

PORTUGAL TELECOM SGPS SA
Form 6-K
July 11, 2005

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 July, 2005

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 Form 40-F

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 No

CONSOLIDATED REPORT

2004

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HIGHLIGHTS

Consolidated Financial Data

Euro million	2004	y.o.y	2003	2002
Operating Revenues	6,023	4.3%	5,776	5,582
EBITDA	2,326	2.6%	2,268	2,230
Operating Income	1,369	4.2%	1,314	1,267
Net Income	500	108.2%	240	391
Net Income excluding Curtailment Costs	624	38.5%	451	427
Earnings per Share (Euro)	0.43	123.9%	0.19	0.31
Net Assets	12,963	(4.4%)	13,558	13,726
Net Debt	3,123	(2.9%)	3,216	4,037
Shareholder's Equity	2,705	(8.0%)	2,941	3,111
Share Capital	1,166	(7.0%)	1,254	1,254
Gearing (%)	48.7	1.4pp	47.3	53.1
EBITDA Margin (%)	38.6	(0.6pp)	39.3	39.9
Net Debt / EBITDA (x)	1.3	(0.1x)	1.4	1.8
EBITDA Cover (x)	11.5	0.2x	11.2	11.3
Capex	783	20.2%	652	776
Capex to Sales (%)	13.0	1.7pp	11.3	13.9
EBITDA minus Capex	1,543	(4.5%)	1,616	1,454
Financial Investments	309	(33.3%)	464	329
Operating Cash Flow	1,756	(7.2%)	1,893	1,225
Acquisition of Treasury Stock	495	152.8%	196	-
Dividends	267	32.8%	201	125
Employees	29,483	4,611	24,872	23,109
Domestic Market	15,107	(115)	15,222	16,893
International Markets	14,376	4,726	9,650	6,216

Financial Data by Business Segment

Euro million	Wireline		TMN		Vivo		PT Multimedia		Other	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
Operating Revenues	2,124	2,138	1,444	1,347	1,503	1,362	729	683	223	246
EBITDA	902	907	747	690	496	509	192	135	(11)	27

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EBITDA margin (%)	39.8	39.7	47.0	45.3	33.0	37.5	26.3	19.7	n.m.	n.m.
Capex	206	165	159	168	265	165	81	57	73	96
EBITDA minus Capex	696	742	588	521	232	344	111	77	(84)	(69)
Capex to Sales (%)	9.1	7.2	10.0	11.1	17.6	11.4	11.0	8.4	n.m.	n.m.

Operating Data

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	2004	y.o.y	2003	2002
Customer Base ('000)				
Wireline Accesses	4,368	3.4%	4,225	4,196
Mobile	31,596	23.7%	25,543	21,235
Pay-TV	1,553	7.7%	1,442	1,307
Broadband (Retail ADSL + Cable)	695	77.7%	391	184
Wireline				
Main Lines ('000)	4,368	3.4%	4,225	4,196
PSTN/ISDN	3,948	(2.2%)	4,037	4,143
ADSL Wholesale	420	123.4%	188	53
ADSL Retail	380	136.2%	161	43
Net Additions ⁽¹⁾ ('000)	144	397.2%	29	(109)
PSTN/ISDN	(88)	(17.1%)	(106)	(158)
ADSL Wholesale	232	71.4%	135	49
ADSL Retail	219	86.4%	118	40
Pricing Plans ('000)	947	148.1%	382	-
ARPU (Euro)	34.8	2.2%	34.1	35.1
Voice	31.3	(1.1%)	31.6	33.3
Data	3.5	44.1%	2.5	1.8
Total Traffic (10 ⁶ min)	16,478	(9.7%)	18,255	20,065
Retail	7,250	(8.8%)	7,947	8,235
F2F Domestic	5,326	(8.8%)	5,841	6,479
F2M	918	(10.2%)	1,023	1,118
Wholesale	9,229	(10.5%)	10,308	11,830
Internet	3,151	(37.3%)	5,023	6,581
Call Completion Rate (%)	99.8	(0.1pp)	99.9	99.9
Faults per 100 Access Lines (no.)	9.7	(0.4pp)	10.1	10.2
Number of Leased Lines ('000)	16	(14.0%)	19	20
Employees (no.)	8,311	(764)	9,075	11,183
Fixed Lines per Employee	526	60	466	375
Domestic Mobile (TMN)				
Active Customers ('000)	5,053	3.4%	4,887	4,426
Net Additions ('000)	167	(63.8%)	461	521
Total Churn (%)	27.7	4.2pp	23.5	25.3
MOU (min.)	121.0	(1.7%)	123.1	130.5
ARPU (Euro)	24.4	(3.4%)	25.2	27.1
Customer Bill	18.3	(0.8%)	18.4	19.0

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Interconnection	6.1	(10.5%)	6.8	8.1
Data as % of Service Revenues (%)	10.0	1.4pp	8.6	7.4
SARC (Euro)	45.8	(20.1%)	57.3	65.0
CCPU (Euro)	11.2	(7.3%)	12.1	13.5
ARPU minus CCPU (Euro)	13.2	0.2%	13.1	13.6

(1) Including ADSL Wholesale.

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Euro million	2004	y.o.y	2003 ⁽¹⁾	2002 ⁽¹⁾
Brazilian Mobile (Vivo)				
Active Customers ('000)	26,543	28.5%	20,656	16,809
Market Share in Areas of Operation (%)	50.9	(5.4pp)	56.2	60.8
Net Additions ('000)	5,887	53.0%	3,847	2,756
MOU (min.)	89.0	(11.7%)	100.7	105.8
ARPU (R\$)	32.8	(16.8%)	39.4	40.9
SARC (R\$)	152.8	25.3%	122.0	116.4
CCPU (R\$)	18.5	(10.4%)	20.6	21.4
ARPU minus CCPU (R\$)	14.3	(23.7%)	18.8	19.5
Multimedia (PT Multimedia)				
Homes Passed ('000)	2,551	3.2%	2,472	2,390
Bi-directional ('000)	2,418	8.8%	2,221	2,048
Pay-TV Customers ('000)	1,553	7.7%	1,442	1,307
Cable	1,160	6.1%	1,094	1,017
DTH	393	12.9%	348	290
Pay-TV Net Additions ('000)	111	(17.2%)	134	147
Pay to Basic ratio (%)	55.6	(3.9pp)	59.5	53.3
Churn (%)	12.6	0.1pp	12.5	16.3
Cable Broadband Accesses ('000)	315	36.9%	230	140
Cable Broadband Net Additions ('000)	85	(5.5%)	90	78
Pay-TV Blended ARPU (Euro)	25.4	6.6%	23.8	21.5

(1) Pro forma information including TCO.

2004 IN BRIEF

- Explosive growth in broadband - PT's aggressive push in broadband, which resulted in over 300,000 new broadband customers, made Portugal one of the fastest growing broadband markets in Europe and with one of the highest penetrations.
- Wireline turnaround - The strong rollout of ADSL and new pricing plans, combined with continued cost rationalisation, resulted in a stabilisation of wireline EBITDA.
- Accelerated Growth in Brazil - Vivo consolidated its leading position in Brazilian mobile with 40% of the total market and over 50% in its areas of operation, amidst a strong acceleration in customer growth.
- Continued innovation in mobile - TMN was the first operator to launch videocalls on 3G in Portugal, while Vivo became the first 3G operator in Brazil with the launch of EV-DO.
- Profitable growth in multimedia - Continued top line growth, underpinned by customer and ARPU expansion in the Pay-TV business, combined with higher efficiency, resulted in an approximately 40% EBITDA margin in the Pay-TV business in the fourth quarter.
- Continued drive for efficiency - EBITDA margins of the domestic businesses improved in 2004 by 1.2pp, underpinned by the cost rationalisation efforts in place, of which the shared services initiative through PT Pro is a key element.
- Reinforcement of commitment to Brazil - PT increased its exposure to the Brazilian mobile market in 2004, through the investment of Euro 269 million in the rights issue of TCP and the partial tender offers of TSD, CRT and TBE.
- Focus on shareholder remuneration - PT increased dividends per share by 38% for 2003 to Euro 0.22 and executed a 10% share buyback. At the end of 2004, PT cancelled 7% of share capital that corresponds to treasury shares bought under the share buyback program. Subject to shareholder

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approval, PT has committed to increase dividends per share by almost 60% for 2004 to Euro 0.35 and execute a new share buyback of 3%.

CHAIRMAN'S STATEMENT

Introduction

Portugal Telecom had, during 2004, a very positive performance, both operationally and financially. This performance was achieved in an adverse domestic economic setting and, moreover, in a difficult sector context, in Portugal as well as in Brazil.

With respect to performance, I would like to call your attention to the 108.2% increase in net income (totalling Euro 500 million) and the reinforcement of the consolidated revenues and EBITDA (increases of 4.3% and 2.6% respectively). These results strengthened PT while at the same time achieving two main goals: the continuance of a reference shareholder remuneration in the telecommunications sector and the reduction of net debt. In fact, in spite of having distributed Euro 763 million to the shareholders in 2004, PT reduced its net debt by Euro 93 million.

The results shown in this annual report demonstrate how important it is to define and adhere to PT's vision for the future that I mentioned in the 2003 report, which has materialised in the aspects of Performance, Role within Portugal, International Vocation and Human Resources. In fact, PT has now a clear common line of action, which guides its entire strategy and activity, and that has allowed it to pursue, with success and despite the challenging environment, its competitive, operational and financial goals.

Moreover, Portugal Telecom, aware that evolutions and discontinuities, as well as new opportunities and threats, are a permanent reality in the telecommunications sector, continues to consider its vision for the future as a systematic process of prospective analysis and planning, self-renovating it in light of the results of its own performance and the changes in its surroundings.

As for 2004, I wish to highlight and approach in more detail, on account of their increasing relevance and the progress achieved in the past year, four themes: Governance, Strategic Management, Internationalisation and Culture.

Corporate Governance

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In the terms of Corporate Governance, Portugal Telecom consolidated its model, having achieved important advancements in the past year. PT is currently a reference in terms of corporate governance among Portuguese companies.

I would also like to highlight on this point our fulfilment of the Sarbanes-Oxley requirements - arising from our listing in the New York Stock Exchange - that resulted in the approval of the code of ethics for Financial Officers, drawn up by the Governance Committee, which I preside.

PT's achievements in terms of corporate governance result in a reference framework for the internal operation of the group, which consequently leads to the recognition by the financial markets of PT's commitment to the highest ethical and professional practices.

Strategic Management

At the level of strategic management and as a result of the efforts undertaken in 2004, PT has at the present time an internal formal cycle for planning and control, with fully systematised components and timings.

This formal cycle is composed of a multi-year strategic plan, reviewed and updated on an annual basis by operational programmes, a timely approved annual budget, and systematic control and backing which guarantee its fulfilment. From this point of view, 2004 was key, since, on top of optimising ongoing processes, there is now an internal setup which is able to respond in a swift and structured manner to the oncoming developments of the group and its surroundings.

It also seems essential to recall the question of technologies, central to the strategy of PT, which today, more than ever, is prepared to face the challenges and opportunities brought on by increasingly fast cycles of innovation and the higher degree of uncertainty thereof. The Group presently has a clear strategic vision of its technological route and, what is more important, of the stance it must adopt in the distinct scenarios of technological evolution which may occur on a short or medium time frame.

I would also like to restate the permanent strategic commitment of Portugal Telecom towards innovation, promoting the adoption of advanced solutions in the markets it operates in, and producing up-to-

date examples of success, from which I would like to highlight the use of mobile telecommunications services and broadband Internet.

Internationalisation

In relation to international operations, which hold a growing importance in the PT's activity, Brazil naturally stands out, where Vivo, already with approximately 26.5 million clients, continues to affirm itself, in an intensely competitive context, as the major mobile operator in its fields of operation, securing its position as the biggest mobile operator in Latin America. I would also like to point out, due to the level of progress achieved, the very positive evolution in Angola, marked by the development of the mobile operation of Unitel, which has reached approximately half a million clients; and in Timor, where the investment in advanced infrastructures for telecommunications represents a critical platform for the country's economic development.

Also noteworthy on behalf of their structuring character are the establishment of a conceptual framework for the Group's internationalisation and the creation of PT Investimentos Internacionais. On account of this, the current operations should be regarded as progressive steps within a long term process towards the Group's internationalisation, which will entail the intensification and complementing of the current strategic network of participations.

