accounting model - based on the pure LRIC option - pointed to MTRs of 1.25 cent. per minute.

To reach this value, ANACOM proposed a glide path with duration of 4 quarters: from the existing 3.5 cent. per minute, applied since August 2011, MTRs would drop to (i) 2.75 cent. per minute on February 2012; (ii) 2.25 cent. per minute on May 2012; (iii) 1.75 cent. per minute on August 2012; and, finally, (iv) 1.25 cent. per minute on November 2012.

This consultation took place until 22 November 2011 and, up to this date the final conclusions of ANACOM are not known.

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Spectrum. By determination of 10 February 2010, ANACOM approved the final decision on the provision and use of electronic media in procedures which involve communication between this Authority and radio network or station licensees, as well as all requirements which apply in this context, under the terms of Decree-Law No. 264/2009 of 28 September.

By determination of 31 March 2010, ANACOM approved the National Frequency Allocation Plan (NFAP) to have effect in 2009/2010. Approval was likewise given to the report on the respective public consultation, launched on 23 December 2009.

By determination of 8 July 2010, ANACOM decided, in the context of the 900/1800 MHz spectrum refarming, to unify into a single title the conditions applicable to the exercise of the rights of use of frequencies allocated to TMN for the provision of the land mobile service, in accordance with GSM 900/1800 and UMTS technologies.

By determination of 16 December of 2010, ANACOM approved the final decision on the designation and availability of 790-862 MHz sub-band for the provision of electronic communication services, in accordance with the Decision 2010/267/EU, including the corresponding amendment to the QNAF - Quadro Nacional de Atribuição de Frequências (National Frequency Allocation Table). By determination of 6 January 2011, ANACOM approved the final decision on the introduction of mobile communication services on board vessels (MCV services).

By determination of 17 October 2011, after a pubic consultation auctioning regulation was published at the official journal (Regulation n.º 560-A/2011, of 19 of October 2011), and for the provision of publicly available terrestrial electronic communication services, using any technology, without prejudice to the obligations set forth in the Radiocommunications Regulation of the International Telecommunication Union (ITU) and in the National Table of Frequency Allocations (NTFA), rights of use for frequencies in bands of 450 MHz, 800 MHz, 900 MHz, 1800 MHz, 2,1 GHz and 2,6 GHz were allocated by means of a multiband auction.

A maximum of 39 rights of use were auctioned, 6 of which in 800 MHz band and 14 of paired spectrum plus 2 of unpaired spectrum in the 2,6 GHz band. The auction model was simultaneous, ascending, open and with multiple rounds. Spectrum caps were established in the allocation of spectrum.

The 800 MHz frequency band may only be used after 26 April 2012, subsequent to the switch-off of the analogue television network, concluding (3rd phase) on 26 April 2012, in accordance with ANACOM decision of June 2010 approving the Plano para o Switch-Off (Switch-off Plan) pursuant to Resolution of the Council of Ministers no. 26/2009 of 17 March and is subject to the establishment of technical and geographic conditions which provide for the compatibility of usage, including between Morocco and Spain.

According to Regulation 560-A/2011, the auction regulation, the holders of rights of use of frequencies which, upon conclusion of the auction, become holders of 2 x 10 MHz in the 800 MHz frequency band or holders of at least 2 x 10 MHz in the 900 MHz frequency band, are subject to an obligation to allow access to their networks according to non-discriminatory. They shall, upon request and in good faith, negotiate access agreements with third parties. Namely, they shall negotiate agreements which allow their networks to be used for the mobile virtual operations of third parties, in the different modes that range from full MVNO to light MVNO, for the provision to end-users of electronic communication services which are equivalent to the services which they offer to their own customers.

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On 6 January 2012, ANACOM approved the final report of the auction for the allocation of rights of use of frequencies in the 450 MHz, 800 MHz, 900 MHz, 1800 GHz, 2.1 GHz and 2.6 GHz bands.

The multiband auction raised a final amount of 372 million euros from the winning bidders, as follows: 113 million euros (Optimus), 113 million euros (TMN) and 146 million euros (Vodafone).

Cost Accountig System ANACOM approved, by deliberation on 7 April 2011, the Draft Decision on the revision of the weighted average cost of capital (WACC) of PT Comunicações, applicable to the years 2010 and 2011. This Draft Decision was submitted to public hearing of the interested parties until 26 May.

By deliberation of 26 August 2011, ANACOM approved the Final Decision on this subject, determining a WACC of 11,6% and 11,0% for 2010 and 2011, respectively.

Regulation on the settlement and collection of regulatory fees. On 31 May, ANACOM corrected the value of the fees owed for the exercise of the activity of supplier of networks and electronic communications services, in the years 2009 and 2010, after computing the actual administrative costs in 2010, and revising the value of provisions in both years. After these corrections, operators were reimbursed.

By deliberation of 25 November 2011, ANACOM settled the contributory percentage t2 (applicable in the case of PT Comunicações) in 0.5714% . This calculation was based on an amount of administrative fees of approximately 30 million euro.

Universal Service. By deliberation of 11 November 2010, ANACOM decided not to oppose the proposal for the fixed telephone service residential tariffs, within the scope of the Universal Service (US), as presented by PT Comunicações on 22 October 2010. Prices were implemented as from 1 January 2011.

By determination of 19 November 2010, ANACOM decided not to oppose the proposal for the tariffs to be applied to calls originated on PT Comunicações network and terminated on other operators networks, as presented by PT Comunicações on 8 November 2010, and implemented as from 1 January 2011.

Pay Phones. On 18 March 2011, ANACOM launched a consultation on the provision of the Pay Phone service, within the scope of the Universal Service (US).

According to the report of the consultation, approved on 7 July 2011, ANACOM stated that: (i) the maintenance of the Pay Phone service as one of the provisions of the US is justified; (ii) the present conditions for the provision of the Pay Phone service, within the scope of the US, should be altered in order to allow a significant reduction of the number of pay phones functioning.

ANACOM also manifested the intention of, in due time, ensue the revision of the present conditions associated to the provision of the US.

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Net Cost of the Universal Service. Between 1 February and 22 March 2011, ANACOM launched two public consultations, one on the definition of the concept of excessive burden, and another on the methodology for the calculation of the NCUS.

By deliberation of 9 June 2011, ANACOM approved the decisions on the definition of excessive burden and on the methodology for the calculation of the NCUS. PT Comunicações submitted an appeal to ANACOM defending the need to correct the methodology and a final decision on this matter was adopted on 18 August, attending the plea presented by PT Comunicações.

By the end of 2011, PT Comunicações submited to ANACOM the calculation of the NCUS pertaining the period between 2007 and 2010. ANACOM will have to submitt these results to an independent auditing process, which did not yet begin, but that should be concluded by the end of 2012, according to the Strategic Plan 2012-2014 of ANACOM.

Designation of the Universal Service Providers. Between 16 November and 30 December 2011 a Public Consultation concerning the process of designation of the Universal Service Provider(s) (USP) took place, which was divided in three allotments: (i) Telephone Service; (ii) Pay Phones; (iii) Directory and Enquiry Services. Beside this division, the provision of Telephone Services and Pay Phones was further divided in 3 geographic areas.

According to the text submitted to consultation, the process of seletion of the USP consists of designating that/those which, ensuring quality and price accessibility, present the lower NC associated to the provision of the service, or, in the case of Directory and Enquiry Services, the highest remuneration being paid to the State. Emphasis was also placed in the respect for the principle of net neutrality, and the concept of functional access to the Internet remaining as a connection which allows a transmission velocity of 56 kbps, although contributions in this matter are expected, relating to the possibility of the market in assuring higher debit rates.

ANACOM took a final decision on this topic on 14 February 2012, and issued its recommendations to the Government. ANACOM announced that it will launch a consultation on the compensation fund after which the Government will be expected to launch the tender for the designation of the company (ies) responsible for the provision of the US.

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

On 28 September 2010, ANACOM approved the final decision regarding this market. The main innovation regarding the previous decision is the introduction of Ethernet segments, with the segmentation of the transit market in Competitive and Non Competitive Areas. The leased lines retail market has been eliminated.

New Regulatory Framework for electronic communications. On 26 May, 2011, the provisions amending the electronic communications regulatory package came into force in the EU. In Portugal, said provisions came into effect on September 2011, pursuant to the publication of

Law No. 51/2011, of September 13.

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The main changes introduced to the regulatory framework are in respect of:

- Reinforcement of consumers rights
- Reinforcement of competitive conditions between operators, in order to allow consumers more choices
- Promotion of investment in new communications infrastructure, namely by freeing spectrum for the provision of broadband services
- Networks security and integrity.

Consumer. In 2011, ANACOM adopted a set of measures envisaging reinforcing consumers rights.

By determination of 13 January, ANACOM approved its project decision on the amendment of its decision of 21 April 2006, regarding the object and form to render available to the public the conditions on the offer and use of electronic communications services. This decision project proposed a relevant number of modifications in respect of providing pre-contractual information.

This project decision was submitted to a public consultation, which lasted until 16 February 2011.

By determination of 10 October 2011, ANACOM issued its final decision in this matter, having granted to providers of electronic communications networks and services a period of 120 business days to implement the changes approved. In respect of standardized offers to the public (including citizens with special needs). This determination imposes to operators the obligation to disclose, in their selling points, including in door-to-door sales, a set of information regarding electronic communications services they provide.

Operators are also required in distance and door-to-door sales to provide the information detailed in ANACOM s determination and the contacts through which the consumer may obtain said information.

On 1 June 2011, ANACOM launched COM.escolha, a new tool to consult/compare prices and simulate consumption within internet, mobile and fixed telephone and television services, and envisaging providing help to residential consumers in choosing electronic communications services best suited to their needs. Each operator should provide at is decision, the information that is uploaded into the comparison tool.

In addition, by determination of 27 October 2011, ANACOM approved a draft decision on the required procedures for subscribers to settle contracts relating to the provision of publicly available electronic communications networks and services.

ANACOM also proposed that operators should implement the measures adopted in ANACOM s final decision and amend their general terms/contracts within 90 business days from the final decision. According to ANACOMs draft decision, contracts should explicit the content of the termination declaration issued by the subscriber, the documents to submit with said declaration, form, means and contacts to submit the termination request.

This draft decision was submitted to a public consultation, which ended on 28 November 2011.

Network security. ANACOM approved, by determination of 22 December 2011, a draft decision on the circumstances, format, and procedure applicable to the report of security breaches or loss of integrity with a

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significant impact on the functioning of electronic communications networks and services available to the public. This draft decision also contains the conditions in which ANACOM considers there is a public interest in disclosing said information to the public, as well as its content, means and deadlines.

This draft decision was submitted to a public consultation until the 27 January 2012 and is now pending a final decision by ANACOM.

Value Added Services based on messages (premium messages). Law No. 51/2011, of 13 September, which is in force from 14 September, introduced block by default of access to value added services based on messages.

Roaming. On 11 February 2011 ended the deadline for submitting contributions to the EC Public Consultation, which had been launched on 8 December 2010, on the revision of Regulation 544/2009 (Roaming II).

Considering that the market for the provision of roaming services is not yet competitive, the EC proposed, within the scope of the future Roaming III , innovative measures, when compared to those present in the current Roaming II, which is due to expire on 30 June 2012.

Beside the maintenance of the dispositions already in place concerning the mechanisms of transparency and expenditure control; price caps applicable to wholesale voice, sms and data tariffs; and maximum prices applicable to retail voice and sms tariffs, the EC proposes introducing: (i) a cap on the retail data tariff (July 2012); (ii) the obligation for mobile operators to provide network access, in order to allow the provision of roaming services (July 2012); and (iii) the decoupling of roaming services, while ensuring maintenance of the client number (July 2014).

The final decision of the EC concerning the content of Roaming III should only be known in May 2012.

Net Neutrality. The European Commission released its findings of the public consultation on Net Neutrality, which took place between 30 June and 30 September 2010. Summarily concluded that the EC measures under the 2009 Regulatory Framework are sufficient to address issues related to NN.

Throughout 2011 the BEREC (Body of European Regulators for Electronic Communications) undertook several initiatives:

- On 15 April BEREC asked Internet stakeholders to answer a set of questions regarding the application of net neutrality principles, including any limitations on Internet access likely to affect the end user. Namely, access to VoIP applications for mobile access networks and access restrictions on applications and content distribution.

- In October launched a public consultation on its proposed guidelines on network neutrality and transparency. PT Group expressed its comments in a common position with other operators.

- In December, BEREC asked operators to complete a questionnaire regarding IP traffic. With this questionnaire BEREC intended to measure any blocking processes or constraints on access to applications, as well as traffic management measures used by ISPs that may impact on the degradation of service. PT Comunicações and TMN sent their answers to ANACOM, on 20 January 2012.

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The EC will decide by the first quarter of 2012, and according to the conclusions of BEREC s studies, it must adopt stricter measures to guarantee a more open internet and the neutrality of networks.

Statistical Information. ANACOM approved, by determination of 3 March 2011, the final decision regarding the new questionnaire in respect of the provision of electronic communications services at a fixed location and nomadic VoIP services. This new questionnaire has replaced some questionnaires previously adopted, and has allowed integration of some information that was sent in other questionnaires.

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03 Strategic profile

Business context: a sector in rapid change with the emergence of multiple players

Global telecommunications sector

Transformation of consumer habits driven by technology. The proliferation of new and innovative players in the telecommunications, media and technology space and the emergence of global players is driving the appearance of new and innovative applications matching and creating additional needs for the end user. This proliferation of new apps and services is also driving the transformation of consumer habits, by promoting the interactivity with peers through social networks, increasing the propensity to multi-tasking and fostering the usage of multi screens for various applications.

Technological evolution and development of new access technologies. The development of new access technologies and networks continues to be an overriding trend, with operators announcing plans, trials and investments in Next Generation Access Networks (NGAN), namely Fibre-To-The-Home (FTTH) networks in the fixed business and Long Term Evolution (LTE / 4G) in the mobile business. The investments that are being carried out in new access technologies, which are significantly more efficient for data transmission will enable operators to increase access speeds at lower costs.