In effect, international investments will most likely turn out to be one of the most powerful factors in the dynamics and consistent affirmation of the Group in its global and regional context, contributing towards the reinforcement of Portugal's role as a link between Europe, Latin America and Africa.

Group Culture

During 2004, we continued to reinforce the corporate culture bases of Portugal Telecom so as to - integrating its legacy from the past and understanding its present reality - exploit its contribution towards the Group's strategic potential for the future.

This issue has deserved special attention from my part, and will continue to do so, as it has clearly shown to be instrumental in drawing out and expressing the potential for knowledge, awareness, and action held within the Group.

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Conclusion

In the year of 2005, we must continue to take new concrete steps within the bounds of these four themes. The holding of an Employee Congress will not only constitute a landmark for the 2004-2006 period, but also represent the launching of a process of broad and structured reflection. In this forum, questions pertaining to PT's corporate culture, its operational capabilities and strategic potential, among other issues, will be approached, so as to provide, as a whole, an answer to the challenges that will arise in the future.

In brief, Portugal Telecom, which I am proud to preside, has come to fulfil, in a successful and consistent manner, its strategic vision for the future, based on a presently solid position, capable of assuring high levels of security and returns to its Shareholders, satisfaction of its Customers' needs, and of mobilisation to its Employees, as well as reinforcing the Group's projection, certainly in Portugal, but, also, in the other economies in which it operates.

Ernâni Rodrigues Lopes
Chairman of the Board of Directors

CEO MESSAGE

2004 was another year of sound performance for Portugal Telecom. Solid execution throughout the year supported a strong generation of operating cash flow, which totalled Euro 1.8 billion. Summarising this past year, I would emphasise four key themes:

- Strong operational and financial performance;
- Significant growth across all businesses, both domestically and abroad;
- Ongoing effort to improve efficiency in the business; and
- Sector leadership in shareholder remuneration policy.

Shareholder remuneration policy

Portugal Telecom shareholders earned a total shareholder return in 2004 of 17%, which is above the return provided by the European telecommunications sector and the Portuguese market. During 2004, we executed the 10% share buyback announced in the previous year and paid dividends in the amount of Euro 0.22 per share. Given the strength and visibility of the cash flow generated by the company, we announced in the second half of the year a proposal to increase dividends for 2004 by almost 60%, to Euro 0.35 per share, and to reinforce the remuneration policy with an additional share buyback of 3%, to be executed until the end of 2005, depending on market conditions. We remained committed to a policy of progressive dividends in the future.

Strong customer growth

We continued to experience significant customer growth in our business in 2004, with emphasis on broadband, mobile and Pay-TV.

Our strategy of aggressively rolling out broadband in Portugal is proving to be a huge success for PT and the country in general, which registered one of the highest growth rates in broadband in Europe. We launched several new services throughout the year that resulted in an unrivalled broad and innovative product offering. Retail broadband customers for the group reached almost 700 thousand, which represented a growth of almost 80%. We believe that the aggressive target of one million broadband customers by the end of 2005 is within our reach.

Mobile was another important engine for growth in 2004. Brazil was the main contributor to customer growth, given the level of penetration

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and competitive intensity of the market. During 2004, we consolidated our leading position in the market, reaching a total of 26.5 million customers, which represented a growth rate of almost 30%. We believe that the Brazilian mobile market should continue to offer an important growth avenue for PT. Despite the already high penetration rate in Portugal, the market continued to grow in 2004. It gave us a great sense of achievement to reach the 5 million customer mark at the end of the year, which allowed us to clearly reinforce our position of leadership.

The Pay-TV business also continued to grow at a healthy pace. Net additions totalled 111 thousand in 2004, bringing our total customer base to 1.6 million. We continue to believe that Pay-TV services in Portugal still offer a significant growth opportunity. We see a potential market for an additional one million customers over the medium term, which could translate into 100 to 150 thousand net additions per annum for PT. The Pay-TV business is expected to remain an important growth lever for the group.

Continued focus on customer needs

As I have said in the past, this performance could not have been achieved without an absolute focus on customer needs.

In Portugal, we continued to develop our offer of voice, video and data services further. The launch of one of the first prepaid broadband services in Europe, allied to the revamping of our two broadband brands, was central to underpin growth by entering new segments of the market. Also as a means of improving the price perception and value of fixed voice in Portugal, we launched three new pricing plan families, which had a significant take-up and should contribute towards greater retention. In terms of video, we continued to expand and to improve the quality of the offer. The repositioning of the Pay-TV brand during the year, towards a more sophisticated and hi-tech service, was also an important achievement.

In terms of mobile, Portugal saw the launch of 3G services by all three operators, with PT being the first to offer a service of videocalls. Euro 2004 provided an excellent opportunity to explore the potential of 3G from a marketing and service application point of view. Leveraging on exclusive content, a large number of services were launched that began to unveil the great potential of 3G for multimedia services. In Brazil, the rollout of 1xRTT and the launch of 3G data

services in certain key regions, using EV-DO, supported a continual launch of new services aimed at providing the best possible mobility experience, such as location-based services, virtual games and video-streaming, among others.

Improving operational efficiency

Our ongoing effort to run the business more efficiently resulted in important gains in 2004. Margins of the domestic businesses expanded across the board, with the reduction in Brazil being essentially linked to strong customer growth. Operating margins before commercial costs in Brazil actually expanded on the back of greater scale and synergies across the group. Structural initiatives, such as the shared services, through PT PRO, and centralised purchasing platform, are starting to produce savings at group level. In fact, the restructuring of business processes currently being undertaken is underpinning further staff reduction programmes in Portugal that is resulting in greater operating efficiency.

Solid execution

The challenges in 2004 were many, but I believe that we managed to deliver a solid execution across all business units, of which I highlight:

- The turnaround of the wireline division, with a stabilisation EBITDA;
- The reaching of aggressive margin targets in Pay-TV, in line with industry best practices;
- The fulfilment of demanding broadband growth targets;
- The continued growth in domestic mobile, supported on strong operational improvements;
- The consolidation of a clear leadership position in Brazilian mobile.

Managing the business responsibly

Portugal Telecom recognises the responsibility it has for all its stakeholders, and commits to the highest standards of business integrity and corporate governance, understanding the important impact it has on society, the environment and the economy in general. Throughout 2004, we worked hard on becoming Sarbanes-Oxley compliant and made important progress in terms of managing the business with an ever increasing focus on sustainability.

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The Executive Committee and I would like to end with a word of gratitude to our customers for choosing Portugal Telecom. We would equally like to thank all our employees for their dedication and professionalism, our suppliers for their support, and, of course, our shareholders for their trust and confidence.

Miguel Horta e Costa
Chief Executive Officer

CAPITAL MARKET

Shareholder Remuneration

Shareholder return, giving preference to a progressive increase in dividends, continues to be a top priority to PT. PT's solid financial position allowed for around Euro 1 billion being returned to shareholders in 2004, through a combination of the share buyback programme and an improved dividend payout.

Progressive increase in dividends

PT distributed Euro 0.10 per share in 2002, Euro 0.16 per share in 2003, and Euro 0.22 per share in 2004, an increase of 38% on the previous year. In 2005, the dividend per share for the year ended 31 December 2004 increases almost 60% over last year to Euro 0.35.

Euro 1 billion to the shareholders in 2004

The 10% share buyback programme announced in September 2003 clearly positioned PT as a leading European telecom operator when it comes to shareholder remuneration. In 2004, PT returned approximately Euro 1 billion to its shareholders, through dividends and the share buyback programme.

Under the 10% share buyback programme, the company was authorised by its General Meeting on 2 April 2004 to acquire up to 10% of its share capital. Under this programme, PT acquired a total of 59,155,441 treasury shares at an average price of Euro 8.13 per share. On 28 December 2004, PT reduced its share capital by 7% from Euro 1,254,285,000 to Euro 1,166,485,050, through the cancellation of 87,799,950 treasury shares, equivalent to 7% of share capital. In addition, as at the date of this report, PT had entered into equity swap contracts under the terms of which it has the option to acquire additional PT shares, equivalent to 3.0% of its previous share capital, at an average price of Euro 9.05 per share. Overall, the average price for the PT shares bought under the 10% share buyback programme was Euro 8.22 per share.

Buyback continues

Reinforcing its commitment to continue delivering compelling returns to its shareholders, PT announced in September 2004 that its management will propose a further share buyback of up to 3% of its share capital (considering the cancellation of the treasury shares acquired under the current 10% share buyback programme), which, subject to market conditions and to PT's financial condition, should be completed by the end of 2005.

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Shares Performance

PT outperformed the market

PT shares outperformed both the DJ Stoxx Telecom and the Euronext PSI 20 indices in 2004, by 2.1pp and 1.4pp respectively, increasing 14.0% on the beginning of the year to close at Euro 9.10. This performance was even more impressive given PSI 20 for 2004 positioned as the third best performing among the major equity markets.

Among the major financial markets, the Bovespa registered the best performance in 2004 (+17.8%), followed by the IBEX (+17.4%) and the PSI20 (+12.6%) .

PT continues to be the most heavily traded company in Portugal

PT continues to be the domestic market leader in terms of liquidity and market capitalisation. Around 1,173 million PT shares were traded in 2004, equivalent to a daily average of 4.5 million, with the trading volume accounting for approximately 40% of the total trading volume of Euronext Lisbon. PT represented 19.3% of the PSI20 index at the end of 2004, being the highest weight of the Portuguese major index. With approximately Euro 11 billion, PT is also the largest company in terms of market capitalisation in Portugal.

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ADRs (NYSE) increased by 23% y.o.y in 2004

In 2004, PT's ADRs increased by 22.9%, closing the year at US\$ 12.31. An average of approximately 110 thousand PT ADRs were traded daily in 2004 on the New York Stock Exchange. The number of ADRs outstanding at the end of 2004 was 61.9 million, of which 66% were owned by international qualified shareholders. PT's ADR programme continues to be one of the most active among European telecom operators. In 2004, PT ranked second in terms of ADRs outstanding as a percentage of total free float, with more than 7%.

Bonds Performance

Rating

During 2004, PT has maintained an A- credit rating from Standard & Poor's and an A3 rating from Moody's, which corresponds to one of the strongest and stable ratings in the sector.

The key credit strength of PT is based on the capability to generate, on a sustainable basis, a strong operating free cash flow, as a result of strong and leading market positions in both fixed and mobile businesses in Portugal and in mobile business in Brazil, as well as the implementation of continued cost cutting initiatives. In addition, despite the initiatives to increase the return to shareholders, PT maintains a strong liquidity position, due to its high level of cash, its debt profile and the additional flexibility provided by its standby lines.

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The telecom companies have continued their effort to reduce debt, which improved the overall credit quality for the sector, with most of the companies ratings between BBB+ and A, according to Standard & Poor's methodology. Last year, Deutsche Telekom, France Telecom and KPN were the ones that have experienced improvements in their rating quality.

Market Conditions

In 2004, the decrease of interest rates and the spread tightening led to the general increase of the 2009 Eurobonds price. Regarding the 2006 Eurobonds, despite the slight decrease of interest rates and the spread tightening, the price has gradually fallen during 2004, becoming closer to par, as these Eurobonds are now close to maturity. The liquidity of the Floating Rate Notes has decreased hugely since the first half of 2004 as they become closer to maturity (February 2005), making the spread performance irrelevant.

During the last quarter of 2004, PT has cancelled Eurobonds in the total amount of Euro 236 million, as follows: Euro 121 million of its Eurobonds maturing in 2009; Euro 101 million of its Eurobonds maturing in 2006 and Euro 15 million of its Floating Rate Notes maturing in 2005. The Eurobonds had been bought back in the secondary market in 2002 and 2003 for a total amount of Euro 230 million.

The performance of PT's Exchangeable Bonds in 2004 was determined mainly by the share price performance and its volatility and, to a lesser extent, by interest rates in the relevant maturities. The increase of PT shares price has led to a general increase of the Exchangeable Bonds price, despite the decrease of the share price volatility. The Exchangeable Bonds issued in 1999 with the initial amount of Euro 509 million matured on 7 June 2004. This was the main factor determining the performance of these Exchangeable Bonds during the period just before their maturity.

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During the last quarter of 2004, PT has cancelled 10,000 Exchangeable Bonds maturing in 2006 in the amount of Euro 50 million, which had been bought back in the secondary market in 2004 for a total amount of Euro 49.9 million.

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Main Shareholders**PT has a diversified shareholder base**

Almost three quarters of PT's share capital is held by foreign shareholders, divided mainly among US and Europe, with the US representing almost a third of the outstanding capital.

The largest investors are BES Group and Telefónica, one of the biggest telecom operators in the world and PT's partner in the Vivo joint venture in Brazil. Additionally, PT has as shareholders the Caixa Geral de Depósitos Group, the BPI Group, Cinveste, Telexpress, as well as large institutional shareholders, like Brandes, Capital and Fidelity. As of 31 December 2004, qualified holdings in PT's share capital were as follows:

Institution	No. of Shares	% of Capital
Telefónica	113,085,650	9.7%
Banco Espírito Santo Group	107,593,232	9.2%
Brandes Investment Partners	83,572,177	7.2%
Capital Group Companies	63,193,870	5.4%
Caixa Geral de Depósitos Group	57,875,682	5.0%
Banco Português de Investimento Group	28,741,615	2.5%
Cinveste	28,338,141	2.4%
Fidelity Group	23,592,185	2.0%
Telexpress *	23,000,000	2.0%

* Holding pursuant to the terms of Article 447 of the Portuguese Commercial Companies Code.

Investor Relations Activities

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

Investor Relations (IR) programme

PT's senior management and IR team stepped up their investor relations activities in 2004. The company participated in several investor events including investor roadshows, analyst and investor presentations, one-on-one meetings and conference calls, as well as appropriate investor conferences in Europe and in the US.

In 2004, PT held a total of approximately 380 contacts with analysts and investors. 220 of these contacts were one-on-one meetings hosted during roadshows and 90 were at investor conferences, while the remaining 70 were at PT's offices through one-on-one meetings and conference-calls.

During the year, PT held four roadshows in Europe and the US, of which the two most significant were held in March 2004, after the announcement of the full year results, and in October 2004 after the announcement of the first half results. The first roadshow covered 8 cities in 6 countries, while the second involved meetings with investors in 13 cities in 10 countries.

PT hosted two presentations to the financial community in Lisbon to present and discuss the company's group and divisional strategy and prospects. The presentations, hosted by a range of PT's senior management, included a profound discussion over several other issues including regulation, pensions funds, corporate governance and shared services.

IR Awards

The domestic and international financial community continues to recognise PT as a leader in terms of investor relations. This was recognised domestically by the awards PT received in July in the 2004 Investor Relations Awards, promoted by Deloitte, Semanário Económico and Diário Económico, namely:

- Best Global Investor Relations Programme - PSI20

- Best Usage of Technology in terms of Investor Relations
- Annual Report (non-financial sector) - Honourable Mention

Internationally, PT won 2 major prizes at the IR Magazine Eurozone Awards, which is widely recognised as the leading international IR awards event:

- Grand Prix for Best Overall Investor Relations
- Best Use of the Internet for Investor Relations

CORPORATE GOVERNANCE

Recent Evolution

The PT Group has, over the last few years, been assuming as one of the main concerns the creation of a structure of Corporate Governance in line with the best international and national practices, providing an answer to the needs of transparency and quality of internal practices and of the information disclosed to investors, to the financial markets and the supervision authorities.

During 2004, the measures taken for such purpose by PT's Board of Directors in the previous two years were consolidated and developed, namely:

- Redefine the Audit Committee's tasks;
- Identify the adequate profile for the members of the Audit Committee, in view of what is provided in the Sarbanes-Oxley Act;
- Define the relationship between the Audit Committee and the Supervisory Board, in view of what is provided in the Portuguese Law and in the Sarbanes-Oxley Act;
- Define measures to be taken by the Group at the internal control system level.

Additionally, in 2002, the Governance Committee and the Strategy Committee were created and the adoption and disclosure of Code of Ethics of the PT Group was resolved, which assembled and clarified the rules of conduct and the values that shall guide all employees of the PT Group.

Also within the context of the new model of corporate governance in 2003 the new articles of association and operation rules of the Audit

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Committee were approved, in accordance with the rules of the NYSE, applicable to the PT Group from 2005. In addition, rules were established on the pre-approval of services barred to external auditors, in accordance with the rules issued by the Securities and Exchange Commission (SEC), in order to ensure the necessary independence of the external auditors.

Already in 2004, the referred Audit Committee consulted and hired external auditors for the years 2004 and 2005, and followed the development and execution of the Internal Control Programme in progress, in addition to its ordinary supervision activities of the Auditing functions.

The year 2004 was also the year of the restructuring of the Corporate Governance Committee now called Governance Committee, as well as of the definition and establishment by such entity of the Code of Ethics for Financial Offers, reinforcing the code of Ethics, existing since 2002, as regards the particularities inherent to the functions of preparation and information disclosure to the market.

In the Corporate Governance report, attached to this document, a detailed analysis is made of the PT Group's corporate governance, in accordance with the established in CMVM's Regulation no. 7/2001.

The creation of a Sustainability Committee aiming to ensure that the business sustainability is integrating and coherent with the Group's strategy is under study.

At last, the creation of a Stakeholders' Board through a redefinition of the scope and responsibilities of the Advisory Board is also under analysis.

STRUCTURE AND MANAGEMENT

PT Group is now structured by business areas which correspond to 5 large core areas: Wireline Business in Portugal, Mobile Business in Portugal (TMN), Multimedia Business (PT Multimedia), International Business, which includes Vivo (the joint-venture with Telefónica Móviles for the mobile business in Brazil) and, finally, Instrumental Companies. The Business Units are coordinated by the holding of the Group, led by its Executive Committee, with the support of the Corporate Centre. The subsidiaries companies' reporting is functional,

not based on hierarchy and, therefore, effective articulation becomes possible.

Instrumental companies are oriented towards processes that are transversal to the PT Group: companies from the Group working for the Group.

PT, the holding of the PT Group, is responsible for the definition of policies and for the normalisation and harmonization of procedures, in order to ensure the implementation of the strategic guidelines defined by the management bodies.

Thus, every business area works in accordance with principles of management autonomy, guided by a common policy, under the coordination of a System of Corporate Planning and Control.

The Corporate Centre responsibilities aim to represent the functional needs of the PT Group and of its participated companies.

STATUTORY BODIES

GENERAL MEETING

Composition and operating rules

The General Meeting is constituted by the shareholders with voting rights, the meeting occurs once a year or whenever required to the General Meeting Chairman by the Board of Directors, the Supervisory Board or by Shareholders representing at least 5% of the share capital.

At present, the board of PT's General Meeting, elected on 4 April 2003 for a period of three years, has the following composition:

- Armando Marques Guedes (Chairman)
- Miguel Galvão Teles (Vice-President)
- Luís Sousa de Macedo (Secretary)

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Participation and exercise of the right to vote

Every shareholder with the right to vote, a vote corresponding to every Euro 500 of capital (e.g. to every 500 shares, at present) can participate in the General Meeting. The holders of American Depositary Shares (ADSs), each ADS representing a common share, are entitled to the same rights as the holders of common shares. These rights shall be exercised through their respective representative.

Proposals to be submitted by the Board of Directors to the General Meeting as well as the reports that should legally accompany them and further preparatory information are made available to the shareholders in the company's registered offices at least 15 days prior to the meeting. Its contents are also disclosed in PT website.

In order to facilitate the access to those documents, especially to foreign shareholders, the Investor Relations Office, when requested, shall send such information by mail, fax or e-mail.

There are no restrictions whatsoever regarding the vote by correspondence, which may fall on all legally foreseen matters.

The result of the resolutions of the General Meeting is made public by the PT through its website, as well as through the Investor Relations Office.

Main responsibilities of the General Meeting

The responsibilities of the General Meeting are established in the Articles of Association of Portugal Telecom.

Resolutions of the 2004 General Annual Meeting

The resolutions of the 2004 General Meeting are available at the Company's website.

REMUNERATION COMMITTEE

The Shareholders General Meeting resolved to delegate on a Remuneration Committee the responsibility for the determination of the remuneration of the members of the corporate bodies. The Remuneration Committee is composed by the following members:

- Armando Marques Guedes
- Augusto Athayde D Albergaria; e
- João Mello Franco

SUPERVISORY BOARD

Portugal Telecom has a Supervisory Board composed by the following elements:

- Pedro Matos Silva (Chairman)
- Gonçalo vaz Botelho (Member)
- Ascensão, Gomes, Cruz & Associado, represented by Mário Gomes
- José Vieira dos Reis (reserve Member)

Powers and Responsibilities

Proceed to the supervisory of the company, in the terms of the Portuguese Code of Commercial Companies.

BOARD OF DIRECTORS

Powers and Responsibilities

The Board of Directors is responsible for the global leadership of the PT Group and for its strategic guidelines, as well as for the management (through the Executive Committee) and the supervision functions, being also its responsibility to ensure the balance between mid and long-term goals and short term goals, in the pursuit of the interests of the company and of its shareholders.

The main responsibilities of the Board of Directors are established in PT Articles of Association.

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Composition and operating rules

PT's Board of Directors is comprised of an uneven number of members, between 15 and 23, elected by the shareholders in a general meeting by a majority of the issued votes, with a term of three years.

Any shareholder, regardless of the capital held, may individually submit proposals for election of the Board of Directors.

On the other hand, and in accordance with the articles of association, a minimum of shareholders representing at least 10% of the share capital, having voted against in the election of the Board of Directors, may appoint a member of the administration body.

The Board of Directors meetings are called by the Chairman, or in extraordinary cases, by two Directors or by the Supervisory Board. Board Members have equal voting rights and all resolutions of the Board of Directors are adopted based on a majority of votes. The Chairman is entitled to a casting vote, should parity occur.

The composition of the Board of Directors of PT is available at its website and the Directors' CVs are presented in the attached Corporate Governance Report.

Delimitation of responsibilities between the Board of Directors and the Executive Committee

In order to better ensure the performance of its functions, PT's Board of Directors created an Executive Committee, delegating in it functions of daily management, and maintaining the supervision and control functions.

The Chief Executive Officer is the leader of the Group's management team. Thus, the CEO is responsible for the operational management of the Group. On the other hand, the Chairman of the Board of Directors, in accordance with the law and the articles of association, has namely to:

- Coordinate the activity of the Board of Directors and distribute matters among Directors, whenever required by management conveniences;
- Watch over the correct implementation of the resolutions of the Board of Directors;

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- Watch over the correct exercise of the Board of Directors' functions of surveillance and control of the Executive Committee's activity.

Remuneration of the Directors

The Remuneration Committee is, by shareholders' delegation, the Statutory Body responsible for the establishment of the remuneration policy of the Directors and for the definition of the remuneration of the Board of Directors. This Committee is directly elected by shareholders, and is mostly composed by independent personalities. None of the Executive Directors are members of this committee, and they exercise no influence in the process of setting remuneration. The Remuneration Committee may use external specialized consultants.

The variable remunerations attributed to the Chairman of the Board of Directors and to the members of the Executive Committee do not include any attribution plans of share acquisition options. The remaining non-executive Directors do not receive any variable remuneration.

The fixed and variable remunerations ascribed to PT's Directors in 2004 are disclosed in the attached Corporate Governance Report.

EXECUTIVE COMMITTEE

Responsibilities

Under the terms of the articles of association and in harmony with the established in commercial law, PT daily management belongs to an Executive Committee, comprised of 5 or 7 Directors. Members have equal voting rights and all resolutions of the Executive Committee require a majority of votes. The Chairman is entitled to a casting vote, should parity occur. The Executive Committee meets once a week.

Composition and operating rules

The Executive Committee sets the dates and frequency of its ordinary meetings. Extraordinary meetings can take place when called by the CEO, by two members of the Executive Committee or by the -Supervisory Board. The Executive Committee may not operate without the presence of the majority of its acting members, which can be ensured through vote by correspondence or by proxy.

To the CEO is due the coordination of the Executive Committee activities and distribute matters by other members, to call and chair

the Executive Committee s meetings and to assure the execution of the adopted resolutions.

The Executive Committee is comprised of the following directors:

Chairman: Miguel Horta and Costa
Officers: Zeinal Bava
Carlos Vasconcellos Cruz
Iriarte Esteves
Paulo Fernandes

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The following organization chart shows the allotment of responsibilities to the members of the Executive Committee:

CORPORATE BODIES SUPPORTING THE EXECUTIVE COMMITTEE

Advisory Board

The Advisory Board analyses, in conjunction with the Executive Committee, areas of special importance for PT, namely matters regarding regulation and competition, international investments, mergers, acquisitions and alienations. The Advisory Board is chaired by Estanislau Mata Costa and further includes the following personalities; Manuel Pinto Barbosa, Diogo Lucena, Aníbal Santos, José Manuel Neves Adelino, José Manuel tribolet, João Confraria, Luís Todo Bom and Luís Nazaré.