Source: Screen Digest; Cisco VM Global IP traffic forecast, 2010-2015; Yankee

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The availability of increasingly faster access speeds, both in fixed and mobile, is underpinning an explosion in data consumption as the high connectivity and capacity of terminal equipments, enabling voice, data and video, sets the background for the emergence of new services. Accordingly, worldwide data consumption will see exponential growth in the medium term, increasing by 5x in the wireline to 32 Exabytes/month and by 65x in the wireless to 2 Exabytes/month between 2009 and 2014.

Change in consumption patterns led by new access devices. The fast development and availability of new access devices are leading to a significant growth of Internet users, which are becoming increasingly more individual, and to more frequent usage thus catalysing an explosion in bandwidth consumption. Access devices like the PC, TV and mobile handset are also becoming increasingly convergent, enabling the emergence of a triple-play multi-screen trend in the sector. Examples of this trend are smartphones, tablet PCs and Internet pads, e-books. In effect, the proliferation of these devices that are connected to the Internet, added to the computer and the laptop, is increasing significantly the ability to be always online.

Source: Screen Digest; Yankee

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695 thousand status updates per second in Facebook

Processed information per hour equivalent to more than **1.5 million movies**

More than **20 hours** of **contents uploaded per minute**

2.9 million e-mails sent per second

Source: Powering growth through digital advantage , McKinsey & Company

New competitive boundaries being set at a global level. The broad telecommunications sector will continue to expand, but increasingly overlapped with equipment manufacturers, Internet service providers and media players, a trend led by growth in connectivity and higher access speeds that will enable the emergence of cloud-based services. Telecom operators are expected to maintain traditional access services and a billing relationship over which users access a myriad of services like music (iTunes), video (YouTube), photos (Facebook, Picasa, Flickr), apps (Google, App Store) and retail (Amazon, Ebay). As a result, there is an increasing consolidation trend in the telecommunications sector with the emergence of new and global players and brands. Cloud computing services are not only emerging as a solid reality in all consumer segments, such as personal and residential, as discussed above, but also for corporates, SMEs and SOHOs, with new offerings like software or infrastructure as a service becoming increasingly popular.

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A new growth paradigm: emerging markets as the growth engine. Emerging markets are leading the growth of the telecommunications sector having grown twice as fast as developed markets (CAGR 2005-07 of 11.7% in Africa, LatAm and Asia as compared to 5.8% in Western Europe and North America). This trend is expected to intensify in the future, as the sector was broadly flat in Western Europe and North America in the period 2007-09 when compared with a 6.9% CAGR over the same period for countries in Africa, LatAm and Asia. With the sector becoming more mature in developed markets, the focus on execution will be key as a lever of differentiation and, ultimately, success.

Telecommunications context in Portugal

Consolidation of bundled offers. 2008-11 was marked by the development, marketing and subsequent proliferation of bundled offers among the several market players, with triple-play packages (bundling TV, voice and broadband) becoming increasingly popular and attractive. The major transformation initiated in 2008 continued throughout 2011 with the consolidation of the presence of cable operators in the voice segment and of copper operators in the TV segment. As a result of its relentless and focused investment in pay-TV and bundled offers, PT has significantly improved its dynamics in voice and data, whilst being able to achieve a position of co-leadership in the pay-TV market.

Increased competitiveness in urban areas. 2008-11 was also marked by a significant change in the landscape of the Portuguese telecommunications market, with operators investing in fibre, namely PT that covered 1.6 million households with FTTH, available and under construction. This trend benefited from increased regulatory visibility,

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with a new regulation concept that followed a geographical segmentation approach, removing some restrictions on PT s broadband offer.

PT s positioning: a customer-oriented innovative company

PT is an international operator focused in three main geographies, Portugal, Brazil and Africa. In addition, PT also has investments in Asia, namely in Macao and in East Timor. PT has more than 93 million customers worldwide and generates 58% of its revenues(8) outside Portugal, including 53% from Brazil.

In the Portuguese market, PT is a customer-oriented company focused on innovation and execution, managing its business along customer segments: (1) Residential: consolidate the inflection of the historical trend in the wireline business, by leveraging its successful TV strategy (having already achieved a market share of 30% in the Portuguese pay-TV market); (2) Personal: continue to develop innovative data and Internet access products and convergent services and apps, leveraging on strong online presence of the SAPO web portal, and on key partnerships, while simultaneously redesigning its tariff structure to improve the underlying trends in the mobile business, and (3) SMEs and Corporate: launch leading edge convergent cloud-based solutions supported by the recently announced next generation Data Centre.

At an international level, PT is focused on improving the operational performance of its assets and on the sharing of best practices across the various businesses. The expansion of international operations to multiple geographies is one of the most important catalysts of value creation in the telecommunications sector and PT has built a relevant portfolio of international operations as referred to above.

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

Portuguese operations

Residential: providing a differentiated and sophisticated multi-screen pay-TV experience. The growing connectivity available on next generation access networks will continue to be an overriding trend in the residential segment enabling the simultaneous connection of multiple devices through wireless and wireline networks inside the customer home (TVs, games consoles, PCs, laptops, tablets, smartphones). Multi-screen TV is a key lever for differentiation and Meo is already converging towards a seamless offering on the TV, PC and smartphone. Cloud-based services are becoming an increasingly popular reality allowing easy access to software and technology and higher security in the storage of key information. PT is following this trend having launched over the recent past several innovative applications and services, including (1) Meo Go, a live-TV service available on Wi-Fi and 3G/4G mobile networks; (2) Meo Kanal, an innovative application aiming at bringing the social media features to the TV set; (3) Meo Games, an on-demand advanced gaming service.

Personal: mobile data and convergence as key growth levers. The increased penetration of smartphones, laptops and other mobile data devices, coupled with an explosive growth and proliferation of data services and apps, sets a favourable background for mobile data services. TMN is clearly in the forefront of mobility data services, offering TV (Meo Mobile), music (Music Box) and access to social networks through innovative aggregator and convergent services, which leverage the know-how and brand of Sapo. TMN also leverages on partnerships with key suppliers, using own brand or third party brands, to maintain a distinctive and attractive offering for smartphones, tablets and laptops.

Additionally TMN remains focused on designing new tariff plans, like the e , an innovative prepaid plan, or the Unlimited post-paid plan, which are simpler and customisable and aimed at catalysing the upselling of

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Internet and lock-in of high value customers, shifting way from pricing competition. As a result, TMN commands circa 50% of market share in mobile broadband, according to a Marktest study, and 48% in smartphones, according to a GfK study, clearly ahead of its overall market share.

Enterprise: new services for both corporates and small/medium business leveraging on PT s unique transport and access networks. Through investments in infrastructure and telecom-IT convergence, PT intends to develop and market advanced integrated solutions for the corporate and SME segments aimed at promoting the penetration of IT/IS and BPO services, thus increasing customer share of wallet and loyalty in these competitive market segments. PT will also leverage its new leading-edge data centre and cloud computing offering, in partnership with Cisco and Microsoft, in order to supply new and distinctive services to the market.

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

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

International operations

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

Brazil: data growth and convergence. In Brazil, through its investment in and partnership with Oi, PT will focus its efforts on leveraging its successful experience in developing innovative and technologically advanced solutions for corporate customers, fixed-mobile convergent offers, mobile broadband, pay-TV and triple-play services to contribute significantly to improve further Oi s operational and financial performance, considering its strong presence in the Brazilian market and the potential for future growth.

Africa and Asia: Opportunistic M&A and consolidation. PT continues to focus on improving the efficiency of international operations through sharing of best practices amongst all its subsidiaries and through an increased proximity that is being achieved by having top management contacting in person or by video-conference frequently to PT s operations around the world to better follow-up key developments in each geography.

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

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Focus on innovation and execution

Innovation: structured approach and partnerships. PT has a structured approach to innovation aimed at establishing a balanced portfolio of projects focused on two key variables: risk level and maturity. Three main categories are defined under this structured approach: (1) incremental innovation (business as usual, low-risk and short-term optimisations); (2) planned innovation (business development, medium-term and medium-risk developments), and (3) exploratory innovation (structural projects, which are long-term and high-risk by nature). Additionally, PT s innovation approach leverages on a network of partnerships with key institutions that are worldwide leaders and a reference in their respective fields. These partnerships are categorised as follows: (1) technological partnerships for the development of new solutions and services (e.g., agreements with Cisco, Corning, Samsung, LG, Huawei and ZTE); (2) partnerships, aimed at sharing best practices and establishing joint collaboration in innovation and R&D (e.g. protocol signed with Singtel); (3) protocols with universities, in order to foster joint R&D and knowledge-building efforts (e.g. partnership with CMU and several Portuguese universities), and (4) R&D partnerships, aimed at developing new technological solutions (e.g. agreements with INESC Inovação and Instituto de Telecomunicações).

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

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

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

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Execution: next generation networks, distribution and customer care. PT is and will continue to be in the forefront of fibre rollout in Portugal and in Europe, having already covered 1.6 million homes passed with FTTH available and under construction, thus placing Portugal as the most penetrated country in Europe with 46% of households covered, an initiative that was recognised by the FTTH Council Europe with the innovation award Deployment and Operation of FTTH networks . PT aims at leveraging its FTTH investment not only to provide advanced and high-speed data and video services to its corporate and residential customers but also to cover TMN s base stations with fibre in order to allow higher download and upload speeds for TMN s data customers (85% of TMN sites are already connected with fibre and 25% already use IP/Ethernet backhauling), and simultaneously paving the way for LTE rollout. In effect LTE services were launched in March 2012, with the LTE network covering 20% of population in Portugal from beginning. PT aims to increase coverage to 80% of population by April 2012 and to 90% by the end of 2012. Finally, PT also leverages the most comprehensive WiFi network in Portugal, with around 1,600 hot spots, to enable traffic offload from mobile to fixed networks. PT is also integrating its fixed and mobile distribution networks, thus further extracting scale and scope synergies and leveraging on cross-selling to achieve further differentiation versus its competitors. In addition, PT is implementing an extensive transformation programme and rejuvenating its field force, in order to improve its quality and responsiveness against a backdrop of increasingly complex TV and IT services provided to customers. This transformation is also extended to the customer care area, by focusing on convergence, integration and self-care to improve QoS and customer experience through process optimisation.

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04 Research and development

In 2011, Portugal Telecom maintained its strong commitment to innovation despite the difficult economic environment, by pursuing its strategic objectives and key corporate priorities in order to achieve sustainable growth. In an increasingly competitive and global market, PT positions itself at the forefront of innovation, both in terms of internal processes and the development of innovative services which better respond to customer needs.

Aware of the role that ICT can play in improving the well-being of citizens, Portugal Telecom continued to stimulate innovation, both in new products and services (with benefits for people, companies and public entities), and in innovative marketing campaigns that ensure a closer relationship with customers, such as PT BlueStation. In this context, Portugal Telecom reinforced its investment in broadband access, based on a robust, high capacity and next generation infrastructure, which ensures a rapid and effective response to market demand for high quality standards, while simultaneously maintaining the focus on environmental sustainability.

Portugal Telecom therefore maintains its path in the area of innovation as a structural and differentiating element, having invested around 219 million Euros in Research, Development and Innovation in 2011, which translates into a 9.3% increase from the previous year.

The following Innovation/R&D projects carried out in 2011 can be highlighted:

- Consolidation and development of **next generation access networks** that enable a truly unique customer experience commitment to FTTH rollout under way and early implementation of LTE;

- Design and launch of **innovative products and services**, leveraging broadband access and higher connection speeds enabled by fibre optics in order to improve customer interactivity and experience. Examples of such products and services are: MEO GO!, MEO Interativo, MEO Karaoke and WebBox;

- Co-development and launch of **proprietary smartphones** (e.g. TMN A7) and **innovative mobile price plans** with the purpose of adapting the services to different customer needs (e.g. TMN kids , TMN e), thus promoting the consumption of mobile data;

- Commitment to **advanced IT/IS solutions in progress**, leveraging PT s cloud computing strategy to provide end-to-end services to business customers virtual private clouds, full outsourcing of IT services and security management;

- Development of **sector-specific solutions** in Health (e.g. medical telecare service for seniors), Education (e.g. *SAPO Campus* and the development of a global solution to manage and control accesses and attendance), Public Sector (e.g. development of *Portal da Segurança* and *Portal da Cultura*) and for SMEs (e.g. new integrated solutions by marketing *OfficeBox Restaurantes e Cafés, OfficeBox Médicos e Clínicas* and *OfficeBox Soluções para Retalho PingWin Software)*;

- Launch of the construction of the **new data centre in Covilhã**, one of the largest in Europe, in response to growing customer needs in terms of processing power and storage capacity (30 Pbytes);

- Implementation of **organizational transformation programs** to maximize process efficiency and quality of service new CRM and O&M tools;

- Implementation of several projects in the **sustainability** arena to minimize Portugal Telecom s environmental footprint, by encouraging all employees to adopt sustainable behaviours (e.g. acquisition and installation of new air conditioning equipment with integrated free cooling systems, monitoring of

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water and energy consumptions and increased environmental awareness in the use of printing equipment).

The structural approach to innovation management introduced by the OPEN Programme, since its inception in 2009, has been critical to promote a culture of innovation across the Group. Innovation is structured around three different time horizons and associated risk profiles: (1) Incremental Innovation short term initiatives for continuous improvement; (2) Planned Innovation development of a medium term technological and service offering roadmap; (3) Exploratory Innovation analysis of the main long term technological trends in the industry and definition of PT s positioning in these areas. In 2011, the Innovation Cockpit area was created, with the goal of monitoring PT s efforts in RDI and promoting the access to innovation funding programmes. Business development teams were also set up, with the aim of coordinating cross-segment, structural innovation projects such as Machine-to-Machine, E-health or Cloud Services.

A. Incremental innovation

The contribution of all the employees in the company towards the generation of ideas for continuous improvement has been one of the main sources of internal innovation and constant improvement of processes and services. In this context, the Market of Ideas consolidated its importance as a critical tool that enables all the employees to actively contribute to PT s innovation processes, by submitting, discussing and rating ideas. The success of this initiative was reinforced during 2011, with the participation of more than two-thirds of the company s employees in the Market since its official launch. These employees were able to answer several challenges launched by the organization in the last three years. This high level of involvement is a testament to the growing receptiveness of all employees to the culture of innovation that has been instilled in the pursuit of a common goal: sustainable growth.

This initiative, besides having generated over 2400 innovative ideas in 2011, also had a positive impact in the motivation of all employees, fostering a closer alignment with the company s strategy. The ideas that were implemented enabled significant operational and environmental improvements.

The results of these initiatives have, in some cases, exceeded the initial expected impact. Among others, the measures implemented in 2011 include:

- **Portal Idade Maior:** development of a SAPO web portal with dedicated contents and services for the senior segment (more than 700 registered users and around 650 thousand visitors);
- **Rationalization of packaging material:** reduction in the volume of material used in the packaging of PT products, such as mobile broadband and mobile phones, for instance through the use of resistant recyclable material. This initiative has already generated savings of over 2 million Euros;
- **Efficient gardens:** use of decorative pebbles in several company gardens which enabled annual savings of 100 thousand euros, by reducing water consumption and maintenance costs. Additionally, the reutilization of rain water and water used in bathrooms for irrigation systems allowed the company to save more than 5 thousand euros per year;
- **Efficient lighting in buildings:** switch off of corridor lights in every main building, during weekends and bank holidays. This measure translated into annual savings of 50 thousand Euros;

- **PT Auctions:** creation of a platform on the intranet where the company can auction obsolete materials, freeing up space in warehouses and collecting money that reverts to charity institutions.

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B. Planned innovation

OPEN continued to develop its work alongside the technical, operational and business areas of Portugal Telecom, guaranteeing a clear medium-term offering roadmap for the several business segments. The aim is to constantly ensure an integrated and detailed development plan for the company s offering, which translates into competitive gains and added functionalities for end users and which maximizes sustained growth for the company.

1. Products and Services

In order to ensure increased loyalty of current customers and to attract new ones, Portugal Telecom has invested heavily in developing and launching innovative and pioneer solutions in the market, ensuring that the evolving needs of the population are fully met. This loyalty has been consolidated over the years, through the promotion of solutions that ensure greater involvement and proximity between customers and PT s product line.

a. New MEO services

Maintaining its commitment towards continuous improvement, MEO has been developing a set of pioneer services in the domestic market, which include a strong focus on promoting a more active and central role of its users. These services are the result of a positioning targeted at improving customer experience, an experience that should become ever more interactive and bidirectional.

Therefore, there was a strong focus on developing additional non-linear content, including new widgets (e.g. MEO Rádios, RFMvi and SAPO Combustíveis) and the availability of new applications designed to make the television experience more interactive, namely specialized channels with exclusive content, such as Secret Story 2 and Biggest Loser 2, and applications with dedicated content (e.g. O Meu Telejornal, Sport TV VoD, Benfica and MEO Surf).

Additionally, and to ensure the enhancement of customer experience, a set of new interactive applications was developed and integrated into the service, such as MEO Interactivo, MEO Karaoke and MEO Kids. These applications introduced new interactive experiences through a broad offering of songs from different languages and categories. To extend this offering, MEO Like Music was also launched, which offers customers the opportunity to watch several exclusive concerts on MEO, live and in high definition, enabling interaction with the artists. Furthermore, MEO VideoClube Card was released, which gives customers a higher degree of control over their monthly spending, by adhering to a prepaid VoD plan.

The MEO Remote app saw the introduction of new features, providing customers with greater control over television content through the use of any portable device (smartphone or tablet PC), such as scheduling recordings remotely.

b. Multi-platform services

To ensure that customers take full advantage of all the services developed by Portugal Telecom on any device, the company has invested in the development of convergent and multi-platform solutions. MEO GO! was

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developed in this context, with the goal of allowing client to access all services, previously available only on the MEOBox, in any online platform (PC, smartphone and tablet PC).

The online application WebBox was also launched, which enhanced PT s Cloud offering for residential customers. WebBox ensures the storage and preservation of files on the internet, allowing users to share any type of document, in a simple, flexible and secure way.

c. New mobile solutions

In 2011, Portugal Telecom continued to develop, both internally and through technological partnerships with leading players, a diversified offer of mobile products and services, such as the launch of new proprietary mobile phones (e.g. TMN A7) and an extended offering of high-end mobile phones and tablet PCs, namely the iPhone 4S, Samsung Galaxy Tab 10.1, Sony Ericsson Xperia PLAY Torch and BlackBerry 9800.

Aligned with a structured segmentation strategy aimed at addressing the specific needs of customer sub-segments, Portugal Telecom launched new mobile price plans, services and applications that enlarged the range of people interested in the company s products and services. Examples of these offerings include:

- **TMN Kids:** designed to attract the younger generations, this service addresses the growing interest of this segment for mobile communications, by centring its service in the concerns of parents regarding security and cost control;
- **TMN e :** this new pre-paid plan introduces additional simplicity, transparency and predictability in the use of the mobile phone. With the same top-up, the new TMN pricing plan allows unlimited voice, messaging and internet access;
- **TMN DRIVE:** application that transforms the smartphone into a GPS navigator. TMN DRIVE provides access to many points of interest, with free access to several Portuguese maps (including islands);
- **SPOTYAD:** innovative service that allows advertisers to promote their brands and products to TMN customers in a fast and simple way, by sending SMS-based messages with discounts and promotions.

d. B2B offering

IT/IS services and solutions

Portugal Telecom has strengthened its strategic focus on innovation as an enabler of efficiency and productivity for its business customers. The development of new SmartCloudPT services, such as Remote Desktops (VDI) and video surveillance solutions, are a reference that translate into competitive advantages for customers to unleash IT cost reductions, increased productivity and mobility.

The new Data Centre in Covilhã, a European reference in terms of energy efficiency and international reach, provides PT with a differentiating value proposition in IT, Cloud and Security services at a global scale.

In fact, Portugal Telecom was recently recognized by Cisco in the areas of Unified Communications and Private Cloud with the Managed Services Channel Partner (MSCP) certification.

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Sector-specific solutions

In 2011, Portugal Telecom maintained its focus in the areas of health and well being, by developing customized solutions for some of the most important national institutions, namely *União das Misericórdias Portuguesas* (UMP), with which the company signed a protocol in June 2011 in order to provide the following services:

- **Home Management:** centralized system for the several UMP units, with integrated scheduling of home visits and volunteers, clinical record of patients, scheduling of treatments, among others, to enable not only an efficient resource allocation, but also better service levels to patients;

- **Telecare UMP:** with the purpose of fighting isolation and providing improved safety to UMP patients, a telecare offer was also customized   this service provides permanent medical assistance through the use of a phone which allows patients to reach support services directly, in case of emergency, 365 days per year, 24 hours per day.

In addition to these services, PT also invested in the development of innovative solutions for the management of chronic diseases, with an emphasis on technology that fosters self-management of the disease by patients.

Recognizing the key role of Education in the country s development, Portugal Telecom also invested in the development of solutions that aim at improving the effectiveness of teaching and responding to growing budgetary constraints. For instance, ISCTE-IUL selected Portugal Telecom for the implementation of a global solution to manage and control accesses and attendance for the entire University, encompassing a total of 150 doors (including lecture rooms, auditoriums and building entrances) and 107 attendance points. PT was selected to provide and install switching equipment for a total of 74 different public schools.

Regarding the Public sector, Portugal Telecom promoted the development of innovative solutions for different Ministries and other Public Entities. At this level, the company developed two web portals   *Portal da Segurança and Portal da Cultura*   with the goal of improving communication between the different related entities and their respective users/citizens.

In what concerns the support to Portuguese SMEs, 2011 marked a reinforced effort in terms of convergent solutions (fixed&mobile and voice&data), as well as in promotional campaigns for fixed and mobile voice. Some of these initiatives were based in the development of sector-specific solutions, such as *OfficeBox Soluções para Retalho, OfficeBox Restaurantes e Cafés* and *OfficeBox Médicos e Clínicas*. The Cloud Computing offering was also reinforced through the launch of www.smartcloudpt.pt, which provides a wide range of solutions for enterprise customers. SmartCloudPT enables the provisioning, in a single portal, of PT Prime and PT Negócios products and services for business customers, helping these to develop their business models in a technological, applicational and communications platform, in a faster and more flexible manner.

Machine-to-Machine

Important steps were also taken in the consolidation of a Machine-to-Machine (M2M) offering, through the launch of a range of solutions that enable the interaction, without human intervention, between objects/devices/machines and the information systems that support the management of these devices. These solutions focus in areas like fleet management, energy efficiency and security, among others. PT has been accelerating the creation of a true Internet of Things, thus promoting the evolution of current company business models and improving overall standards of living.

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2. Technological Infrastructure

In order to offer increasingly innovative services that meet customer needs and requirements, Portugal Telecom has maintained its long term commitment to the upgrade of its leading-edge technological infrastructure.

a. Network Infrastructure

In the fixed network, Portugal Telecom expanded its FTTH coverage, with more than 1.6 million homes passed with FTTH, available and under constrution, maintaining Portugal s leading position in Europe in the implementation of a fibre network. Moreover, the FTTH network was strengthened with new ONT *Optical Network Terminal* functionalities and equipment for fibre network monitoring.

Additionally, Portugal Telecom continued its large-scale IPv6 implementation program, with a focus on both enterprise and residential segments, placing the company in the forefront of operators that provide this protocol to their customers.

With an exponential growth in network traffic, Portugal Telecom was also one of the first operators in the world that implemented connections of 100 Gbps between its main network hubs.

In the mobile network, TMN continued to take decisive steps towards implementing a leading-edge 4G network, including the swap of its 2G for a 4G enabled network, having performed in Cascais and Braga the first ever 4G trials in real urban environments in Portugal. Thousands of Portuguese citizens were able to experience the power of the fourth generation of mobile communications during several demonstrations of solutions directed to both individual and enterprise customers.

A relevant upgrade to TMN s mobile network was also conducted by introducing multi-standard equipments, enabling improvements in the quality of service and the adoption of more efficient and environmentally sustainable technologies.

Lastly, Portugal Telecom undertook major steps in the optimization of the mobile network infrastructure by developing solutions to seamlessly handover traffic from the mobile network to WiFi networks.

b. Data Centres

On the 21 October 2011, in Covilhã, Portugal Telecom began the construction of one of the largest Data Centres in the world, which will become totally functional at the end of 2012 and will be supported by a high debit fibre optics network that will connect it to the main global communications networks. Designed by Professor Carrilho da Graça, the new Data Centre will occupy over 75,500 m2 and will have the capacity for more than 50 thousand servers with 30 Pbytes, allowing the export of data storage capacity to European companies and technology providers. The project will create more that 1,400 qualified jobs, directly and indirectly, positioning Covilhã as one of the cities that will contribute the most to the economic development of the country.

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The new Data Centre will also differentiate itself through the high levels of sustainability and energy efficiency, with savings of 144 thousand tons of CO_2 and 40% in energy consumption.

The commitment to Covilhã also involves partnerships with several local entities, namely with business associations (e.g. ANIL and NERBAC) and academic institutions (e.g. Universidade da Beira Interior e Associação de Estudantes da Universidade da Beira Interior).

3. Operational Efficiency

There were also several projects developed and launched with the purpose of achieving higher levels of operational efficiency and productivity of the entire organization, regarding both processes and the management of customer relations and company resources. In this field, several projects can be highlighted:

- **SAP RMCA Project:** consolidation and development of an integrated collections management system for every company of the Group;

- **CRM Project:** single CRM solution for all the companies of the Group based in Portugal (PTC, PT Prime and TMN), enabling improvements in the quality of service provided, in the relationships established with customers, in the focus of commercial efforts and in the capabilities of the sales force (cross-selling, acquisition and retention of customers);

- **SIT-E Project:** evolution of the order entry software that supports B2B services to a new platform, with impact in terms of time-to-market of new products and services, ensuring a better record of business products and services;

- **Selfcare Global and PT Client Projects:** convergence of the several self-care portals of the different customer segments in a unique, multiplatform interface, where customers can access and manage, in an integrated manner, the entire portfolio of PT services;

- **Order Management:** this system increases the flexibility in the provisioning of services, supporting the operational departments.

4. Environmental sustainability

To be regarded as an economic, social and environmental reference is a key strategic commitment of PT, which has been imprinted in its culture and acting model. In order to serve current and future generations, the company must constantly strive to launch the foundations for new ways of living, working and communicating for the next 100 years. In this sense, environmental sustainability continues to be critical to the company, being part of its five strategic pillars.