Disclosure Committee

In order to provide support to the Executive Committee in the process of disclosure of information to the markets, the Disclosure Committee has been constituted. This committee has the purpose of ensuring the quality and reliability of the information disclosed to the financial markets and ensuring the fulfilment of all the national and international regulatory requirements relating to this matter. It is therefore the responsibility of this committee to approve and execute the procedures and controls necessary to ensure that the disclosure of information by Portugal Telecom to the shareholders and investors (i) fulfils the applicable laws and regulations, (ii) is accurate, complete and timely and (iii) represents with reliability the

financial condition and the results of the Group's operations in all aspects that are materially relevant to the adequate knowledge of its financial condition and performance.

The disclosure procedures and controls referred above are fully described in the attached Corporate Governance Report.

OTHER COMMITTEES OF THE BOARD OF DIRECTORS

Name	Functions	Members	Meetings frequency
Governance Committee	<p>To study, revise and evaluate the corporate governance principles applicable to the PT Group, namely regarding the Directors' responsibilities, the relations between Directors and Shareholders, relations with the Stakeholders and the general evaluation of the government terms of the Group in the performance of the Board of Directors and its Committees.</p> <p>To advise and propose to the Board of Directors the adoption and revision of the governance model of the holding of the Group, namely regarding internal rules and procedures related to corporate governance principles and practices, its articulation and relation with the management structure, the Shareholders, the other Stakeholders and the market, the prevention of conflicts of interest and the information discipline.</p> <p>To supervise and apply the Code of Ethics of the Pt Group, following its implementation and, when necessary or convenient, interpreting its rules and integrating the cases not provided for, as well as issuing opinions on the matters referred in the preceding and other similar matters, when demanded by the Board of Directors.</p>	<p>Ernâni Rodrigues Lopes (Chairman); Miguel Horta e Costa; João Mello Franco; Henrique Granadeiro; Jorge Tomé; Jorge Bleck; Carlos Blanco de Moraes.</p>	<p>Quarterly or whenever called by the Chairman</p>
Audit Committee	<p>To assist the Board of Directors and the Executive Committee in (1) supervising the quality and integrity of the financial information in the financial reporting documents, (2) evaluating the External Auditors' independence and capability, (3) assessing the quality, integrity and efficiency of the internal control system, (4) evaluating the external auditors' and the Internal Audit Department's performance and (5) evaluating the compliance with legal provisions and regulations, as well as recommendations and guidelines issued by the relevant authorities. Ensuring the definition and/ or implementation of policies aiming at</p>	<p>João Mello Franco (Chairman); Nuno Silvério Marques; Thomaz Paes de Vasconcellos.</p>	<p>At least once every two months, and whenever necessary</p>

	compliance with national and international laws and regulations to which PT is bound.		
Strategy Committee	To debate, analyse and present recommendations on the Group's Strategic Plan. To deem the impact and efficiency of the Strategic Plan and the great strategic decisions made, suggesting possible adjustments. To study and prepare for further discussion at a meeting of the Board of Directors, issues suggested by the Chairman and/or the CEO, related with strategic topics that may arise during the year. Carlos Vasconcellos Cruz;	Ernâni Rodrigues Lopes (Chairman); Miguel Horta e Costa; Zeinal Bava; Iriarte Esteves; Paulo Fernandes; Joaquim Goes; Carlos Oliveira Cruz; Fernando Ulrich; António Viana Baptista; Luís Champalimaud; Patrick Monteiro de Barros.	Quarterly

SHAREHOLDERS

Shareholders Structure

The shareholders structure of PT is disclosed in the Capital Markets Chapter, as well as in the attached Corporate Governance Report.

Relationship With Shareholders

As established by commercial law, general meetings must be given a 30 days notice both in the official journal and in the daily press. The notice shall be posted in PT website. The contents of all proposals to be submitted by the administrative body shall be made available to the shareholders at least 15 days before the meeting. They will also be made available in PT website.

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Class A shares, held in full by the Portuguese State, grant veto power in certain matters, which however is limited and essentially of a protective nature, as described in the attached Corporate Governance Report.

PT has a clear dividend policy which is explained in the articles of association in terms of a minimum percentage, and which is publicly announced in advance by the Board of Directors.

DIVIDENDS DISTRIBUTION POLICY AND SHARE BUYBACK PROGRAMME

Dividend distribution

The Board of Directors of PT has a dividends distribution policy that takes into consideration business opportunities of the PT Group, investors' expectations and financing needs through equity, as well as the opportunity cost of capital.

Share Buyback Programme

It has been approved at the 2004 Annual General Meeting a share buyback programme, whose execution comprises the acquisition of own shares representing up to 10% of PT's share capital. This program is presently in the stage of conclusion, its structure preserving and respecting a neutrality principle, not only in what concerns any interference in the shareholding composition but also regarding price conditions impact and market operation rules.

RISK MANAGEMENT

Risk management is ensured by PT based on the identification and prior establishment of critical risks in terms of priorities, being developed after worth, risk management strategies and implemented controls as deemed adequate to reduce risk to an acceptable level.

Bearing in mind that the business risk's management is the responsibility of all personnel, PT has been developing methodologies aiming to create a risk-awareness culture, which establishes a common language to identify, define priorities, assess and control the critical business risks.

Main risk factors inherent to the business of the PT Group

The main risk factors inherent to the business of the PT Group are described in detail in the attached Corporate Governance Report, among which:

- Regulation;
- Competition;
- Technological evolution;
- Strategic partnerships;
- Retaining talents;
- Financial markets.

Internal Control

Aiming to satisfy the regulation demands PT is subject to - both domestic and internationally - PT has developed an Internal Control project, coordinated by the Report and Consolidation Directorate, aiming essentially to guarantee the conformance with objectives, policies and established procedures, guarantee the reliability of financial data, minimise fraud and ensure that the identified critical risks are controlled and reduced to an acceptable level.

The PT Group owns resources, namely a Directorate of corporate Internal Audit, which ensures the supervision of the execution of the defined control policies and procedures.

TRANSPARENCY

Ethics

The Code of Ethics is binding to all personnel, in order to guarantee a group of ethical conducts valid for all companies of the Group, its update and implementation being permanently checked by the Governance Committee. The complete text of the Code of Ethics of the Group Portugal Telecom is available for consultation at the company's official website (www.telecom.pt) and can also be made available through the Investor Relations Office.

In 2004, the Board also approved the Code of Ethics for Financial Officers, highlighting the importance of specific ethic rules applicable to all employees that are, directly or indirectly, involved in the preparation, analysis and reporting of financial statements, press releases or any other information to disclose to the market related with any entities within the PT Group.

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Directors Independence

According to the independence criteria established by the CMVM, the Directors of PT can be generally considered to be independent, as analysed in greater detail in the attached Corporate Governance Report.

External Auditors

In order to safeguard independence of independent auditors, the Audit Committee, in accordance with its articles of association, is responsible for appointing and hiring independent auditors, terminating their functions and pre-approving any services to be contracted to external auditors. Moreover, the Audit Committee is responsible for the evaluation of external auditors' independence and performance. The remunerations of the external auditors of the PT Group are disclosed in the attached Corporate Governance Report.

Investor Relations

The Investor Relations Office was created in March 1995, with the goal of ensuring adequate relations with shareholders, investors and analysts, as well as with financial markets in general, and in particular, with the Stock Exchanges where PT's shares are listed and their respective supervising authorities (CMVM and SEC).

The activities performed by the investor relations are described in the preceding Capital Markets Chapter.

PT publishes annually the Report and Accounts, which includes detailed information about the company and is prepared according to the company's and capital market applicable. Additionally, it is prepared a half-year Report and Accounts, containing synthetic information about the activity of the Group in the semester, and are prepared press-releases, disclosing to the market quarterly financial information.

The investor relations publish immediately information concerning relevant facts occurred in connection with its activity or securities which is made available to Shareholders through the website (www.telecom.pt). The shareholders may get the Reports and Accounts and Press-releases through PT website.

BUSINESS PERFORMANCE

Macro Economic Environment

International Economic Situation

The Global economy expanded significantly in 2004, underpinned by the strength of the US economy and the acceleration of the emerging market economies. Global GDP grew by 5% in real terms, up from 3.9% in 2003.

Global economic activity accelerated despite the strong increase in commodity prices, namely oil, which rose from USD 31 to USD 41.5 at the end of 2004, reflecting the climate of uncertainty in the Middle East. In the US, the evolution of energy prices and internal demand resulted in a moderate but sustained increase in inflation, which drove the Federal Reserve to raise the reference interest rate by 125bp to 2.25%. The European Central Bank, on the other hand, decided to maintain during 2004 the reference refinance rate unchanged at 2%, as the inflation pressures in Europe remained under control.

GDP in the US is estimated to have grown by 4.4% in real terms in 2004, up from 3% in 2003. In spite of the increase in interest rates, households and corporations continued to benefit from extremely favourable conditions for consumption and investment, with both consumer and corporate confidence rising throughout the year. The expansionary fiscal policy and the strength of the real estate market contributed to an acceleration of disposable income for households and to a growth of private consumption of nearly 4% in real terms. Corporate expenditure in equipment and software grew by around 14%, while the construction sector maintained a strong pace, benefiting from stable long term interest rates.

In the Euro Zone, GDP rose by 1.8% in real terms, after a 0.6% increase in 2003. Private consumption and corporate confidence levels remained weak, in part related to the delay in structural reforms and the continuation of restrictive public accounts policies. The appreciation of the Euro in relation to the dollar, of around 8%, hindered the evolution of net external demand. Nonetheless, with high liquidity levels, the Euro Zone registered an increase in credit to the private sector and for house purchases, which improved corporate and consumer confidence by the end of the year.

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GDP Evolution (in real terms)
Global Economy, US, China, Euro Zone and Japan
2002/2004

Economic Situation In Portugal

The Portuguese economy recovered in 2004, with GDP growing by 1.1% in real terms, after a decrease of 1.1% in 2003. The improving economy benefited further from Portugal hosting the Euro 2004 football championship and the Rock in Rio Lisbon event.

The positive evolution of the Portuguese economy throughout the year was underpinned by an improvement in internal demand, in particular of private consumption and investment. Household consumption increased by more than 2% (-0.3% in 2003), supported by a slight increase of disposable income and the higher consumption of durable goods. Investment expanded by 1.9%, compared to a decrease of 9.8% in 2003. Most investment components registered a positive development, with the exception of the construction sector. Net external demand contributed negatively to the GDP growth, with the 7.0% growth of imports outpacing the 6.5% growth of exports.

Real growth rates (%), except when indicated

	2000	2001	2002	2003	2004
GDP	3.4	1.7	0.4	-1.1	1.1
Private Consumption	2.9	1.2	1.1	-0.3	2.2
Public Consumption	4.1	3.3	2.3	0.3	0.4
Investment	2.4	1.2	-5.1	-9.8	1.9
Exports	7.8	1.4	1.9	4.9	6.5
Imports	5.5	1.1	-0.2	-0.1	7.0
Inflation (CPI)	2.9	4.4	3.6	3.3	2.4
Fiscal Deficit (% of GDP)	-2.9	-4.4	-2.7	-2.8	-2.9
Public Debt (% of GDP)	53.3	55.8	58.4	60.3	62.0
Unemployment (% of Labor Force)	4.0	4.1	5.1	6.3	6.5
Current Balance (% of GDP)	-8.9	-8.5	-5.2	-3.6	-5.4

Source: INE, Bank of Portugal, ES Research for 2004

Although GDP increased overall in 2004, there was a reversal of trend in the second half of the year, with confidence and labour market indicators reversing the positive trend. The unemployment rate began to rise again in the third quarter, with the year end level increasing from 6.3% in 2003 to 7.1% in 2004.

In spite of the pressure associated with the increase in energy prices, the consumer price index maintained a decelerating trend, with the average inflation rate decreasing from 3.3% in 2003 to 2.4% in 2004. This evolution was possible given the moderate increase in unit labour costs, the deceleration in the prices of non-energy industrial goods and the subdued increase of food prices.