On the one hand, every structuring project developed by Portugal Telecom is planned in order to minimize the environmental impact of the company. On the other hand, every employee is encouraged to contribute with ideas for improvement in this area and to look for new ways to reduce the environmental footprint of their work processes. The recognition of the company s effort in the promotion of sustainable behaviours and initiatives is evident by the presence of the company in the two most relevant indexes in this field the Dow Jones Sustainability Index (DJSI) and the FTSE4Good, positioning the Group as a reference in terms of sustainability and reduction of its environmental footprint at a global level. In this context, some measures implemented in 2011 should be highlighted:

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- **Green IT Through Virtualization:** Portugal Telecom has been increasing its internal virtualization indexes, by committing to the massive use of cloud solutions in order to enhance significant energy efficiency gains, resulting in an increase of the virtualization index from 34% in 2010 to 42% of the total server infrastructure in 2011;

- **CopyPoint:** through the consolidation of the entire set of printing and fax devices in a centralized management service, PT achieved significant efficiency gains, ensuring an alignment with the best environmental practices and encouraging behavioural changes in the employees. This project allowed, in the first semester after implementation, a reduction of 20% in paper consumption, 40% in consumables and 60% in equipment energy consumption;

- **Efficient air conditioning systems:** replacement of old, less efficient air conditioning equipment with new equipment with refrigeration power adapted to existing loads, and thus more energy efficient. It is important to highlight that the majority of these machines already have *freecooling* systems;

- **Installation of new LED lighting:** replacement of every fluorescent light bulb in every PT building with new LED lighting technology, resulting in a 94% reduction in energy consumption (savings of 25 thousand Euros annually) and an increase of their useful life;

- **Monitoring and detailed analysis of energy consumption:** detailed presentation of energy consumption information in real time. By presenting diagnostics and improvement measures, it enables the reduction of electrical energy consumption in some company areas. It is also possible to develop specific actions in the technical field, as well as in raising awareness of all the employees;

- **Autonomous photovoltaic solution:** development of an innovative autonomous photovoltaic solution to overcome the previous energy inefficiencies. This action resulted in annual energy savings of 15,277 kWh, a reduction in CO_2 emissions of 7.18 tons. The expected payback period on this investment is 4.3 years. This project allowed a dismissal of around 90% of the total energy previously consumed, simultaneously guaranteeing the continuous security of the satellite station.

C. Exploratory Innovation

The current competitive environment and the tremendous technological advances witnessed in recent years have induced rapid changes in the industry and a constant emergence of new paradigms. In this context, exploratory innovation plays a critical role in achieving the high standards of competitiveness required for success and business sustainability, securing market leadership in the long term. Portugal Telecom assumes exploratory innovation as a cornerstone of its sustainability model leveraged on the expertise of its internal research and development teams. In addition to the internally developed skills in this field, Portugal Telecom uses an extensive network of partnerships to enhance its knowledge in issues concerning exploratory technology, from suppliers and industry partners to universities and research institutions.

1. Exploratory Innovation driven by internal units

Portugal Telecom s exploratory projects are mainly carried out by PT Inovação, with a particular focus on optimising technological infrastructure, and SAPO, an internal software boutique oriented towards the development and integration of multiplatform applications.

The various exploratory innovation projects at PT have been recognized and supported by several funding programs, both national and international, thus reducing the risk associated with investments where, due to the

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long term horizon of their implementation, returns is an uncertainty. In this context, in 2011, several projects were approved through a variety of funding programs such as QREN, CIP and FP7 (of the European Commission), in a very broad spectrum of research areas such as Health, Cloud Computing, Smart Cities and Machine-to-Machine.

a. PT Inovação

During 2011, PT Inovação worked on several exploratory areas, most notably:

- Design and prototype of a solution for aggregating access networks (multi radio access) to provide video services over high debt networks based on WiFi and HSPA terminals with Android OS;
- Design and performance evaluation of a solution that aggregates LTE bands (700, 2600MHz);
- Design of indoor location based solutions based on fingerprint in WiFi networks;
- Design of a solution that optimizes parameterization of APs femto in LTE networks;
- Design of cooperative energy efficiency solutions in wireless networks with a particular focus on 3GPP LTE and femtocells;
- Development of framework prototype of seamless mobility and network offload solution;
- Study and testing in pervasive computing;
- Development of context framework prototype;
- Design and testing of electronic authentication solutions for e-Gov services using mobile devices;
- Testing and prototyping in mobile augmented reality and social computing;
- Proof of concept for augmented reality mobile gaming for collaborative participation, e.g. for enhanced branding and churn prevention;
- Exploration of new interaction solutions for digital companions;
- Testing, implementation and demonstration of network virtualisation solutions and cloud networking (IaaS);
- Design and testing in the cloud services field (PaaS - Platform as a Service);
- Participation in various initiatives and projects regarding future internet.

Many of these projects were carried out under international collaboration programmes, which were mainly developed along these three lines:

- In the context of projects promoted by the European Union (within its Framework Programmes FP7 and CIP), with the following 12 projects:

- FIVER Development of architecture for access network based on FTTH. Quintuple-play services offer: IP data (GbE), voice (LTE femtocell), HDTV (UWB), LAN (WiMAX), and home security / control (WiMAX);

- COGEU Analysis of new approaches for the exploration of TV White Spaces (TVWS) and the evaluation of gains achieved with the use of 3G/LTE TVWS (e.g. capacity);

- C2POWER Optimization of energy efficiency in cellular networks through cooperation between RATs;

- ALICANTE Development of an ecosystem for advanced distribution and adaptation of digital multimedia content in heterogeneous environments;

- Bravehealth Creation of a platform for control and treatment of cardiovascular patients through continuous and remote monitoring of the cardiovascular system;

- SAIL Development of Cloud Networking, aimed at integrated management and control of IT and network resources, demonstrated through prototypes;

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- MEDIEVAL Definition of a new mobile architecture for multimedia services;
- SOCIETIES increase in the knowledge of PSS for Community Smart Spaces (CSS);
- Cloud4SOA Development of interoperability mechanisms for Cloud Computing infrastructure. Development of a pilot to integrate a Service Delivery Framework (SDF) in a Cloud Computing environment;
- VOICES Improved access to content and services in emerging countries. Development of pilots in Africa on health, agriculture and reforestation;
- SEMIRAMIS Design and testing of a secure infrastructure, authentication, authorization, management and information sharing involving public and private entities;
- WHERE2 Design, development and evaluation of techniques for indoor mobile terminal location with accuracy similar to outdoor GPS environments.
- In EURESCOM s strategic studies in telecommunications (e.g. Project P2154 Network Measurements and Analysis of IP Traffic, Project P2155 - Towards networks and services supporting the human cognition and P2054 Energy Efficiency Business opportunities for telecom operators);
- In the EUREKA Celtic-Plus programme and ITEA 2 (e.g. elaboration of the proposal for the GreenT Project Green Terminals for Next Generation Wireless Systems and involvement in the CarCoDE proposal - Platform for Smart Car to Car Content Delivery).

Regarding intellectual property, PT Inovação filed two provisional patent requests and converted another four provisional requests into permanent requests (two of which were international patent requests):

- Provisional patent requests:
- Método de Equalização Não-Linear do Canal Ótico no Domínio da Frequência ;
- Filtro Seletivo de Canais de Televisão Integrado num terminal de fibra ótica .

- Conversion of provisional into permanent patent requests:
- Concentrator for networked sensors and remote meters, supporting diverse network access technologies with automatic fallback strategies, and sensor access security support ;
- Managing Link Layer Resources for Media Independent Handover , co-developed with the Aegean University and the National Centre for Scientific Research Demokritos ;
- Sistema de informação para atendimento ao público , co-developed with UTAD;
- Componente óptico reflectivo integrado num terminal de fibra óptica .

b. SAPO

SAPO has assumed an increasingly important role in the development of innovative and creative solutions, thereby enhancing the delivery of pioneering products and services in the market and extending this philosophy throughout the organization. Currently, SAPO employs over 200 people in the development of R&D activities.

The main areas of investigation pursued by SAPO are centred around the development of multiplatform apps, the creation of web content, the generation of online communities, the improvement of user interfaces and the development of online advertising platforms.

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2. R&D Ecosystem of Partnerships

Portugal Telecom has established a network of strategic partnerships with leading-edge companies and institutions, fostering an enlarged and dynamic ecosystem of exploratory innovation. This guarantees access to cutting-edge solutions and ensures shorter time-to-market.

These partnerships can be grouped into: (a) technological partnerships; (b) strategic partnerships; (c) partnerships with universities, and (d) partnerships with research institutions.

a. Technological Partnerships

Portugal Telecom has maintained agreements with leading international suppliers, such as Corning, Cisco, and Huawei, in order to provide its customers with access to next generation services based on fibre optics. These partnerships are not limited to supplier relationships, also covering joint development of solutions adapted to the Portuguese market. In 2011, Portugal Telecom also maintained key partnerships with equipment vendors such as Samsung, LG, Nokia Siemens and ZTE, for the joint development of customised products for the Portuguese market.

b. Partnerships with Telecom Operators

Portugal Telecom maintained its focus on establishing partnerships with other telecommunications operators to share best practices and collaborate in innovation projects. In this context, PT and Singtel, the leading operator in Singapore, maintained joint collaboration efforts to share knowledge, benchmarks and operational and commercial best practices.

c. Partnerships with Universities

Portugal Telecom has been working with several international and national universities in the development of projects with an exploratory nature. In this context, PT maintained its participation in the Carnegie Mellon Programme, acting as an industrial partner. Some major projects developed with universities include:

- **SENODs Cyber-Physical Systems Technologies for Energy-Optimized Data Centres** aligned with the company s sustainability strategy, this project, supported on cyber-physical system technologies, aims to address energy efficiency challenges in data centres. The innovative solution which was tested, based on a wireless sensorial network, enabled the identification of areas for improvement in infrastructure management by reducing energy consumption and TCO (total cost of ownership);

- **TRONE Trustworthy and Resilient Operations in a Network Environment** in 2011 the following results were achieved by this project: (1) adaptation of tools for diagnosing faults in virtualization systems, (2) development of a resilient architecture for monitoring

(Intrusion Fault Tolerant Broker), and (3) the creation of a prototype for hardened virtualization mechanisms, capable of intrusion detection, recursive use of virtualization and trusted hardware components;

- **NeTS Next Generation Network Operations and Management** a new operational framework was developed to integrate in the PULSE platform, which allows the inferring of root-causes of failures that may arise in IP networks and services of the PT Group in real-time (with special focus on IPTV services).

Regarding the Carnegie-Mellon programme, Portugal Telecom also collaborated in the development and guidance of eight projects for master s theses with particular focus on security associated with IPTV, IPv6 and

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Mobile Payments, in addition to providing support to 12 employees for the completion of Professional Master s programs.

With respect to the work with Portuguese Universities, Portugal Telecom has collaborated over the years with leading universities in various development projects (Aveiro, Porto - FEUP, Coimbra, Minho, Trás-os-Montes and Alto Douro, Beira Interior, Lisbon - IST, Eduardo Mondlane University and Faculdade de Ciências). In this context, the following initiatives carried out in 2011 can be highlighted:

- **VERBATIM Project** Development of modules for automatic processing of news in the Portuguese language through the creation of methods for automatic extraction of quotations (direct and indirect) and the identification and tracking of news topics for subsequent automatic classification of news;

- **LTE integration in future network architecture in a mobility perspective** investigation of an LTE network architecture with a focus on mechanisms and QoS parameters as well as studies of mobility management processes defined by 3GPP;

- **Advanced Playground & Innovation -** portal that allows the aggregation of several API s available not only for SAPO products, but also for their partner and not accessible to the general public. The portal will thus enhance closer cooperation with Universities in a more controlled environment;

- **Distribution of context-aware content in social networks -** development of a Context Aware application that enables the distribution of User Generated Content, based on information obtained via Context Broker;

- **REACTION Project** computational journalism with recovery, extraction and information aggregation mechanisms for news management by analyzing news content available online;

- **POLO II - Intelligent Personal Learning Environment -** exploration of techniques and methodologies for collecting and extracting information based on context and the development of prototypes in which these techniques are applied in a personal learning environment;

- **DoctorMobile -** Development of a system of monitoring patients with chronic pain, resorting to the use of smartphones by collecting periodic information on the status of patients and automatic generation of alert messages to doctors and patients;

- **SAPO Listas -** construction of a language resource consisting of lists of words grouped in semantic categories providing lexical-semantic information to support the construction of systems for information extraction and text classification;

- **SAPOFit Project -** development of m-health applications (mobile health) for Android OS and iPhone OS aimed at monitoring and evaluating the health status of the user, and the recording of daily sporting activities;

- **iNeighbour TV Project -** encouragement of the use of social networking applied to consumption contexts of seniors and their information needs (e.g. health content), based on the supply of new technological solutions of Meo Presentation Framework.

- **Web Technologies** application of new solutions to educational contexts, materialised in SAPO CAMPUS a tool that converges new Web 2.0 services (blogs, videos, photos, wiki, messenger, widgets) with PLE Personal Learning Environment concepts;

With the intent of promoting a closer relationship between the industry and universities, the SAPO Labs project has the main objective of developing innovative projects in the area of technology, with a start-up incubation environment.

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d. Partnerships with Research Institutions

To consolidate the exploration of new opportunities in the long term, Portugal Telecom has also established several protocols with various research institutions, such as INESC (Porto and Coimbra), the Institute of Telecommunications and the Instituto Pedro Nunes. Through these protocols, Portugal Telecom seeks to bring its business areas closer to research institutions, thus ensuring the development of innovative projects with goals such as the optimization, integration and security of networks, the development of IP multimedia systems, the creation of new platforms to expose and create cloud services and the communication between machines.

In addition, PT Inovação, as a founding member of Instituto de Telecomunicações, has been actively involved in the funding of a very broad range of projects in subjects such as Context Aware, Health, Cloud, and Machine-to-Machine.

3. Innovation in International Operations

Portugal Telecom is an operator with a global presence, and thus seeks to spread a culture of innovation across the various geographies in which it is present, thereby contributing to the development of emerging economies in several continents.

PT Inovação has been a key element of this strategy and has established centres of innovation in Brazil and several African countries. Currently, almost half of its revenues are already generated in markets outside Europe (5% in South America, 13% in Africa and 23% in Asia).