In terms of fiscal policy, the recourse to extraordinary revenues equivalent to 2.2% of GDP allowed for a global fiscal deficit of 2.9% of GDP. The fiscal deficit adjusted to cyclical effects and to interest expense is estimated to have reduced by 1.2pp to 0.6% of GDP, reflecting a more restrictive fiscal policy in 2004.

Economic Situation In Brazil

The Brazilian economy expanded by 5.1% in 2004, which compares positively with a decrease of 0.2% in 2003. This is the highest GDP growth rate in a decade. The country benefited from strong demand for commodities in 2004, namely from countries like China, but also from an environment of low interest rates, high liquidity and low risk aversion, related to a weak dollar.

Most macroeconomic indicators ended the year with a positive performance, after a beginning of the year characterised by concerns over a possible inflection in monetary policy. Exports increased by 32%, a strong improvement from the 12% growth in 2003, while domestic consumption, which had decreased in 2003, also grew. Unemployment fell, reflecting the better macro-economic conditions.

Inflation in 2004 reached 7.6% (IPCA), as a result of high international prices for oil and other commodities. Notwithstanding, this marked an improvement against the 9.3% registered in 2003. To contain inflationary pressures, the Central Bank tightened monetary policy throughout the second half of 2004, increasing by 125bp the SELIC basic interest rate to 17.75% at year-end. The Brazilian Real

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performed well against the USD in 2004, appreciating by 8.1% and ending the year at 2.65. The improvement in the Brazilian Real reflects mainly the strength of the economy and the increase of real interest rates.

The Brazilian government also presented strong fiscal results in 2004. The consolidated primary budget surplus of the Public sector was the highest since 1994, when the Plano Real was implemented. As a percentage of GDP, the budget surplus was equivalent to 4.61% of GDP, higher than the 4.25% registered in 2003. The result guaranteed the fulfilment of internal and IMF fiscal targets and a reduction of net public debt as a percentage of GDP from 57.2% in 2003 to 51.8% of GDP. The balance also ended the year with a surplus of USD 33.7 billion, benefiting from the improvement in exports mentioned previously. In 2004, S&P and Fitch increased their rating for the Brazilian economy, reflecting the improving fundamentals of external accounts and of the solvency indices of public debt.

Evolution of USD/BRL and EUR/BRL

Analysis Financial Condition and Results of Operations

In this section we present a detailed discussion and analysis of PT's financial condition and business performance for the year 2004.

The following financial analysis should be read in conjunction with the consolidated financial statements and the Notes included elsewhere in this Report. The consolidated financial statements of Portugal Telecom are presented in Euros, and have been prepared in accordance with generally accepted accounting principles in Portugal (Portuguese GAAP).

During 2004, PT's reportable segments were the following:

Wireline	Retail - PT Comunicações e PT.com Wholesale - PT Comunicações Data and Corporate - PT Prime Other wireline operations - PT Comunicações e PT.com
Domestic Mobile	TMN
Brazilian Mobile	Vivo
PT Multimedia	Pay TV and Cable Internet - TV Cabo Portugal and PT Conteúdos Audiovisuals - Lusomundo Audiovisuais and Lusomundo Cinemas Media - Lusomundo Serviços and Lusomundo Media Other Multimedia Operations - PTM holding company

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CONSOLIDATED RESULTSConsolidated Income Statement⁽¹⁾

Euro million	2004	2003	y.o.y
Operating Revenues	6,022.9	5,776.1	4.3%
Wireline	2,123.8	2,138.1	(0.7%)
Domestic Mobile (TMN)	1,444.3	1,346.7	7.2%
Brazilian Mobile (Vivo)	1,503.0	1,361.5	10.4%
Multimedia (PT Multimedia)	729.0	683.5	6.7%
Other	222.8	246.3	(9.6%)
Operating Costs excluding D&A	3,696.9	3,508.4	5.4%
Wages and Salaries	746.2	705.9	5.7%
Post Retirement Benefits	138.5	222.9	(37.9%)
Costs of Telecommunications	552.3	587.1	(5.9%)
Subsidies	(15.1)	(20.6)	(26.7%)
Maintenance and Repairs	119.6	126.5	(5.5%)
Own Work Capitalised	(89.5)	(74.5)	20.2%
Raw Materials and Consumables	68.4	74.0	(7.5%)
Costs of Products Sold	594.7	550.2	8.1%
Telephone Directories	86.9	90.4	(3.9%)
Marketing and Publicity	188.7	141.9	33.0%
General and Administrative Expenses	1075.9	966.5	11.3%
Provision for Doubtful Receivables	171.7	130.8	31.3%
Other Net Operating Income	(67.3)	(90.0)	(25.2%)
Taxes Other than Income Taxes	126.0	97.1	29.7%
EBITDA	2,325.9	2,267.7	2.6%
Depreciation and Amortisation	957.3	954.0	0.4%
Operating Income	1,368.6	1,313.7	4.2%
Other Expenses (Income)	587.8	616.4	(4.6%)
Net Interest Expenses	202.9	201.8	0.5%
Net Foreign Currency Losses (Gains)	32.7	41.9	(21.9%)
Net Other Financial Expenses (Income)	12.5	(95.4)	n.m.
Goodwill Amortisation	97.1	110.6	(12.2%)
Losses (Gains) on Disp. of Fixed Assets	12.0	(28.6)	(142.0%)
Equity in Losses (Earnings) of Affiliates	(27.7)	19.2	n.m.
Work Force Reduction Programme Costs	170.8	314.1	(45.6%)
Non-recurring Items (Losses / (Gains))	87.4	52.8	65.6%
Income before Income Taxes	780.8	697.3	12.0%
Provision for Income Taxes	(179.1)	(377.9)	(52.6%)
Income Applicable to Minority Interests	(101.6)	(79.2)	28.2%
Consolidated Net Income	500.1	240.2	108.2%

(1) Considering a Euro/Real average exchange rate of 3.6359 in 2004 and 3.4849 in 2003.

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Consolidated Operating Revenues

Consolidated Operating Revenues - Contribution by Segment

Euro million	2004	2003	y.o.y
Wireline	2,123.8	2,138.1	(0.7%)
Domestic Mobile (TMN)	1,444.3	1,346.7	7.2%
Brazilian Mobile (Vivo) ⁽¹⁾	1,503.0	1,361.5	10.4%
Multimedia (PT Multimedia)	729.0	683.5	6.7%
Pay-TV and Cable Internet	494.6	432.2	14.4%
Other	222.8	246.3	(9.6%)
Total Operating Revenues	6,022.9	5,776.1	4.3%
Domestic Retail Revenues	1,837.8	1,801.9	2.0%
Wireline	1,377.2	1,403.1	(1.8%)
Pay-TV and Cable Internet	460.6	398.8	15.5%
Avg. Revenue per Household (ARPH)	42.0	41.1	2.0%

(1) Considering a Euro/Real average exchange rate of 3.6359 in 2004 and 3.4849 in 2003.

Consolidated operating revenues increased by 4.3% y.o.y in 2004 to Euro 6,023 million, reflecting the higher contributions from Vivo, TMN and PT Multimedia. Assuming a flat Real/Euro exchange rate, operating revenues would have increased by 5.5% y.o.y in 2004 to Euro 6,093 million.

In 2004, the consolidation method of Mascom in Botswana was changed from full consolidation to equity accounting due to the divestment of this subsidiary, which was initiated in 2003 and completed in September 2004. The change in the consolidation method for Mascom had a negative impact of 1.1pp on the growth of consolidated operating revenues in 2004. In previous years, revenues from Mascom were booked under Other Businesses .

Operating revenues from the domestic businesses rose by 3.1% y.o.y in 2004, underpinned by the strong performance of TMN and PT Multimedia.

In 2004, domestic retail revenues (wireline + pay-TV) increased by 2.0% y.o.y to Euro 1,838 million, with the average revenue per household (ARPH) increasing to Euro 42.0 per month from Euro 41.1 in 2003. The aggressive rollout of broadband services and video products are steadily changing the mix of the ARPH. In 2004, data and video revenues represented 9.9% and 20.6% of ARPH, respectively, as compared to 5.8% and 18.5% in 2003. Wireline net retail revenues (wireline retail revenues less corresponding telecommunications costs) increased by 3.6% y.o.y in 2004 to Euro 1,152 million, reflecting the successful rollout of ADSL and the new pricing plans.

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The contribution to consolidated operating revenues from the mobile businesses rose by 2.0pp y.o.y to 48.9% in 2004. Vivo represented 25.0% of consolidated operating revenues in 2004, an increase of 1.4pp over last year.

Consolidated Operating Revenues - Standalone Revenues by Segment

Euro million	2004	2003	y.o.y
Wireline	2,266.3	2,287.9	(0.9%)
Domestic Mobile (TMN)	1,588.3	1,522.6	4.3%
Brazilian Mobile (Vivo) ⁽¹⁾	1,503.0	1,361.5	10.4%
Multimedia (PT Multimedia)	729.8	684.3	6.6%
Pay-TV and Cable Internet	495.6	432.8	14.5%
Other and Eliminations	(64.5)	(80.2)	(19.6%)
Total Operating Revenues	6,022.9	5,776.1	4.3%

(1) Considering a Euro/Real average exchange rate of 3.6359 in 2004 and 3.4849 in 2003.

The difference in the growth rates of the standalone revenues and the contribution to consolidated revenues of the domestic mobile business is related to the decline in F2M interconnection fees during the year.

EBITDA

EBITDA by Business Segment

Euro million	2004	2003	y.o.y	2004 Margin
Wireline	902.4	907.3	(0.5%)	39.8
Domestic Mobile (TMN)	746.7	689.9	8.2%	47.0
Brazilian Mobile (Vivo) ⁽¹⁾	496.3	508.7	(2.4%)	33.0
Multimedia (PT Multimedia)	191.6	134.7	42.2%	26.3
Pay-TV and Cable Internet	182.8	128.2	42.6%	36.9
Other	(11.1)	27.2	n.m.	n.m.
Total EBITDA	2,325.9	2,267.7	2.6%	38.6
EBITDA Margin (%)	38.6	39.3	(0.6pp)	

(1) Considering a Euro/Real average exchange rate of 3.6359 in 2004 and 3.4849 in 2003.

EBITDA increased by 2.6% y.o.y in 2004 to Euro 2,326 million, despite the decrease of 0.6pp in EBITDA margin to 38.6%. In absolute terms, EBITDA growth in 2004 was equally driven by TMN and PT Multimedia. Margin performance improved across all of the domestic businesses, with margin pressure in Vivo being explained by robust customer growth and intensifying competition.

Based on a flat Real/Euro exchange rate, EBITDA would have increased by 3.6% y.o.y in 2004 to Euro 2,348 million. The change in the consolidation method for Mascom described above had a negative impact

of 1.2pp on the EBITDA growth in 2004. In previous years, the EBITDA from Mascom was booked under Other Businesses .

In 2004, EBITDA of the domestic businesses increased by 6.3% y.o.y, supporting consolidated EBITDA growth in the period. A combination of the stabilisation of the wireline business and strong margin expansion in PT Multimedia and TMN supported this positive domestic performance.

The contribution to consolidated EBITDA from the mobile businesses rose by 0.6pp y.o.y to 53.4% in 2004. The contribution of TMN to consolidated EBITDA increased by 1.7pp y.o.y to 32.1% in 2004, while Vivo's contribution decreased by 1.1pp y.o.y to 21.3% .

PT Multimedia's contribution to consolidated EBITDA improved by 2.3pp y.o.y to 8.2% in 2004, on the back of the 42.6% y.o.y increase in the EBITDA of the Pay-TV and Cable Internet business, which achieved a 40% EBITDA margin in the fourth quarter of 2004.

Consolidated Operating Costs

Consolidated Operating Costs ⁽¹⁾

Euro million	2004	2003	y.o.y	2004 %Revenues
Wages and Salaries	746.2	705.9	5.7%	12.4
Post Retirement Benefits	138.5	222.9	(37.9%)	2.3
Telecommunication Costs	552.3	587.1	(5.9%)	9.2
Costs of Products Sold	594.7	550.2	8.1%	9.9
Marketing and Publicity	188.7	141.9	33.0%	3.1
Provision for Doubtful Rec.	171.7	130.8	31.3%	2.9
General & Administrative Exp.	1,075.9	966.5	11.3%	17.9
Other Operating Costs	228.9	203.0	12.8%	3.8
Oper. Costs excluding D&A	3,696.9	3,508.4	5.4%	61.4
Depreciation & Amortisation	957.3	954.0	0.4%	15.9
Total Operating Costs	4,654.3	4,462.4	4.3%	77.3

(1) Considering a Euro/Real average exchange rate of 3.6359 in 2004 and 3.4849 in 2003. Consolidated operating costs amounted to Euro 4,654 million in 2004, an increase of 4.3% y.o.y, in line with consolidated revenue growth.