Additionally, Portugal Telecom has invested heavily in innovation in all of its international operations. The following initiatives should be highlighted:

- **Unitel (Angola):** investment in the development of mobile data offers, the launch of innovative services, the expansion and improvement to 2G and 3G networks and the deployment of a fibre optics backbone in Luanda and provinces;

- **MTC (Namibia):** launch of innovative services such as *Aweh Aweh* (with weekly top-ups and better terms for customers) and the Netman internet service (with a speed of 7.2 mbps). Additionally, a significant investment was made in the upgrade of the 2G and 3G networks (with single RAN technology), as well as in backbone development;

- **CVT (Cape Verde):** launch of innovative services such as CVT Negócios (targeting the business segment) and residential and business bundled offers (with laptops, ADSL, mobile broadband and TV), as well as investment in new communications technologies (e.g. deployment of a modern fibre optics network). Additionally, a significant IS upgrade was performed through a more versatile and robust BSS/OSS solution;

- **CST (São Tomé and Príncipe):** investment in network capacity to cope with a strong growth in the customer base and development of clean energy supply solution for remote base stations (solar and wind power);

- **CTM (Macao):** development of data offering, investment in expansion and improvement of 2G and 3G networks and deployment of fibre optics (FTTH) connections for key corporate customers;

- **TT (East Timor):** continued streamlining of service offering (3G mobile broadband, pre and post-paid; bundle with PC, 3G dongle and included balance; mobile Internet; and Sapo.tl Portal) and infrastructure

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development, such as the expansion of the 2G and 3G networks and the significant upgrade of information systems. Additionally, a project was launched to supply power to stations using solar energy.

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05 Financial Review

Consolidated income statement

Consolidated income statement (1)			**Euro million**
	2011	**2010**	**y.o.y**
Operating revenues	**6,146.8**	**3,742.3**	**64.3%**
Portugal (2)	2,892.0	3,124.5	(7.4)%
Residential	682.3	647.0	5.4%
Personal	768.4	865.0	(11.2)%
Enterprise	982.1	1,079.6	(9.0)%
Wholesale, other and eliminations	459.2	532.8	(13.8)%
Brazil • Oi	2,412.1	n.a.	n.m.
Other and eliminations	842.7	617.8	36.4%
Operating costs (3)	**3,958.9**	**2,250.6**	**75.9%**
Wages and salaries	1,020.5	637.1	60.2%
Direct costs	1,012.3	547.6	84.9%
Commercial costs	517.7	392.9	31.7%
Other operating costs	1,408.4	672.9	109.3%
EBITDA (4)	**2,188.0**	**1,491.7**	**46.7%**
Post retirement benefits	58.5	38.2	53.2%
Depreciation and amortisation	1,325.6	758.6	74.7%
Income from operations (5)	**803.9**	**694.9**	**15.7%**
Other expenses (income)	**59.9**	**281.2**	**(78.7)%**
Curtailment costs, net	36.4	145.5	(75.0)%
Net losses (gains) on disposal of fixed assets	(9.2)	(5.5)	65.8%
Net other costs (gains)	32.6	141.2	(76.9)%
Income before financ. & inc. taxes	**744.0**	**413.8**	**79.8%**
Financial expenses (income)	**212.9**	**81.6**	**160.9%**
Net interest expenses (income)	297.1	185.0	60.6%
Equity in earnings of affiliates, net	(209.2)	(141.7)	47.6%
Net other financial losses (gains)	125.0	38.3	226.7%
Income before income taxes	**531.1**	**332.2**	**59.9%**
Provision for income taxes	(108.2)	(77.5)	39.6%
Income from continued operations	**422.9**	**254.6**	**66.1%**
Income from discontinued operations	0.0	5,565.4	n.m.
Income before non-controlling interests	**422.9**	**5,820.1**	**(92.7)%**
Losses (income) attributable to non-controlling interests	(83.8)	(147.9)	(43.3)%
Consolidated net income	**339.1**	**5,672.2**	**(94.0)%**

(1) Following PT s strategic investment in Oi and Contax on 28 March 2011, PT proportionally consolidated the earnings of these businesses as from 1 April 2011. **(2)** Businesses in Portugal include former wireline and TMN. This caption includes the impact of the decline in regulated mobile termination rates (MTRs). **(3)** Operating costs = wages and salaries + direct costs + commercial costs + other operating costs.
(4) EBITDA = income from operations + post retirement benefits + depreciation and amortisation. **(5)** Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + other costs (gains).

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Consolidated operating revenues

In 2011, **consolidated operating revenues** increased by 64.3% y.o.y to Euro 6,147 million, as compared to Euro 3,742 million in 2010, as a result of the proportional consolidation of Oi and Contax, as from 1 April 2011 (Euro 2,768 million), and Dedic/GPTI, as from 1 July 2011, following the completion of the exchange of PT s interest in this business for an additional stake in Contax. Excluding this effect, consolidated operating revenues would have decreased by 9.7% y.o.y to Euro 3,380 million in 2011, as a result of revenue decline in Portuguese telecommunication businesses and the disposal of Dedic/GPTI to Contax on 1 July 2011 and notwithstanding revenue growth in international operations, namely MTC in Namibia and Timor Telecom.

In 2011, **revenues from Portuguese telecommunication businesses** decreased by 7.4% y.o.y (Euro 232 million), due to: (1) revenue decline in the Personal customer segment (Euro 97 million), as a result of lower equipment sales (Euro 12 million), lower interconnection revenues (Euro 29 million) and lower customer revenues (Euro 55 million) reflecting challenging economic conditions, the impact of a VAT increase (+3pp y.o.y in 1H11 and 2pp y.o.y in 2H11) and increased popularity of tribal plans; (2) the decline in the Enterprise segment (Euro 97 million), as a result of public administration freeze of relevant projects and also lower interconnections revenues, and (3) lower revenues associated with the wholesale and other businesses (Euro 74 million), including a negative impact from the directories business (Euro 20 million), in which PT has a financial investment of 25% and the company is managed by Truvo. The total direct impact of regulation in revenues amounted to Euro 38 million in 2011, including declining MTRs, roaming prices and other. Excluding the impact of regulation, revenues in Portuguese telecommunication businesses would have declined by 6.2% y.o.y. These negative effects were partially offset by an increase in revenues from Residential customer segment (+5.4% y.o.y), namely Pay-TV and broadband revenues, which are underpinned by the success of Meo s double and triple-play offers. In 2011, non-voice revenues in Portugal represented 46.5% of service revenues, having grown 3.6pp y.o.y. The transformation of PT s services portfolio and changes in the revenue mix is making its performance more resilient and predictable.

In the **Residential customer segment, operating revenues** increased by 5.4% y.o.y in 2011, from Euro 647 million to Euro 682 million, on the back of the continued strong performance of Meo triple-play offer (voice, broadband and pay-TV). Residential retail accesses or retail revenue generating units (RGUs) increased by 9.2% y.o.y, reaching 3,557 thousand, with pay-TV and broadband accesses already accounting for 53% of total residential retail accesses in 2011. Unique customers stood at 1,881 thousand, up by 1.0% y.o.y and RGU per unique customer reached 1.9 at the end of 2011. Pay-TV customers increased by 198 thousand, reaching 972 thousand, up by 25.5% y.o.y, while broadband customers increased by 102 thousand to 911 thousand, up by 12.6% y.o.y. Retail RGU per access increased by 9.1% y.o.y in 2011 to 2.12. This solid performance was underpinned by the investment in the coverage of 1.6 million households with FTTH, available and under construction, which continues to show steady commercial traction as more households become available for commercial sales.

In 2011, **Personal operating revenues** decreased by Euro 97 million (-11.2% y.o.y) to Euro 768 million, mainly due to lower customer revenues (Euro 55 million), interconnection revenues (Euro 29 million) and equipment sales (Euro 12 million). The 8.2% y.o.y decline in customer revenues reflected the effects of challenging economic conditions, which has made customers even more price sensitive, more competitive pressures and increased popularity of tribal plans. Customer revenues also reflected lower revenues from mobile broadband, which due to increased prices sensitivity and take up of double and triple-play offers is leading customers to move to lower value plans. Lower interconnection revenues reflected primarily the glide path of MTRs. In 2011, data revenues from Personal operating segment accounted for 30.9% of service revenues (+1.7pp y.o.y), as a result of the solid performance of data packages internetnotelemovel , which continued to show strong growth, on the back of the commercial success of e nunca mais acaba and increased penetration of smartphones, which is partially offsetting the pressure on mobile broadband revenues.

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Operating revenues from the Enterprise customer segment decreased by 9.0% y.o.y in 2011(Euro 97 million), from Euro 1,080 million to Euro 982 million, penalised by the economic environment and consequent cost cutting efforts from companies and the one-off projects with the public administration that took place in 2010. PT s strategy continued to focus on convergent offers and unlimited fixed-to-mobile voice and data solutions, integrated and vertical offers bundled with specific business software and flexible pricing solutions on a per workstation basis. Additionally, PT continued to provide advanced one-stop-shop IT/IS solutions focusing on BPO and on the marketing of machine-to-machine solutions. These offers leverage on PT s investment in FTTH and cloud computing, which allow the offering of cloud-based services in partnership with software and hardware vendors.

Wholesale and other operating revenues, including intra-portuguese businesses eliminations, decreased by Euro 74 million (-13.8% y.o.y) to Euro 459 million, impacted by: (1) lower revenues from directories (Euro 20 million); (2) lower wholesale revenues (Euro 25 million), mainly due to lower ULL revenues and lower capacity sales, and (3) lower revenues from public phones (Euro 4 million). The impact of regulation in wholesale revenues was Euro 3 million in 2011.

In 2011, **Oi s revenues** stood at Euro 2,412 million, equivalent to R$ 5,612 million. Oi s results are proportionally consolidated as from 1 April 2011, reflecting the 25.6% direct and indirect stake that PT owns in Telemar Participações, the controlling shareholder of Oi, which fully consolidates Oi companies, including Tele Norte Leste Participações, Telemar Norte Leste and Brasil Telecom.

Other revenues, including intra-group eliminations, increased by 36.4% y.o.y in 2011 to Euro 843 million. This performance was mainly due to: (1) the impact of the proportional consolidation of Contax as from 1 April 2011 (Euro 359 million), including Dedic/GPTI as from 1 July 2011, and (2) an increase of 10.6% and 7.0% y.o.y at Timor Telecom and MTC, respectively. These effects were partially offset by a lower contribution from Dedic/GPTI, that was fully consolidated until 30 June 2011 and then integrated in Contax.

The contribution from fully and proportionally consolidated international assets to operating revenues stood at 57.7% in 4Q11, while Brazil accounted for 52.6% of consolidated operating revenues.

Consolidated Operating Costs (excluding post retirement benefit costs and depreciation and amortization)

Consolidated operating costs excluding depreciation and amortization costs and post retirement benefits, amounted to Euro 3,959 million in 2011 and Euro 2,251 million in 2010, an increase of Euro 1,708 million primarily explained by the impact of the proportional consolidation of Oi and Contax as from 1 April 2011 (Euro 1,986 million), including the Dedic/GPTI business as from 1 July 2011. Adjusting for this effect, consolidated operating costs would have decreased by 12.3% y.o.y (Euro 277 million) in 2011 to Euro 1,973 million, reflecting basically (1) a reduction at Portuguese operations, primarily as a result of strict cost control, strong focus on the profitability of operations and lower direct costs resulting from the decrease in operating revenues, and (2) a lower contribution from Dedic/GPTI as this business was fully consolidated until 30 June 2011 and then integrated in Contax.

Wages and salaries increased by 60.2% y.o.y (Euro 383 million) in 2011 to Euro 1,020 million, as compared to Euro 637 million in 2010, mainly due to the impact of the proportional consolidation of Oi and Contax as from 1 April 2011 (Euro 505 million), including the Dedic/GPTI business as from 1 July 2011. Adjusting for this effect, wages and salaries would have decreased by 19.2% y.o.y (Euro 122 million) in 2011 to Euro 515 million, reflecting lower contributions from: (1) Dedic/GPTI, as this business was fully consolidated until 30 June 2011 and then integrated in Contax, and (2) the telecommunications business in Portugal, reflecting primarily lower variable and overtime

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remunerations, higher efficiency levels in certain internal processes and lower personnel costs as a result of the restructuring plan implemented in the end of 2010. Wages and salaries accounted for 16.6% of consolidated operating revenues in 2011.

Direct costs increased by 84.9% y.o.y (Euro 465 million) in 2011 to Euro 1,012 million and accounted for 16.5% of consolidated operating revenues. This increase reflected primarily the impact of the proportional consolidation of Oi and Contax as from 1 April 2011 (Euro 521 million). Adjusting for this effect, direct costs would have decreased by 10.3% y.o.y (Euro 57 million) in 2011 to Euro 491 million, primarily due to lower contributions from the telecommunications business in Portugal, as a result of a decrease in interconnection costs, due to lower MTRs, and the decline in the directories business, which more than offset an increase in programming costs due to the continued growth in pay-TV customers, notwithstanding a decline in programming costs per customer as pay-TV is reaching critical mass.

Commercial costs, which include costs of products sold, commissions and marketing and publicity, increased by 31.7% y.o.y (Euro 125 million) in 2011 to Euro 518 million and accounted for 8.4% of consolidated operating revenues. This increase reflected primarily the impact of the proportional consolidation of Oi and Contax as from 1 April 2011 (Euro 152 million). Excluding this effect, commercial costs would have decreased by 7.0% y.o.y (Euro 28 million) in 2011 to Euro 365 million, mainly due to a reduction at the Portuguese telecommunications business, reflecting primarily lower costs of products sold due to the racionalisation of TMN s handset portfolio and lower equipment sales, which more than offset higher commissions on the back of higher commercial activity in the 2011 Christmas period.

Other operating costs, which mainly include support services, supplies and external services, indirect taxes and provisions, amounted to Euro 1,408 million in 2011, as compared to Euro 673 million in 2010. This increase reflected primarily the impact of the proportional consolidation of Oi and Contax as from 1 April 2011 (Euro 807 million), which includes Dedic/GPTI as from 1 July 2011. Adjusting for this effect, other operating costs would have decreased by 10.6% y.o.y in 2011 to Euro 602 million, basically due to lower contributions from: (1) the telecommunications business in Portugal, as the increases in support services and provisions were offset by lower maintenance and repairs, following the rollout of Portugal Telecom s FTTH network, and by the benefits resulting from cost cutting initiatives undertaken such as renegotiation of collection fees and car pooling for sales force; and (2) the Dedic/GPTI business, which was fully consolidated until 30 June 2011 and then integrated in Contax.