Wages and salaries increased by 5.7% y.o.y in 2004 to Euro 746 million and represented 12.4% of operating revenues, compared to 12.2% in 2003. In the case of the wireline business, which accounted for 39.5% of consolidated wages and salaries, these costs fell by 6.2% y.o.y in 2004, benefiting from the staff reduction programme being executed. The contribution of Vivo to consolidated wages and salaries increased

in 2004 by 23.8% y.o.y, primarily because TCO was only fully consolidated by Vivo as of May 2003.

In 2004, post retirement benefit costs (PRBs) decreased by 37.9% y.o.y to Euro 139 million and accounted for 2.3% of consolidated operating revenues. This decline was primarily due to a recent change in Portuguese law revising the method of calculating the pension of an employee upon retirement, which generated a prior year service gain of Euro 67 million. Furthermore, the Portuguese State agreed to increase its contribution to healthcare costs, which also resulted in lower PRBs in 2004.

In 2004, telecommunications costs fell by 5.9% y.o.y to Euro 552 million, mainly as a result of lower traffic volumes in wireline and the decrease in fixed-to-mobile interconnection fees in Portugal. Telecommunications costs accounted for 9.2% of consolidated operating revenues in 2004.

Costs of products sold increased by 8.1% y.o.y to Euro 595 million in 2004, primarily driven by the strong customer growth in Vivo and the gliding adjustment to IFRSs in terms of the accounting for SACs at TMN. SACs incurred during 2004 were no longer deferred, but expensed in the year, while those from previous years were still amortised in operating costs. This cost item represented 9.9% of consolidated operating revenues in 2004.

Marketing and publicity costs rose by 33.0% y.o.y in 2004 to Euro 189 million, mainly as a result of the increase in advertising spend and promotional activities in connection with the rollout of new products and services across all business units. The increase in this caption is also accounted for by the fact that TCO was only fully consolidated by Vivo as of May 2003. This cost item represented 3.1% of consolidated operating revenues in 2004.

Provisions for doubtful receivables, inventories and others increased by 31.3% y.o.y to Euro 172 million in 2004. The increase in this caption is primarily due to a higher level of provisioning in the wireline business, resulting mainly from one-off provisions to cover risks associated with cancellations of certain onerous contracts. Provisions accounted for 2.9% of consolidated operating revenues in 2004.

General and administrative expenses increased by 11.3% y.o.y in 2004 to Euro 1,076 million. In addition to the fact that TCO was only fully consolidated by Vivo as of May 2003, there was an increase in commercial costs, mainly in connection with commissions and call centres, resulting from the strong growth in broadband and pricing plans in the wireline business, and mobile customers in Brazil. General and administrative expenses accounted for 17.9% of consolidated operating revenues in 2004.

Depreciation and amortisation costs remained broadly flat in 2004 at Euro 957 million. Excluding the effect of a transfer to intangible assets of a portion of goodwill related to the value attributable to licenses held by Vivo's subsidiaries described below, which had an impact in this caption of Euro 42 million, depreciation and amortisation would have decreased by 4,1% in 2004. Depreciation charges exceeded capex by Euro 174 million in 2004, resulting in a capex to depreciation ratio of 0.82 times in 2004. This cost item accounted for 15.9% of consolidated operating revenues in 2004.

Operating Income

Operating income in 2004 rose by 4.2% y.o.y to Euro 1,369 million, with operating margin remaining flat at 22.7% .

Net Income

Net income amounted to Euro 500 million in 2004, which represented an increase of 108.2% over the same period of last year. Excluding curtailment charges, net income would have increased by 38.5% y.o.y in 2004 to Euro 624 million.

Net interest expenses remained broadly flat in 2004 and amounted to Euro 203 million, which corresponds to an average cost of debt, including debt from Vivo in Brazil, of approximately 6.2% in 2004.

Net foreign currency losses decreased to Euro 33 million in 2004 from Euro 42 million in 2003, primarily because of the evolution of the Real exchange rate over the period.

Net other financial expenses amounted to Euro 13 million in 2004, which compares to a net other financial income of Euro 95 million in 2003. This caption includes various financial expenses including

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banking commissions and related taxes. In 2003, this caption included gains related to a reduction in the provision to cover estimated losses on certain equity swaps related to PT Multimedia and PT shares, as a result of the rise in the underlying share price as at 31 December 2003, and gains in certain derivative products. Net other financial expenses in 2004 also includes gains from the referred swaps on PT Multimedia shares.

Goodwill amortisation amounted to Euro 97 million in 2004, a decrease of 12.2% over last year. A portion of goodwill related to the value attributable to licences held by Vivo's subsidiaries was transferred to intangible assets at the end of 2003. The amortisation of these licences, which in 2004 amounted to approximately Euro 33 million, is now included in Depreciation and Amortisation. Excluding this effect, this caption would have increased 26.4% in 2004 mainly as result of a gliding adjustment to IFRSs consisting on the adoption of a linear method for the amortisation of goodwill, instead of a nonlinear method based on the revenues of Vivo used in prior years. In 2004, goodwill amortisation included mainly the amortisation of goodwill related to the investments in Vivo (Euro 39 million), PT Multimedia (Euro 10 million), PT.com (Euro 9 million), Lusomundo Media (Euro 8 million), PT Comunicações (Euro 7 million) and Lusomundo Audiovisuals (Euro 6 million).

Net losses on the disposal of fixed assets amounted to Euro 12 million, which compares to net gains of Euro 29 million in the previous year. In 2003, this caption included a one-off gain of Euro 35 million related with the sale of a building to the pension fund.

Equity accounting in earnings of affiliated companies amounted to Euro 28 million in 2004, which compares to a loss of Euro 19 million in 2003. In 2004, this caption included mainly PT's share in the earnings of CTM (Macau), Unitel (Angola), Mascom (Botswana) and Páginas Amarelas totalling Euro 39 million, and in the losses of Médi Télécom (Morocco), TV Cabo Macau and Banco Best totalling Euro 10 million. The improvement in this caption of Euro 47 million is primarily explained by: (1) the reduction in the losses of Médi Télécom (from Euro 25 million to Euro 6 million) and Sport TV (from Euro 5 million to Euro 1 million); (2) the increase in the earnings of Unitel (from Euro 6 million to Euro 17 million); and (3) the change in the consolidation method of Mascom in 2004 from full consolidation to the equity method (earnings of Euro 8 million in 2004).

Workforce reduction programme costs amounted to Euro 171 million in 2004 (Euro 314 million in 2003) and were related primarily to the reduction of 651 employees in the wireline business. This curtailment cost item represents mainly the discounted value of salaries to be paid to pre-retired and suspended employees up to retirement age, thus representing an early recognition of future costs.

Net non-recurring costs amounted to Euro 87 million in 2004, which compares to Euro 53 million in 2003. In 2004, this caption included primarily a provision of Euro 40 million to cover any potential impairment of goodwill relating to the audiovisuals business, a provision of Euro 26 million in the Pay-TV business related to the dismantling of the analogue Premium channels offer and expenses of Euro 10 million incurred in the wireline business for the settlement of a litigation case with DECO (the Portuguese consumers association).

The provision for income taxes decreased to Euro 179 million in 2004 from Euro 378 million in 2003, mainly as a result of (1) the recognition in 2004 of a deferred tax asset of Euro 103 million in connection with tax losses carried forward at PT Multimedia, and (2) the Euro 142 million increase in this caption in 2003 resulting from an accounting adjustment in deferred taxes related to the decrease of the corporate tax rate in Portugal from 33% to 27.5% . In 2004, this caption includes a non-cash component in the amount of Euro 238 million that was recorded against a reduction of tax losses carried forward recorded in deferred tax assets in previous years.

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CAPEX

Capex by Business Segment

Euro million	2004	2003	y.o.y	2004 %Revenues
Wireline	206.4	165.3	24.9%	9.1
Domestic Mobile (TMN)	158.8	168.5	(5.8%)	10.0
Brazilian Mobile (Vivo) ⁽¹⁾	264.5	164.6	60.7%	17.6
Multimedia (PT Multimedia)	80.5	57.4	40.2%	11.0
Pay-TV and Cable Internet	70.6	44.4	59.0%	14.3
Other	72.8	95.8	(24.0%)	n.m.
Total Capex	783.0	651.6	20.2%	13.0

(1) Considering a Euro/Real average exchange rate of 3.6359 in 2004 and 3.4849 in 2003.

Total capex increased by 20.2% y.o.y in 2004 to Euro 783 million, as a result of the increase in wireline, Vivo and PT Multimedia capex. Total capex in 2004 was equivalent to 13.0% of consolidated operating revenues.

Wireline capex in 2004 increased by 24.9% y.o.y to Euro 206 million, equivalent to a capex to sales ratio of 9.1% . This increase is primarily related to the strong growth in broadband accesses.

TMN s capex fell by 5.8% y.o.y to Euro 159 million in 2004, equivalent to 10.0% of operating revenues. Excluding the investment of Euro 33 million, in connection with the payment made in 2003 pursuant to an agreement between the three Portuguese mobile operators and OniWay, TMN s capex in 2004 would have increased by 17.2% y.o.y. TMN spent almost a third of total capex in the UMTS rollout in 2004.

PT s share of Vivo s capex in 2004 amounted to Euro 265 million, an increase of 60.7% y.o.y and equivalent to 17.6% of operating revenues. This increase is primarily explained by the investment in capacity expansion, the progressive rollout of 1xRTT and the launch of EV-DO, as well as the fact that TCO was only fully consolidated by Vivo as of May 2003.

In 2004, PT Multimedia s capex increased by 40.2% y.o.y to Euro 81 million, equivalent to 11.0% of operating revenues. Around a third of PT Multimedia s capex was related to terminal equipment, including set-top boxes and cable modems.

Other capex decreased by 24.0% y.o.y to Euro 73 million in 2004 and was mainly related to the development of the shared services platform

and the rollout of Corporate SAP in order to improve efficiency in back-office processes. This caption also includes investments in IT and R&D, as well as capex related to fully consolidated businesses not included in the main segments.

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CASH FLOW**EBITDA minus Capex**

EBITDA minus Capex by Business Segment

Euro million	2004	2003	y.o.y	2004 %Revenues
Wireline	696.0	742.0	(6.2%)	30.7
Domestic Mobile (TMN)	587.9	521.4	12.8%	37.0
Brazilian Mobile (Vivo) ⁽¹⁾	231.8	344.1	(32.6%)	15.4
Multimedia (PT Multimedia)	111.1	77.2	43.8%	15.2
Pay-TV and Cable Internet	112.2	83.8	33.9%	22.6
Other	(83.9)	(68.6)	n.m.	n.m.
Total EBITDA minus Capex	1,542.9	1,616.1	(4.5%)	25.6

(1) Considering a Euro/Real average exchange rate of 3.6359 in 2004 and 3.4849 in 2003.

EBITDA minus Capex totalled Euro 1,543 million in 2004, decreasing by 4.5% y.o.y, as a result of the decrease in wireline and Vivo, which offset the increase in TMN and PTM. The domestic businesses, on a combined basis, registered an improvement in EBITDA minus Capex of 4.1% y.o.y and accounted for approximately 90% of the total EBITDA minus Capex in 2004.