EBITDA

EBITDA increased by 46.7% y.o.y to Euro 2,188 million in 2011, as compared to Euro 1,492 million in 2010, primarily due to the impact of the proportional consolidation of Oi and Contax as from 1 April 2011 (Euro 782 million), including Dedic/GPTI in Contax as from 1 July 2011. Excluding this effect, EBITDA would have decreased by 5.8% y.o.y to Euro 1,406 million in 2011, equivalent to a margin of 41.6% (+1.8pp y.o.y). EBITDA performance in the period, excluding the proportional consolidation of Oi and Contax, was impacted by the revenue decline and notwithstanding a 12.3% y.o.y reduction in operating costs. This effect was partially offset by the improvement in gross margin from the residential segment in 2011, as a result of achieving critical mass in the pay-TV business, higher penetration of FTTH customers and continued focus on cost cutting.

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

	2011	2010	y.o.y
Portugal	1,305.5	1,377.6	(5.2)%
Brazil • Oi	747.6	0.0	n.m.
Other	134.9	114.1	18.2%
EBITDA	**2,188.0**	**1,491.7**	**46.7%**
EBITDA margin (%)	35.6	39.9	(4.3)pp

(1) EBITDA = income from operations + post retirement benefits + depreciation and amortisation.

EBITDA from Portuguese telecommunication businesses amounted to Euro 1,306 million in 2011 (-5.2% y.o.y), equivalent to a 45.1% margin, a 1.1pp annual improvement. In 4Q11, EBITDA margin increased by 0.3pp y.o.y, reaching 43.5%, a resilient performance (+1.3pp in 3Q11, +1.2pp in 2Q11, +1.5pp in 1Q11) that underlines the sustainability of PT s cost cutting initiatives. Operating costs decreased by 9.2% y.o.y, on the back of: (1) pay-TV reaching critical mass, which leads to lower programming costs per customer; (2) fibre rollout, which has a superior quality of service leading to lower customer support and network maintenance costs; (3) the implementation of transformation initiatives, namely in customer care and field force, promoting the usage of self-care and benefiting from fixed-mobile integration; (4) simplification of commercial offers and business processes, namely for the Personal customer segment, and (5) additional measures undertaken in anticipation of weaker macro fundamentals, reflecting PT s strong cost focus. This solid performance was achieved against a backdrop of lower contribution to revenues and EBITDA derived from the directories business, which contracted Euro 20 million and Euro 6 million, respectively.

In 2011, **Oi s EBITDA** reached Euro 748 million, equivalent to R$ 1,739 million, corresponding to its proportional consolidation as from 1 April 2011. EBITDA margin in the period stood at 31.0%.

Other EBITDA increased by 18.2% y.o.y to Euro 135 million in 2011 mainly due to: (1) the impact of the proportional consolidation of Contax as from 1 April 2011 (Euro 37 million), and (2) the 9.1% and 2.3% y.o.y growth in Timor Telecom and CVT, respectively. These effects were partially offset by a lower contribution from Dedic/GPTI business, that was fully consolidated until 30 June 2011 and then integrated in Contax.

Fully and proportionally consolidated international assets represented 45.2% of PT s EBITDA in 4Q11. Brazilian businesses accounted for 37.7% of EBITDA in the period and fully consolidated African businesses accounted for 5.8% of EBITDA.

Net Income

Post retirement benefits costs increased to Euro 59 million in 2011 from Euro 38 million in 2010, reflecting primarily a prior year service gain booked in 2010, amounting to Euro 31 million, related to regulatory changes introduced in the pension formula. Adjusting for this effect, post retirement benefits costs would have decreased by Euro 11 million, reflecting primarily the positive impact of the transfer of regulatory unfunded pension obligations to the Portuguese State (Euro 16 million), which was completed in December 2010 and was partially offset by the impact of the proportional consolidation of Oi as from 1 April 2011 (Euro 5 million).

Depreciation and amortisation costs increased by 74.7% y.o.y to Euro 1,326 million in 2011, reflecting primarily the proportional consolidation of Oi and Contax (Euro 545 million). In 2011, depreciation and amortisation costs included the amortisation of intangible assets recognised as a result of the purchase price allocation of PT s investments in Oi and Contax, amounting to Euro 47 million in 2011. Adjusting for the proportional consolidation of Oi and Contax, depreciation and amortisation costs would have increased by 2.9% to Euro 781 million in 2011, due to higher contribution from the Portuguese telecommunication businesses (Euro 22 million), as a result of the

FTTH rollout and pay-TV growth, partially offset by the impact of the swap of TMN s 2G equipment to LTE (4G enabled equipment).

Curtailment costs decreased to Euro 36 million in 2011 compared to Euro 146 million in 2010, reflecting the reduction in employees undertaken by the end of 2010.

Net interest expenses increased to Euro 297 million in 2011 as compared to Euro 185 million in 2010, reflecting primarily the impact of the proportional consolidation of Oi and Contax, including the holding companies, as from 1 April 2011 (Euro 175 million). Adjusting for this effect, net interest expenses would have decreased by Euro 63 million to Euro 122 million in 2011, mainly as a result of: (1) an Euro 51 million interest gain in 1Q11 on the cash deposits in Brazilian Reais that were used to pay the strategic investments in Oi and Contax on 28 March 2011, and (2) the reduction in the average cost of debt from Portuguese businesses, excluding the impact of the interest income on cash deposits in Brazilian Reais as referred to above, which stood at 3.3% in 2011 compared to 4.4% in 2010. These effects more than offset the impact of the increase in the average net debt from Portuguese businesses, reflecting: (1) the investments in Oi and Contax concluded on 28 March 2011 (Euro 3,728 million); (2) the dividends paid in June 2011 (Euro 1,118 million), and (3) the debt related to the transfer of unfunded pension obligations completed in December 2010 (Euro 1,022 million), which more than offset the impact of the first and second instalments received from Telefónica in 2010 (Euro 5,500 million) and the last instalment received in October 2011 (Euro 2,000 million) in relation to the Vivo transaction.

Equity in earnings of affiliates amounted to Euro 209 million in 2011, as compared to Euro 142 million in 2010. In 2011, this caption includes a gain of Euro 38 million related to the completion of the disposal of the investment in UOL for a total amount of Euro 156 million, while in 2010 includes non-recurring losses on investments in associate companies, totalling Euro 36 million, to adjust its carrying value to the corresponding estimated recoverable amounts. Adjusting for these effects and also for PT s share in UOL s earnings in 2010 (Euro 14 million), equity accounting in earnings of affiliated companies would have amounted to Euro 172 million in 2011 and Euro 164 million in 2010 reflecting primarily the improvement in earnings of Unitel and CTM.

Net other financial losses, which include net foreign currency losses, net gains on financial assets and net other financial expenses, increased from Euro 38 million in 2010 to Euro 125 million in 2011, reflecting primarily: (1) the impact of the proportional consolidation of Oi and Contax as from 1 April 2011 (Euro 68 million), and (2) certain financial taxes incurred in Brazil in connection with the transfer of funds for the investment in Oi (Euro 14 million).

Income taxes increased to Euro 108 million in 2011, from Euro 78 million in 2010, corresponding to an effective tax rate of 20.4% and 23.3%, respectively. This increase is primarily explained by: (1) a tax gain recorded in 2010, amounting to Euro 59 million, in relation to a corporate restructuring of Africatel businesses, and (2) the impact of the proportional consolidation of Oi and Contax as from 1 April 2011 (Euro 7 million). Adjusting for the above mentioned one-off tax effects, income taxes would have decreased mainly due to the impact of lower non-deductible interest expenses, while the effective tax rate, adjusted for the effects mentioned above and the impacts of non recurrent losses recorded in 2010 and adjustments to prior year income taxes, would have been 24.4% in 2011 and 25.6% in 2010.

Income from discontinued operations amounted to Euro 5,565 million in 2010, including primarily: (1) the capital gain, net of related expenses, obtained with the disposal of the investment in Vivo, which was concluded on 27 September 2010; (2) Vivo s earnings before non-controlling interests up to the disposal date, and (3) the accumulated currency translation adjustments that were recognised in net income on the date of disposal, although not contributing to the distributable net income.

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Income attributable to non-controlling interests amounted to Euro 84 million in 2011, including the impact of the proportional consolidation of income attributable to non-controlling interests of Oi and Contax as from 1 April 2011 (Euro 10 million), as compared to Euro 148 million in 2010, includig the income attributable to non-controlling interests of Vivo (Euro 61 million). Adjusting for the above mentioned effects, income attributable to non-controlling interests would have decreased from Euro 87 million in 2010 to Euro 74 million in 2011, primarily explained by the reduction in non-controlling interests from African businesses (Euro 11 million).

Net income amounted to Euro 339 million in 2011. In 2010, net income amounted to Euro 5,672 million, primarily affected by the net income from discontinued operations and the corresponding non-controlling interests related to the disposal of the investment in Vivo.

Capex

Capex increased by 53.3% y.o.y to Euro 1,224 million in 2011, as compared to Euro 798 million in 2010, mainly due to the impact of the proportional consolidation of Oi and Contax as from 1 April 2011 (Euro 474 million). Excluding this effect, capex would have decreased by 6.1% y.o.y in 2011 to Euro 750 million, equivalent to 22.2% of revenues.

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

	2011	2010	y.o.y
Portugal	647.0	657.2	(1.6)%
Brazil • Oi	444.3	0.0	n.m.
Other	132.5	141.2	(6.1)%
Total capex	**1,223.8**	**798.4**	**53.3%**
Capex as % of revenues (%)	19.9	21.3	(1.4)pp

(1) Capex does not include Euro 142 million in 2011 and Euro 139 million in 4Q11, primarily related to the recognition of the LTE and DTT licenses at the Portuguese telecommunication businesses and 3G license at CVT, while in 4Q10 excludes the acquisition of real estate from the pension funds (Euro 236 million).

Capex from Portuguese telecommunication businesses decreased by 1.6% y.o.y to Euro 647 million in 2011 and was directed towards investments in future proof technologies, namely FTTH, including the coverage of mobile base stations with fibre, and 4G/LTE. As a result of its investments in technology, PT has strengthened further the value proposition to its corporate, SME/SOHO and residential customers by extending FTTH coverage to approximately 1,600 thousand households (available and under construction). Capex performance reflected a decline in capex from residential segment due to a decrease in customer-related capex as a result of: (1) a lower number of set-top-boxes per fibre TV customer as compared to ADSL; (2) lower unitary cost of set-top-boxes, optical network terminators and home gateways, and (3) improved refurbishment rates of set-top boxes. This decrease in customer-related capex was offset by the investments in the swap of TMN s 2G equipments to LTE (4G) enabled equipment, increased investments in capacity of existing 3G and 3.5G networks, namely in urban areas, and initial deployment of the 4G network. Additionally, PT has been strengthening its mobile data capabilities and its network quality by leveraging the existing FTTH deployment to boost its mobile network quality and lead the 4G roll-out in the Portuguese market. PT is also investing in the construction of a state of the art 75.5 thousand sqm data centre, which will enable PT to enhance its value proposition to all customer segments whilst providing increased flexibility and maximising efficiency.

In 2011, Oi s capex proportionally consolidated as from 1 April 2011 reached Euro 444 million, equivalent to R$1,034 million. The investments in the wireline network were aimed at: (1) improving network quality and expanding coverage; (2) increasing speed of broadband services, and (3) providing data packages to corporate customers. In the wireless network, focus was placed on coverage expansion, encompassing all regions, and capacity of data traffic (3G) in strategic locations.

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In 2011, other capex decreased to Euro 133 million, compared to Euro 141 million in 2010. This performance is primarily explained by lower capex at Dedic/GPTI, MTC in Namibia, and CVT in Cape Verde. These effects more than offset the impact of the proportional consolidation of Contax as from 1 April 2011 (Euro 30 million), including Dedic/GPTI as from 1 July 2011, and higher capex at Timor Telecom.

Cash Flow

Operating cash flow increased to Euro 1,185 million in 2011, compared to Euro 406 million in 2010, including the impact of the proportional consolidation of Oi and Contax as from 1 April 2011 (Euro 386 million). Adjusting for this effect, operating cash flow would have increased by Euro 393 million to Euro 799 million in 2011, mainly due to a significant improvement in working capital management (Euro 458 million), primarily explained by: (1) the one-off reduction in the payment cycle to certain suppliers undertaken in 4Q10, following the cash inflow from the Vivo transaction, leading to lower payments to suppliers in 2011, and (2) a lower investment related to trade receivables in Portuguese businesses.

Free cash flow (1) **Euro million**

	2011	2010	y.o.y
EBITDA minus Capex	964.2	693.3	39.1%
Non-cash items (2)	141.6	35.0	n.m.
Change in working capital	79.2	(322.6)	n.m.
Operating cash flow	**1,185.0**	**405.6**	**192.1%**
Interests	(260.6)	(227.7)	14.4%
Net reimbursements (contributions) to pension funds (3)	(23.1)	25.9	n.m.
Paym. to pre-retired, suspended employees and other	(175.2)	(161.1)	8.7%
Income taxes	(163.5)	(62.5)	161.8%
Dividends received	146.9	10.0	n.m.
Net disposal (acquisition) of financial investments	123.4	2.4	n.m.
Share capital reductions at Brasilcel	0.0	89.9	n.m.
Other cash movements (4)	(300.2)	(97.1)	209.1%
Free cash flow	**532.8**	**(14.5)**	**n.m.**

(1) Free cash flow excludes the cash out-flow related to the investments in Oi and Contax (Euro 3,728 million in 2011) and the cash in-flows related to the Vivo transaction (Euro 2,000 million in 2011 and Euro 5,500 million in 2010). **(2)** The increase in this caption is primarly explained by the impact of the proportional consolidation of Oi. **(3)** In 2010, this caption includes a reimbursement amounting to Euro 75 million related to excess financing of healthcare obligations. **(4)** In 2011, this caption includes payments of expenses incurred with the strategic investment in Oi, bank commissions and certain payments of contractual penalties and legal actions, mainly at Oi and Contax.

Excluding the cash out-flow related to the acquisition of PT s investment in Oi and Contax in 1Q11 (Euro 3,728 million) and the instalments received from Telefónica related to the Vivo transaction (Euro 2,000 million in 2011 and Euro 5,500 million in 2010), free cash flow amounted to Euro 533 million in 2011, compared to negative Euro 14 million in 2010. This performance is primarily explained by: (1) a higher operating cash flow (Euro 779 million) as referred to above; (2) the proceeds received from the disposal of the investment in UOL amounting to Euro 156 million, and (3) dividends received from Unitel (Euro 126 million) in 1H11 relating to 2009 earnings, as the 2008 dividends had been fully received in 4Q09. These effects were partially offset by: (1) an increase in payments regarding legal actions (Euro 188 million), as a result of the proportional consolidation of Oi; (2) higher payments of income taxes (Euro 101 million), mainly related to the impact of the proportional consolidation of Oi and Contax (Euro 62 million) and withholding taxes on financial applications incorporated with the proceeds from the disposal of Vivo; (3) an amount of Euro 90 million received from Brasilcel in 2010 in relation to share capital reductions; (4) an increase in net payments related to post retirement benefits (Euro 63 million), due to the Euro 75 million reimbursement in 1Q10; (5) an amount paid by Contax in 2Q11 for the acquisition of the investment in Allus (Euro 44 million), and (6) an increase of Euro 33 million in interest paid, as the impact of the proportional consolidation of Oi, Contax and its controlling shareholders as from 1 April 2011 (Euro 181 million) more than offset the interest received on the cash deposits in Brazilian Reais used to pay the strategic investment in Oi and Contax. For

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comparative purposes, PT s free cash flow adjusted for the investments in Oi and Contax, and the proportional consolidation of its free cash flow would have amounted to Euro 720 million in 2011, including a favourable change in working capital and the proceeds from the sale of UOL, as compared to negative Euro 14 million in 2010.

Consolidated Net Debt

Consolidated net debt excluding the proportional consolidation of Oi, Contax, and its controlling shareholders, and the tax effect on the payments due to the Portuguese State in connection with the pensions transaction, amounted to Euro 4,068 million as at 31 December 2011. Consolidated net debt increased from Euro 2,100 million at the end of December 2010 to Euro 6,613 million as at 31 December 2011, an increase of Euro 4,513 million reflecting: (1) the acquisition of the strategic investments in Oi and Contax for a total consideration of Euro 3,728 million and the proportional consolidation of its net debt position amounting to Euro 2,053 million as at 31 March 2011; (2) dividends paid by PT to its shareholders (Euro 1,118 million) and by its subsidiaries to non-controlling interests (Euro 94 million), and (3) the acquisition by Oi of PT s own shares in 2Q11 (Euro 87 million). These effects were partially offset by: (1) the last instalment received from Telefónica regarding the Vivo transaction (Euro 2,000 million); (2) the free cash flow generated in the period, adjusted for the acquisition of the investments in Oi and Contax and the proceeds from the disposal of Vivo, amounting to Euro 533 million, and (3) the impact of the depreciation of the Brazilian Real against the Euro, leading to a reduction in net debt of Euro 43 million.

Change in net debt **Euro million**

	2011	**2010**
Net debt (initial balance as reported)	**2,099.8**	**5,528.0**
Less: Vivo s net debt	0.0	699.0
Net debt (initial balance adjusted)	**2,099.8**	**4,829.0**
Less: free cash flow	532.8	(14.5)
Instalments received related to Vivo transaction	(2,000.0)	(5,500.0)
Acquisition of strategic investment in Oi and Contax	3,727.6	0.0
Translation effect on foreign currency debt	(43.4)	0.0
Dividends paid by PT	1,118.0	1,379.5
Acquisition of own shares	86.8	0.0
Changes in consolidation perimeter (Oi and Contax)	2,052.5	0.0
Recognition of the liabilities related to the transfer of the pension plans	0.0	1,021.7
Other (1)	104.4	355.2
Net debt (final balance)	**6,612.8**	**2,099.8**
Less: Tax effect on unfunded post retirement benefits obligations (2)	226.1	226.1
Adjusted net debt (final balance)	**6,386.7**	**1,873.7**
Less: Net debt from Oi and Contax, inc. holding companies	2,318.9	0.0
Adjusted net debt exc. Oi and Contax (final balance)	**4,067.9**	**1,873.7**
Change in net debt	4,513.0	(2,729.2)
Change in net debt (%)	214.9%	(49.4)%

(1) In 2011 and 2010, this caption includes mainly Euro 94 million and Euro 80 million, respectively, related to dividends paid by PT s fully and proportionally consolidated subsidiaries to non-controlling interests. **(2)** Tax effect on pension debt due to the Portuguese State including Euro 113 million related to the 2011 contribution which was accounted for as tax losses carried forward.

Excluding the proportional consolidation of Oi and Contax, the amount of cash available plus the undrawn amount of PT s committed commercial paper lines and facilities totalled Euro 5,095 million at the end of December 2011, of which Euro 1,040 million was undrawn committed commercial paper lines and facilities. After the Euro 600 million 5-year Eurobond issued in January 2011 and the Euro 1,200 million 3-year credit facility signed in March and April 2011, with eight leading international banks, PT has its debt maturities fully financed until the end of 2013 and financial flexibility to continue to honour its commitments. Additionally, in 4Q11, PT has extended the maturity of a Euro 100 million standby facility maturing in October 2011 for additional 3.25 years and has signed 2 new loan

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agreements with the European Investment Bank for a total amount of Euro 240 million. As at 31 December 2011, an amount of Euro 140 million has been drawn down under these two loan agreements. In 2011 PT bought back Euro 62 million of its bonds, with a notional amount of Euro 64 million, generating a financial gain of Euro 2 million. These acquisitions were carried out during 4Q11.

In 2011, excluding the Euro 51 million interest gain on cash deposits related to the strategic investment in Oi, PT s average cost of net debt stood at 3.3%, down from 4.4% in 2010, and cost of gross debt stood at 4.3% in 2011, broadly stable when compared to 2010 (4.2%). As at 31 December 2011, PT s consolidated net debt had a maturity of 5.9 years. As at 31 December 2011, excluding the proportional consolidation of Oi and Contax, the maturity of PT s net debt was also 5.9 years and the net debt to EBITDA ratio was 2.9x..

Post Retirement Benefits Obligations

As at 31 December 2011, the projected post retirement benefits obligations (PBO) from Portuguese businesses related to pensions supplements and healthcare amounted to Euro 474 million and market value of assets under management amounted to Euro 345 million, compared to Euro 472 million and Euro 448 million as at 31 December 2010, respectively. In addition, PT had liabilities in the form of salaries due to suspended and pre-retired employees amounting to Euro 782 million as at 31 December 2011, which are not subject to any legal funding requirement. These monthly salaries are paid directly by PT to the beneficiaries until retirement age. As a result, total gross unfunded obligations from Portuguese businesses amounted to Euro 912 million and after-tax unfunded obligations amounted to Euro 684 million. PT s post retirement benefits plans for pensions supplements and healthcare are closed to new participants.

In addition, following the strategic investment in Oi, PT proportionally consolidated its net post retirement benefit obligations, amounting to Euro 52 million as at 31 March 2011 and Euro 62 million as at 31 December 2011, which relate to several plans with different characteristics, including defined contribution plans and defined benefits plans. Most of these plans are already closed to new participants. Oi has several plans that present a surplus position which is not recorded as an asset as it is not possible to obtain reimbursements.

Post retirement benefits obligations		**Euro million**
	31 December 2011	**31 December 2010**
Pensions obligations	121.6	129.9
Healthcare obligations	352.6	342.5
PBO of pension and healthcare obligations	**474.1**	**472.4**
Market value of funds (1)	(344.7)	(448.1)
Unfunded pensions and healthcare obligations	**129.4**	**24.2**
Salaries to suspended and pre-retired employees	782.5	924.3
Gross unfunded obligations from Portuguese businesses	**911.9**	**948.6**
After-tax unfunded obligations from Portuguese businesses	683.9	711.4
Gross unfunded obligations at Oi	61.7	0.0
Unrecognised prior years service gains	16.8	18.3
Accrued post retirement benefits	**990.4**	**966.9**

(1) The reduction in the market value of funds resulted mainly from: (i) payments of supplements of Euro 9.7 million; (ii) the negative performance of assets under management amounting to Euro 72.1 million (equivalent to negative 16.6% in 2011), and (iii) the refund of healthcare expenses paid on account by PT amounting to Euro 23.3 million.

Total gross unfunded obligations from Portuguese businesses decreased by Euro 37 million to Euro 912 million as at 31 December 2011, primarily as a result of salary payments to suspended and pre-retired employees made during the period, amounting to Euro 175 million, which were partially offset by total post retirement benefits and curtailment costs (Euro 67 million) and net actuarial losses (Euro 72 million) recognised in the period. Unfunded obligations from Oi increased from Euro 52 million as at 31 March 2011 to Euro 62 million as at 31 December 2011,

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reflecting primarily post retirement benefits costs (Euro 5 million) and net actuarial losses (Euro 9 million) recognised in the period, partially offset by the impact of the depreciation of the Brazilian Real against the Euro (Euro 3 million).

Change in gross unfunded obligations **Euro million**

	2011	2010
Gross unfunded obligations (initial balance)	948.6	1,467.4
Changes in the consolidation perimeter	52.5	0.0
Post retirement benefits costs (PRB) (1)	34.9	38.7
Curtailment cost	36.4	148.6
Net reimbursements (contributions) to pension funds (2)	(1.3)	25.9
Salary payments to pre-retired, suspended employees and other	(175.2)	(161.1)
Net actuarial (gains) losses (3)	80.5	450.7
Foreign currency translation adjustments	(2.9)	0.0
Gross unfunded obligations (final balance)	973.7	948.6

(1) In 2011, this caption excludes the service cost related to active employees transferred to the Portuguese State amounting to Euro 25.1 million. **(2)** In 2011, this caption includes reimbursements net of healthcare expenses amounting to Euro 5.3 million, and termination payments amounting to Euro 3.8 million. In addition PT made, contributions amounting to Euro 21.8 million related to the service cost of the employees transferred to the Portuguese State. **(3)** In 2011, net actuarial losses include primarily a loss of Euro 98 million related to the difference between actual (-16.6%) and expected return of assets (+6%) related to pension plans from Portuguese operatins, partially offset by a gain of Euro 19 million related to the change in the actuarial assumprion related to the salary growth rate for pension plans from Portuguese operations.

Post retirement benefits costs increased to Euro 59 million in 2011 from Euro 38 million in 2010, reflecting primarily a prior year service gain booked in 2010, amounting to Euro 31 million, related to regulatory changes introduced in 2010 in the pension formula. Adjusting for this effect, the reduction in post retirement benefits costs, amounting to Euro 11 million, is primarily explained by the impact of the transfer of regulatory unfunded pension obligations to the Portuguese State (Euro 16 million), which was completed in December 2010, partially offset by the proportional consolidation of Oi as from 1 April 2011 (Euro 5 million).

Equity

Change in shareholders equity (excluding non-controlling interests) **Euro million**

	2011
Equity before non-controlling interests (initial balance)	**4,392.4**
Net income	339.1
Net currency translation adjustments	(281.3)
Dividends	(1,118.0)
Interim dividends	(184.8)
Net actuarial gains (losses), net of taxes	(56.7)
PT s shares acquired by Oi (1)	(148.3)
Other (2)	(114.4)
Equity before non-controlling interests (final balance)	**2,828.1**

Change in equity before non-controlling interests	**(1,564.4)**
Change in equity before non-controlling interests (%)	**(35.6)%**

(1) This caption includes Euro 61 million paid by Oi for the acquisition of PT s shares before 31 March 2011 (initial consolidation of Oi). **(2)** This caption includes primarily the negative impact resulting from the reassessement of the fair value of certain tangible assets that are recognised in accordance with the revaluation mode.

As at 31 December 2011, shareholders equity excluding non-controlling interests amounted to Euro 2,828 million, a decrease of Euro 1,564 million in 2011. This decrease is primarily explained by: (1) the dividends paid by PT to its shareholders in June 2011 (Euro 1,118 million) and the interim dividends attributed in December 2011 and paid in January 2012 (Euro 185 million); (2) negative currency translation adjustments amounting to Euro 281 million, mainly related to the depreciation of the Brazilian real against the Euro; (3) the acquisition by Oi of PT s own shares (Euro 148 million), which for accounting purposes are classified as treasury shares based on PT s interest in Oi; (4) net actuarial losses recognised in the period (Euro 57 million, net of tax effect), and (5) a negative impact recorded

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directly in shareholders equity resulting from the reassessment of the fair value of certain tangible assets recognised in accordance with the revaluation model. These effects more than offset the net income generated in the period of Euro 339 million.

Strategic Investment in Oi

On 28 March 2011, PT concluded its strategic investments in Telemar Norte Leste, S.A. (Oi) and Contax, S.A. (Contax) for a total consideration of R$8,437 million (Euro 3,728 million). These strategic investments were made in connection with the agreements entered into with the controlling shareholders of Telemar Participações, S.A., which controls Oi, and CTX Participações, S.A., which controls Contax. Under these agreements, PT shares the control of these companies and plays a key role in the strategic financial and operational policies and, consequently, the acquired investments are treated for accounting purposes as jointly controlled entities. Therefore and as allowed by IAS 31, PT proportionally conslidates the assets, liabilities and earnings of these companies, in line with the accounting policy applied in previous years. Additionally, the process of exchange of PT s interest in Dedic/GPTI for an additional stake in Contax was completed on 1 July 2011. Oi is proportionally consolidated through the 25.6% direct and indirect stake that PT owns in Telemar Participações, which controls and fully consolidates Oi companies, including Tele Norte Leste Participações, Telemar Norte Leste and Brasil Telecom. Contax is proportionally consolidated through the 44.4% direct and indirect stake that PT owns in CTX Participações, which controls and fully consolidates Contax, which in turn fully consolidates Dedic/GPTI as from 1 July 2011.