Free Cash Flow

Euro million	2004	2003	y.o.y
EBITDA minus Capex	1,542.9	1,616.1	(4.5%)
Non-Cash Items included in EBITDA:			
Post Retirement Benefit Costs	138.5	222.9	(37.9%)
Non-Cur. Prov., Tax Prov. & Other N.-Cash Items	37.9	21.2	n.m.
Change in Working Capital	36.8	32.3	14.0%
Operating Cash Flow	1,756.2	1,892.6	(7.2%)
Acquisition of Financial Investments ⁽¹⁾	(322.8)	(343.0)	(5.9%)
Minorities from Rights Issues	94.5	0.0	n.m.
Interest Paid	(252.6)	(285.9)	(11.7%)
Payments Related to Post Retirement Benefits ⁽²⁾	(298.6)	(225.1)	32.7%
Income Taxes Paid by Certain Subsidiaries	(66.0)	(53.7)	22.9%
Other Cash Movements	(34.8)	229.5	n.m.
Free Cash Flow	876.0	1,214.4	(27.9%)

(1) In 2004, this caption included mainly the following payments: (1) Euro 16 million related to the acquisition of a further 17% stake in the share capital of Sport TV; (2) Euro 40 million related to an intercompany loan granted to Sport TV for the acquisition by this associated company of the Portuguese league football rights; (3) Euro 7 million for the acquisition of a 1.93% stake in the share capital of Media Capital; (4) Euro 10 million related

with PT's share in the acquisition by Vivo of a further 10.5% stake in the share capital of Sudestecel (an intermediate holding company that has a controlling position in Tele Sudeste Celular Participações); (5) Euro 13 million related to PT's share in the payment by TCP of an additional instalment in connection with the acquisition of TCO made in 2003; (6) Euro 86 million related with PT's share in the acquisition by Brasilcel of a further 4.2% in Tele Sudeste Celular Participações, 22.7% in Tele Leste Celular Participações and 15.5% in CRT Celular Participações; and (7) Euro 127 million related with PT's share in the acquisition by TCP of a further 21.7% in TCO.

- (2) In 2004, this caption included (1) Euro 68 million related to additional contributions to the pension funds made during the period in connection with the work force reductions in 2003

and 2004; (2) Euro 58 million related to normal contributions to the pension funds made during the period; (3) Euro 143 million related to payments of salaries to pre-retired and suspended employees; and (4) Euro 30 million related to payments to PT-ACS in connection with healthcare services provided to retired, pre-retired and suspended employees. The 32.7% increase in this caption is due to the fact that in 2003 part of the total contributions to the pension funds were made through the contribution in kind of a building in Lisbon (Euro 96 million).

Operating cash flow decreased by 7.2% y.o.y in 2004 to Euro 1,756 million, mainly as a result of the decrease in EBITDA minus Capex, excluding PRBs and other non-cash items. Free cash flow amounted to Euro 876 million in 2004, a decrease of 27.9% y.o.y, primarily because (1) operating cash flow decreased by 7.2% as previously discussed; (2) in 2003 there was an inflow of Euro 201 million related to a reimbursement of income taxes; and (3) payments related to post retirement benefits increased by 32.7% in 2004. Excluding the inflow related to the reimbursement of income taxes in 2003, free cash flow in 2004 would have decreased by 13.5% y.o.y. In 2004, the acquisition of financial investments includes Euro 213 million related to the successful partial tender offers for Vivo subsidiaries, completed in the fourth quarter of 2004, in which Vivo increased the stake in its subsidiaries.

CONSOLIDATED BALANCE SHEET

Consolidated Balance Sheet

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Euro million	31 December 2004	31 December 2003
Current Assets	4,667.1	5,039.7
Cash and Short Term Investments	1,940.1	2,531.1
Accounts Receivable, Net	1,622.4	1,517.3
Inventories, Net	177.1	102.9
Deferred Taxes Assets (Short Term)	773.8	748.1
Prepaid Expenses and Other Current Assets	153.6	140.2
Investments, net	432.6	448.1
Fixed Assets, net	4,062.9	4,268.0
Intangible Assets, net	3,212.9	3,150.1
Defered Tax Assets (Medium and Long Term)	492.0	583.5
Other	96.1	68.5
Total Assets	12,963.4	13,557.8
Current Liabilities	3,783.1	3,354.5
Short Term Debt	1,396.8	1,191.1
Accounts Payable	1,399.6	1,225.9
Accrued Expenses	638.5	589.4
Taxes Payable	82.8	102.9
Deferred Income	237.5	212.4
Deferred Taxes Liabilities (Short Term)	27.9	32.8
Medium and Long Term Debt	3,666.2	4,555.6
Accrued Post Retirement Liability	1,269.9	1,256.0
Deferred Tax Liabilities (Medium and Long Term)	288.7	300.7
Provisions for Other Risks and Charges	460.9	361.4
Other	208.8	144.8
Total Liabilities	9,677.6	9,973.0
Minority Interests	581.0	644.0
Total Shareholders' Equity	2,704.8	2,940.8
Total Liabilities, Minorities and Shareholders' Equity	12,963.4	13,557.8

The gearing ratio [Net Debt / (Net Debt + Equity + Minority Interests)] as at 31 December 2004 increased to 48.7% from 47.3% at the end of 2003, while the equity plus long term debt to total assets ratio decreased to 49.1% from 55.3% over the same period. At the end of December 2004, the net debt to EBITDA ratio was 1.3 times and the EBITDA cover was 11.5 times.

The net exposure (assets minus liabilities) to Brazil amounted to approximately R\$ 8,000 as at 31 December 2004 (Euro 2,206 million at the Real/Euro exchange rate prevailing as at 31 December 2004). The assets denominated in Brazilian Reais in the balance sheet as at 31 December 2004 amounted to Euro 4,164 million, equivalent to approximately 32.1% of total assets. Approximately 98% of the net exposure (assets minus liabilities) to Brazil is accounted for by the 50% stake in Vivo.

The accrued post retirement liability increased by Euro 14 million to Euro 1,270 million in 2004, primarily as a result of the difference between the Euro 299 million paid in connection with post retirement

benefits and the PRBs and curtailment costs of the period amounting to Euro 139 million and Euro 171 million, respectively.

Consolidated Net Debt

Change in Net Debt

Euro million	2004	2003	y.o.y
Net Debt (Initial Balance)	3,215.6	4,037.0	(20.3%)
Free Cash Flow	876.0	1,214.4	(27.9%)
Gains on Certain Foreign Currency Derivatives	(20.9)	54.9	n.m.
Translation Effects of US Dollar and Real Denominated Debt	0.3	1.6	(81.5%)
Impact of TCO Consolidation	-	(52.9)	n.m.
Dividends Paid	(267.5)	(200.7)	33.3%
Acquisitions of Treasury Shares ⁽¹⁾	(495.3)	(195.9)	152.8%
Net Debt (Final Balance)	3,123.0	3,215.6	(2.9%)
Change in Net Debt	92.6	821.4	(88.7%)
Change in Net Debt (%)	(2.9%)	(20.3%)	17.5pp

(1) In 2004, this caption includes Euro 14 million related to acquisitions made in the fourth quarter of 2003 and Euro 481 million related to acquisitions made during 2004.

Consolidated net debt as at 31 December 2004 amounted to 3,123 million, a decrease of Euro 93 million compared to year-end 2003, as a result of the Euro 876 million free cash flow generated in the period, which was used for the payment of dividends (Euro 267 million) and the acquisition of treasury shares (Euro 495 million). As part of the 10% share buyback programme announced in September 2003, PT had entered into equity swap contracts on PT shares that at the end of 2004 had a notional value of Euro 190 million, equivalent to 1.72% of share capital prior to cancellation of the 7% treasury shares held by PT.

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Consolidated Net Debt

Euro million	31 December 2004	31 December 2003	y.o.y	y.o.y
Short Term	1,396.8	1,191.1	205.8	17.3%
Bank Loans	473.9	293.8	180.1	61.3%
Convertible Bonds	0.0	450.5	(450.5)	(100.0%)
Other Bond Loans	585.0	124.7	460.3	369.1%
Other Loans	338.0	322.1	15.9	4.9%
Medium and long term	3,666.2	4,555.6	(889.4)	(19.5%)
Convertible Bond	390.3	440.3	(50.0)	(11.4%)
Other Bond Loans	1,848.2	2,669.1	(821.0)	(30.8%)
Bank Loans	1,337.0	1,363.6	(26.6)	(1.9%)
Other Loans	90.7	82.5	8.1	9.9%
Total Indebtedness	5,063.1	5,746.7	(683.6)	(11.9%)
Cash and Short Term-Investments	1,940.1	2,531.1	(591.0)	(23.3%)
Net Debt	3,123.0	3,215.6	(92.6)	(2.9%)
Equity Swap Contracts on PT shares	189.5	197.5	(7.9)	(4.0%)
Shareholders Loans to TCP	88.1	582.3	(494.2)	(84.9%)

As at 31 December 2004, 72.4% of total indebtedness was medium and long term, while 55.2% of total indebtedness was at fixed rates. As at 31 December 2004, 84.6% of total debt was denominated in Euros, 2.3% in US Dollars and 13.0% in Brazilian Reais. The average maturity of the loan portfolio is currently 3.5 years. At the end of the year, the only loans with rating triggers (if PT is downgraded to BBB+) were two EIB loans totalling Euro 150 million. In December 2004, PT established with EIB a further Euro 150 million stand-by facility, with the same rating triggers as the previous two. In addition, PT has fully underwritten and available commercial paper lines amounting to Euro 875 million, of which Euro 313 million had been drawn down as at 31 December 2004. PT also has stand-by facilities amounting to Euro 900 million, of which Euro 575 million had been drawn down as at 31 December 2004. Most of Vivo's net debt (50% consolidated by PT, amounting to Euro 372 million), is either Real denominated or has been swapped into Reais.

PT's average cost of debt in 2004 was 6.2%, including loans obtained in Brazil and denominated in Reais. Excluding Brazilian debt, the average cost of debt in 2004 was 4.7%.

Net Debt Maturity Profile

Maturity	Net Debt	Notes
2005	(543.3)	Net cash position, which includes a Euro 585 million Eurobond issued in Nov. 2001
2006	1,524.5	Includes a Euro 390 million Exchangeable Bond issued in Dec. 2001 and a Euro 900 million Eurobond issued in Feb. 2001
2007	458.4	
2008	507.1	
2009	959.0	Includes a Euro 880 million Eurobond issued in Apr. 1999
2010	77.8	
2011	66.5	
2012	46.0	
2013	25.9	
2014	0.8	
Total	3,123.0	

Shareholders Equity

As at 31 December 2004, shareholders' equity amounted to Euro 2,705 million, a decrease of Euro 236 million from the end of last year, as a result mainly of: (1) the dividends paid in 2004 amounting to Euro 267 million; (2) the acquisition of treasury stock amounting to Euro 481 million, in line with the announced share buyback programme; (3) the distribution of PT shares to employees amounting to Euro 6 million; (4) the net income generated during the year of Euro 500 million; and (5) the effect of positive translation adjustments of Euro 21 million, mainly due to the appreciation of the Brazilian Real exchange rate against the Euro (Euro/R\$ 3.6646 at year-end 2003 compared to Euro/R\$ 3.6147 at the end of December 2004).

Further to the 10% share buyback programme announced in 2003, as at 31 December 2004, PT had repurchased 8.72% of its share capital, 7.0% through treasury stock and 1.72% through equity swap contracts on PT shares. On 28 December 2004, the 7.0% treasury stock was cancelled and, as a result, PT's share capital was reduced from Euro 1,254 million to Euro 1,166 million.

As at 3 March 2005, PT had equity swap contracts under the terms of which it has the option to buy 37,628,550 PT shares, equivalent to 3.0% of share capital prior to the cancellation of the 7.0% treasury shares on 28 December 2004.

Pursuant to Portuguese legislation, the amount of distributable reserves is determined according to the standalone financial statements of the company prepared in accordance with Portuguese GAAP.

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As at 31 December 2004, distributable reserves of PT amounted to Euro 851 million. The level of distributable reserves is impacted by the amount of (1) treasury stock owned; (2) net income generated; and (3) dividends paid out. Additionally, distributable reserves may be negatively impacted by a depreciation of the Real/Euro exchange rate. Taking into account the level of PT's exposure to Brazil as at 31 December 2004, such a depreciation would only have a negative impact on distributable reserves if the Real/Euro exchange rate were to depreciate beyond 4.2.

Post Retirement Benefits

As at 31 December 2004, the projected benefit obligations (PBO) of PT's post retirement benefits including pensions, healthcare obligations and salaries to pre-retired employees amounted to Euro 4,294 million (Euro 2,606 million for pensions, Euro 702 million for healthcare benefits, and Euro 986 million for salaries to pre-retired employees). The PBO was computed based on a discount rate of 5.75% for pensions and healthcare obligations and 4% for the obligations related to the payment of salaries to pre-retired employees. The PBO increased by Euro 247 million over the end of last year mainly as a result of the increase of Euro 164 million resulting from the workforce reduction programme covering 651 employees and the increase resulting from the change in actuarial assumptions (discount rate and mortality tables). PT's post-retirement benefits (pension and healthcare plans), which have been closed to new participants, cover approximately 34,500 employees, with 32% of the employees still in service.