PT made the strategic investment in Oi and Contax through its wholly owned holding companies Bratel Brasil and PT Brasil, respectively, having acquired economic interests of 25.3% in Oi and 14.1% in Contax. The economic interest in Contax was increased to 19.5% on 1 July 2011, following the exchange of PT s interest in Dedic/GPTI for an additional stake in Contax, as referrred to above.

Following the approval of Oi s corporate simplification by the general meetings of the companies constituting the Oi group held on 27 February 2012, the current corporate structure composed by Tele Norte Leste Participações, Telemar Norte Leste and Brasil Telecom is integrated in Brasil Telecom, which is to be renamed Oi S.A., and has only two share classes (common shares, ON, and preferred shares, PN). These shares are traded in the Bovespa and in the NYSE, through an ADR programme. As a result of this approval, PT will maintain the 25.6% direct and indirect stake in the controlling holding, Telemar Participações, while PT s economic position in Oi, direct and indirect, will be between 21.5% and 25.1% . Therefore, PT will continue to proportionally consolidate its 25.6% stake in Telemar Participações, which fully consolidates Oi.

Consolidated Statement of Financial Position

The main changes in the statement of financial position are mainly explained by the aquisition and proportional consolidation of the investments in Oi and Contax. This operation was completed as at 28 March 2011, and therefore PT proportionally consolidated the assets and liabilities of these companies in its statement of financial position as from 31 March 2011.

Total assets and liabilities increased from Euro 15.2 billion and Euro 10.6 billion as at 31 December 2010 to Euro 22.9 billion and Euro 19.2 billion as at 31 December 2011, respectively, reflecting primarily the impacts of the acquisition and proportional consolidation of Oi and Contax, amounting to Euro 8.0 billion and Euro 7.3 billion, respectively. Excluding these effects, total liabilities increased by Euro 1.4 billion, primarily due to the Euro 600 million Eurobond

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issued in January 2011 and the increase in the usage of certain credit facilities and short-term commercial paper programmes, partially offset by the impact of the depreciation of the Brazilian Real against the Euro, and total assets decreased by Euro 0.2 billion, as the dividends paid by PT to its shareholders, amounting to Euro 1.1 billion, and the impact of the depreciation of the Brazilian Real against the Euro, were partially offset by the cash obtained from the financings mentioned above.

Total assets and liabilities that were proportionally consolidated for the first time as at 31 March 2011, considering the goodwill recorded as a result of this transaction, include primarily tangible and intangible assets (Euro 7,094 million), cash and cash equivalents (Euro 1,696 million), current accounts receivable (Euro 767 million), deferred tax assets (Euro 658 million), gross debt (Euro 3,749 million), provisions (Euro 807 million) and related judicial deposits (Euro 984 million), accounts payable and accrued expenses (Euro 976 million), taxes payable (Euro 630 million) and deferred tax liabilities (Euro 873 million).

Consolidated statement of financial position **Euro million**

	31 December 2011	**31 December 2010**
Cash and equivalents	5,668.1	5,106.5
Accounts receivable, net	1,936.3	3,403.2
Inventories, net	133.5	101.5
Judicial Deposits	1,084.1	0.0
Financial investments	556.3	539.6
Intangible assets, net	5,424.1	1,111.7
Tangible assets, net	6,228.6	3,874.6
Accrued post retirement asset	13.6	1.9
Other assets	579.5	338.1
Deferred tax assets and prepaid expenses	1,319.6	692.7
Total assets	22,943.8	15,169.9
Accounts payable	1,446.2	722.6
Gross debt	12,281.0	7,206.3
Accrued post retirement liability	1,004.1	968.8
Other liabilities	3,104.7	1,063.0
Deferred tax liabilities and deferred income	1,365.1	600.1
Total liabilities	19,201.0	10,560.8
Equity before non-controlling interests	2,828.1	4,392.4
Non-controlling interests	914.7	216.7
Total shareholders equity	3,742.8	4,609.1
Total liabilities and shareholders equity	22,943.8	15,169.9

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06 Business performance

Portuguese Telecommunication Businesses

As from 3Q11, PT reports its Portuguese telecommunication businesses, which include wireline and TMN, as a new operating segment. As part of this new operating report format, PT also reports revenues of its Portuguese telecommunication businesses on a per customer segment basis, which are as follows: (1) Residential , which comprises fixed telephony, broadband and pay-TV services, including double and triple-play services provided to homes, and was previously booked under the wireline segment; (2) Personal , which includes mainly mobile voice and broadband services provided to individuals and was previously included in TMN, and (3) Enterprise , which includes mobile and fixed voice, broadband and video services as well as customised and more sophisticated applications and ICT services marketed to large corporations and small and medium businesses and that was previously registered both in wireline and in TMN. Other services, including wholesale services and directories, are registered under a different revenue caption, Wholesale, other and eliminations .

In 2011, the Portuguese telecommunication businesses continued to show steady customer growth, with fixed retail customers growing by 5.9% y.o.y to 4,795 thousand (net additions reached 268 thousand in 2011) and mobile customers up by 0.3% y.o.y to 7, 444 thousand (24 thousand net additions in 2011).

Portuguese operating data

	2011	**2010**	**y.o.y**
Fixed retail accesses (000)	4,795	4,527	5.9%
PSTN/ISDN	2,648	2,695	(1.8)%
Broadband customers	1,105	1,001	10.4%
Pay-TV customers	1,042	830	25.6%
Mobile Customers (000)	7,444	7,419	0.3%
Postpaid	2,378	2,291	3.8%
Prepaid	5,066	5,129	(1.2)%
Net additions (000)			
Fixed retail accesses	268	337	(20.3)%
PSTN/ISDN	(48)	(51)	6.4%
Broadband customers	104	139	(25.2)%
Pay-TV customers	212	249	(14.8)%
Mobile Customers	24	167	(85.4)%
Postpaid	87	56	55.8%
Prepaid	(63)	111	(156.6)%
Data as % of mobile service revenues (%)	27.7	24.6	3.1pp

Growth of fixed retail customers was underpinned by a solid performance of Meo, PT s pay-TV service, with an accelerated growth of pay-TV customers, which were up by 25.6% y.o.y to 1,042 thousand (net additions of 212 thousand in 2011), and with broadband customers increasing by 10.4% y.o.y to 1,105 thousand (net additions of 104 thousand in 2011). The success of Meo is achieved on the back of a very differentiated value proposition, which leverages on an innovative non-linear pay-TV service offering a seamless multiscreen experience with live TV channels, video on demand, games and music on demand available on multiple devices. With 1,042 thousand

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customers, Meo surpassed the one million customers threshold in November 2011, in just three and half years after it was launched on a nation wide basis in April 2008, and already commands a 35.5% market share.

Mobile customers benefited from a solid performance of postpaid customers, which grew by 3.8% y.o.y (87 thousand net adds in 2011). The e nunca mais acaba tariff plan, which reached 755 thousand customers in 2011 as well as the wireless broadband customers also continued to show solid growth trends.

Residential

In 2011, retail net additions reached 300 thousand, as a result of the growth of the pay-TV service, which accounted for 198 thousand net additions, bringing the total pay-TV residential customers to 972 thousand (up by 25.5% y.o.y). Fixed broadband net additions in 2011 stood at 102 thousand, with the residential broadband customer base growing by 12.6% y.o.y to 911 thousand. Residential PSTN/ISDN lines stood at 1,674 lines, with net additions of 1 thousand in 2011 and 3 thousand in 4Q11, also reflecting the positive impact of the triple-play offers and notwithstanding aggressive commercial offers by the main competitor. Residential revenue generating units per unique customers stood at 1.9, up 8.1% y.o.y reflecting the continued success of Meo. As a result of this success, residential ARPU was up by 5.4% y.o.y to Euro 30.8. This performance is even more noteworthy as it was achieved against a backdrop of: (1) a challenging economic environment, which leads to some pressure on those services that are more exposed to the economic environment, such as premium and thematic channels, video on demand and other value added services, and (2) aggressive commercial stance by certain competitors that offer unlimited international voice traffic in the monthly fee, with a direct negative impact on traffic revenues.

Residential operating data

	2011	2010	y.o.y
Fixed retail accesses (000)	3,557	3,257	9.2%
PSTN/ISDN	1,674	1,673	0.1%
Broadband customers	911	809	12.6%
Pay-TV customers	972	775	25.5%
Unique customers	1,881	1,862	1.0%
Net additions (000)			
Fixed retail accesses	300	376	(20.2)%
PSTN/ISDN	1	11	(89.3)%
Broadband customers	102	130	(22.1)%
Pay-TV customers	198	235	(15.9)%
ARPU (Euro)	30.8	29.2	5.4%
Non-voice revenues as % of revenues (%)	58.5	51.3	7.2pp

The solid growth of residential customers is clearly supported by the success of Meo, PT s innovative pay-TV service that has already moved towards a seamless multiscreen experience, with live TV channels, video-on-demand and games and music on demand on all screens. Meo delivers a highly differentiated content proposition, with more than 150 TV channels, including exclusive content, HD and 3D channels, thousands of VoD titles and interactivity over anchor programmes (e.g. Ídolos, Secret Story, Biggest Loser). Meo also offers advanced and customised interactive applications across multiple widgets available through the blue button on the Meo remote control and covering areas such as: (1) News, including a personalised newscast app, developed in a partnership with RTP, and the application Sapo Kiosk; (2) Sports, including a football app, a surf app, and specific sports channel apps such the as BenficaTV app and the SportTV app; (3) Music, including MusicBox, a multiscreen music streaming service, a radio streaming app and a karaoke app; (4) Kids, including an all encompassing childrens portal where

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kids can access channels, VoD content, music clips, karaoke, games and tailored educational content; (5) Convenience, including apps for weather, traffic, pharmacies, and several others, and (6) Personal content, including the online photo storage app.

During 2011, PT continued to surprise the pay-TV market with new content experiences. Leveraging on the second edition of Secret Story, the notorious reality show on TVI (a local FTA channel), Meo launched an exclusive Secret Story channel in late September 2011, airing live 24h of the Secret Story house, with an interactive application that allowed customers to select the camera from which they wanted to follow contestants in the show and delivered exclusive best of videos. This channel was a clear commercial success, reaching over 10% audience share and out-performing all other pay-TV channels on most days of the week since it was launched. With RTP, another leading FTA channel, Meo launched a new interactive application that allows customers to create their own news playlists by selecting and aggregating categorised news clips from a catalogue automatically collected and categorised by Meo-RTP throughout the day. Meo also strengthened its music offer by launching a radio application that brings together 25 radio stations on the TV screen. Radio stations include: (1) the radio stations of the Renascença group, the clear leader in this market; (2) SW TMN, PT s new radio station targeted at the youth segment, and (3) several international radios.

In the last quarter of 2011, Meo launched Meo Go, an OTT service that fully addresses in home multiscreen and out of home content mobility on multiple devices. With Meo Go PT made 60 live TV channels and its VoD service available on smartphones, tablets and PCs from all major operating systems (iOS, Android and Windows Phone7), though any connectivity.

In February 2012, Meo took another significant step in terms of innovation and launched Meo Kanal , the first true network effect on a pay-TV service. Meo Kanal is a service that allows customers to produce, edit and share multimedia content on television, on their own TV channel. Channels can be accessed through the green button on the Meo Remote control. Meo Kanal allows customers to create free private channels, requiring and access PIN that is shared only among family members, friends or any other desired group, or public channels, accessible to the whole Meo community. Meo Kanal finally brings the social network experience to the TV. This innovative application has already surpassed the 8,000 channel mark.

In 2011, Meo continued its line of innovative communication and the advertising show Fora da Box debuted its 4th episode in December 2011. This Christmas episode was played out as a musical and conveyed the story of the four Meo majors outside the home and featured a special guest as well as the usual celebrities Rui Unas and Paulo Futre. The market continues to perceive the Meo brand as young, innovative and fun. The Meo brand reached leadership in terms of notoriety and currently has the highest spontaneous recall in telecommunications. In 2011, Meo reached 51% spontaneous recall when compared to other triple-play operators, having reached 62% in September, increasing its distance to the second operator to more than 40pp.

Operating revenues in the Residential customer segment were up by 5.4% y.o.y in 2011 to Euro 682 million, a noteworthy performance that is clearly leveraged on Meo s commercial success, which is underpinning growth of double-play and triple-play services. As a result of this success, the weight of non-voice services in Residential stood at 58.5% in 2011, up by 7.2pp y.o.y.

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Personal

Mobile Personal customers, including voice and broadband customers, were broadly stable in 2011 (31 thousand net disconnections in the period) with the increase in postpaid customers (+4.1% y.o.y, 42 thousand net additions) almost compensating the decline in prepaid customers (-1.5% y.o.y, 73 thousand net disconnections). In 4Q11, customer net additions reached 60 thousand, with TMN showing an improved performance both in: (1) postpaid customers (10 thousand net additions), leveraging on the commercial success of the Unlimited tariff plans and on the continued growth of mobile broadband customers, and (2) prepaid customers, underpinned by the solid performance of the e nunca mais acaba tariff plans.

Personal operating data

	2011	2010	y.o.y
Mobile Customers (000)	5,932	5,963	(0.5)%
Postpaid	1,064	1,021	4.1%
Prepaid	4,868	4,942	(1.5)%
Net additions (000)	(31)	157	(119.6)%
Postpaid	42		