According to the rules of the ISP (Instituto de Seguros de Portugal , the Portuguese insurance regulator), the pension plans for retired staff have to be fully funded, which is the case for PT's pension funds. Regarding funding of the pension funds for pre-retired staff and staff still in service, this can be completed until retirement age. The estimated average working life of staff still in service is 14 years. New funding of the pension funds is capped at 25% of the salaries of the employees included in the pension funds, because of tax reasons. In 2004, PT contributed also the maximum allowed, under those tax limits.

In Portugal there is no legislation covering the establishment of funds to cover post retirement healthcare benefits (Euro 702 million) and salaries to pre-retired employees (Euro 986 million). PT only has

to pay for these benefits when the healthcare services are actually rendered to employees and a corresponding claim is charged to PT, and when salaries are paid by PT to pre-retired employees. Accordingly, there is no need to fund these benefits together at present. However, PT is analysing tax efficient alternatives that will allow the funding of certain of these obligations.

At 31 December 2004, the market value of the pension funds amounted to Euro 1,973 million, an increase of Euro 145 million from the end of 2003, that resulted primarily from the strong performance of the pension funds (actual return of 8.1% in 2004) through a diversified portfolio, including 35% in equities. At 31 December 2004, the unfunded gap on PT's post retirement benefits amounted to Euro 2,321 million.

Restructuring of the pension funds management is complete, with new management guidelines already approved by PT's Board of Directors and Executive Committee. The new custodian banks and asset managers by class have been also approved. The asset allocation as at 31 December 2004, was 35% equity, 34% bonds, 16% real estate and 15% cash and others. The effective year-to-date performance of the pension funds until the end of February 2005 was 1.3%. At 31 December 2004, the deferred costs related to post retirement benefits amounted to Euro 1,051 million and accordingly the net balance of unfunded liabilities and deferred costs was Euro 1,270 million, as reflected in PT's balance sheet in the caption Accrued Post Retirement Liability and in accordance with the requirements of International Accounting Standard No. 19.

The deferred costs related to post-retirement benefits correspond to: (1) Euro 65 million related to the Initial Transition Obligation (obligation on the initial date for recognition of post retirement liabilities which was 1 January 1993), that is being amortised over an 18-year period corresponding to the expected working life of employees on that date; and (2) Euro 993 million related to actuarial losses and gains, which correspond to differences between the assumptions considered in the actuarial studies and the actual results related to those benefits (including differences in the return of pension fund assets, salary increases and healthcare costs), that is being amortised over a 14 year period corresponding to the average working life of employees.

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The interest cost associated with the full amount of the PBO has been charged to PT's income statement under the caption Post Retirement Benefits, which is booked above the EBITDA line. In 2004, the interest cost of the plans amounted to Euro 213 million. The expected return on the pension funds assets, calculated based on a 6% rate of return assumption, was estimated at Euro 111 million and recorded as a deduction to the above mentioned interest cost. The service cost for staff in service and covered by the plans in 2004 amounted to Euro 24 million. The amortisation and deferral of actuarial losses amounted to Euro 80 million in 2004. Additionally, in 2004 there was a gain of Euro 67 million related to the change in the calculation of the pension benefit to 90% of the employee's last year of salary, that was recorded in the income statement as a reduction to the 2004 PRBs. Thus the net periodic post retirement costs for 2004, which includes the interest cost of unfunded liabilities and the amortisation of deferred costs, was Euro 139 million. PT's cash outflow in 2004 associated with post retirement benefits amounted to Euro 299 million, of which (1) Euro 126 million related to contributions to the pension funds; (2) Euro 30 million related to healthcare services rendered to pensioners and pre-retired employees; and (3) Euro 143 million related to salaries paid to pre-retired employees.

For the purposes of calculating the debt ratios, if the unfunded liability is treated as debt-like in nature, the EBITDA amount used to calculate those ratios needs to be adjusted accordingly. If the post retirement liabilities were fully funded, that would mean that the expected return on fund assets would equal the interest cost of the plans' PBO and, as a result, the net periodic pension cost would have decreased and the EBITDA would have increased by the same amount. In the case of PT, the impact of funding the pension funds would be an increase in EBITDA of Euro 102 million.

Operating Review

Wireline Business

At 31 December 2004, PT owned 100% of the companies included in the wireline segment.

The turnaround of the wireline division during 2004 was underpinned by several key initiatives that focused on customer retention and the

creation of new revenues opportunities. At the centre of this strategy lies broadband. The aggressive rollout of ADSL was a key initiative that led not only improved customer retention, but more importantly, to the creation of new revenues streams that cushioned the pressure felt in terms of traditional voice services.

The tremendous focus placed on broadband at group level meant that Portugal was one of the fastest growing broadband markets in Europe in 2004. Throughout the year new broadband products and offers were launched, resulting in an extensive and innovative product offering by PT. The launch of one of the first broadband prepaid offers in Europe was vital to drive growth and penetrate new market segments. The revamping of the ADSL product brand - Sapo ADSL - was also a major achievement, clearly contributing to the significant growth experienced in broadband.

Bearing in mind the importance of broadband for the development of the information society, and with PT's objective of expanding the domestic broadband addressable market, several projects were undertaken aimed at increasing PC penetration in Portugal. The PC for ALL product, which bundled affordable quality PCs with consumer finance, was of major importance to introduce a new vitality in the domestic retail market for PCs. The project developed with the Ministry of Education, whereby PT provides broadband access to the vast majority of schools in Portugal, should also be key to develop info-literacy in the country.

The launch of three new pricing plan families, based on the concepts of simplicity, freedom and discount, was an important step towards improving price perception of wireline services in Portugal. The simplicity pricing plan, which essentially charges a single price for all fixed-to-fixed calls, had a meaningful take-up among consumers. Equally successful was the weekend flat rate offer, which drew on the experience gained with PT's campaign that offered thirteen Spring Sundays of free fixed-to-fixed traffic. The combination of the weekend flat rate and the off-peak weekday bucket plans proved to be an important means of improving the value perception of the wireline product.

The sale of new trendy cordless phones, with mobile handset functionalities, is an important initiative to improve usage and customer retention, while the bundling of home security solutions is

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creating additional value and stickiness around the ownership of a traditional copper line.

As a result of the strong growth in ADSL and the slowdown in traditional line loss, total main lines increased by 144 thousand to 4,368 thousand, representing an increase of 3.4% over the previous year. Net disconnections of PSTN/ISDN lines amounted to 88 thousand in 2004, which compares favourably with 106 thousand in 2003. In terms of ADSL, wholesale connections rose to 420 thousand in 2004, up from 188 at the end of 2003. Retail ADSL posted even faster growth, with the 219 thousand net additions bringing the total customer base to 380 thousand at the end of 2004.

Growth was extremely robust in terms of pricing plans, which at the end of 2004 totalled 947 thousand, increasing two and a half fold from the 382 thousand at the end of the previous year. Penetration of pricing plans at the end of 2004 stood at 24.0% of total PSTN/ISDN lines and 36.4% of residential lines.

In terms of the corporate and data business, the focus was also on customer retention and on improvement of the quality of the offering. In 2004, PT improved the internal CRM platforms and readjusted the portfolio of products and services in order to further focus its activity in the evolution of customers needs. For instance, the offers have been adjusting as the corporate market continued in 2004 to increase the interest for high bandwidth trustful solutions. The increasing competition in the corporate segment has spurred the continual introduction of new services and solutions. Corporate bundles offering fixed, mobile, data and outsourcing services are provided both to large corporate customers and to SMEs. In this SMEs segment, PT developed pre-packaged offers that combine simplicity, flexibility and scalability and an interesting value for money proposal.

In May 2004, the relevant regulatory authorities approved the fixed telephony service prices proposed by PT for 2004. These prices were set within the rules of the pricing convention, complying with an annual price cap of CPI minus 2.75%, which assumed an inflation range of 1.5% to 2.5% as per the Portuguese State Budget for 2004. The new prices were implemented on 1 August 2004 and resulted in a 2.9% increase in line rental and a decrease of 20.7% and 28.0% in the price of regional and domestic long distance calls respectively.

Fixed-to-fixed interconnection fees maintained their negative trend, falling by 12.2% for call termination and by 14.1% for call origination. Fixed-to-fixed interconnection fees are aligned with the European average. As for fixed-to-mobile, the interconnection price was cut by 10% on 1 July 2004 to Euro 0.185 (in TMN and Vodafone).

Total traffic decreased by 9.7% in 2004, as a result of a decrease of 8.8% in retail traffic and of 10.5% in wholesale traffic. The evolution of wholesale traffic was strongly influenced by the 37.3% decline in dial-up Internet traffic, as a result of the aggressive rollout of broadband, while retail traffic continued to be affected by fixed-to-mobile substitution and rising competition from alternative operators.

In spite of some pressure in terms of voice ARPU, which fell by 1.1% in 2004, total ARPU increased by 2.2%. This positive performance was underpinned by the strong expansion of data ARPU that increased by 44.1% in 2004 and already represented 10.1% of total ARPU in 2004. ADSL ARPU totalled Euro 32.4 in 2004, which compares with Euro 35.4 in the previous year. This normal dilution in ADSL ARPU is explained mainly by the take-up of lower segment products, such as prepaid, which has nonetheless been partly mitigated by the continued growth of sales to the SOHO market.

Total operating revenues of wireline decreased by 0.9% in 2004 to Euro 2,266 million, as shown in the table below.

Wireline Operating Revenues ⁽¹⁾

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Euro million	2004	2003	y.o.y
Retail	1,383.8	1,410.2	(1.9%)
Fixed Charges	670.3	647.5	3.5%
Traffic	590.9	682.8	(13.5%)
Domestic	514.7	593.0	(13.2%)
International	76.3	89.8	(15.1%)
ADSL Retail	99.9	39.5	152.9%
ISP and Other	22.7	40.4	(43.8%)
Wholesale	442.0	444.8	(0.6%)
Traffic	247.9	238.7	3.9%
Leased Lines	153.5	163.6	(6.2%)
Other	40.5	42.5	(4.7%)
Data & Corporate	242.0	235.9	2.6%
Data Communications	102.3	92.6	10.5%
Leased Lines	48.7	55.1	(11.8%)
Network Manag. & Outsourcing	20.1	27.2	(26.1%)
Other	71.0	60.9	16.4%
Other Wireline Revenues	198.5	196.9	0.8%
Other Fixed Line Telephone Services	25.4	17.3	46.3%
Sales of Telecom. Equipment	37.6	37.0	1.7%
Telephone Directories	129.7	136.1	(4.7%)
Portals	5.8	6.5	(10.7%)
Total Operating Revenues	2,266.3	2,287.9	(0.9%)

(1) Includes intragroup transactions.

In terms of retail revenues, fixed charges increased by 3.5% in 2004 to Euro 670 million, on the back of a higher contribution from pricing plans, that accounted for 6.0% of fixed charges, and the increase in line rental in accordance with the price cap mechanism, that offset the line loss. In contrast, traffic revenues fell by 13.5% in 2004, as a result of declining traffic volumes, the implementation of the price cap, and the reduction of fixed-to-mobile prices. Retail ADSL revenues amounted to Euro 100 million in 2004, an increase of two and half times compared to the previous year, while ISP dial-up revenues fell to Euro 23 million as a result of the aggressive rollout of broadband. Overall, retail revenues decreased by 1.9% in 2004 to Euro 1,384 million.

The decline in traffic revenues is in part explained by the reduction of interconnection rates, namely fixed-to-mobile. However, fixed-to-mobile rate cuts also result in lower telecom costs, as the interconnection costs paid to mobile operators is reduced. As a result of this pass-through effect, net retail revenues, calculated as retail revenues less corresponding telecom costs, increased by 3.6% in 2004 to Euro 1,152 million.

Wholesale revenues decreased by 0.6% in 2004 to Euro 442 million, mainly as a result of the decrease in leased lines, partly compensated

by the increase in traffic revenues in 2004. This increase is primarily related to the change in the accounting for transit traffic from net to gross, which had a positive impact of approximately Euro 23 million in 2004.

Data and corporate revenues increased by 2.6% in 2004 to Euro 242 million, mainly as a result of the increase of 10.5% in data communications to Euro 102 million. For this effect, it was essential the launch of new services for the Internet access, with bandwidth up to 155 Mbps, that meet the needs of the corporate segment. Data communications also benefited in 2004 from the hosting of the Euro 2004, as PT was responsible for projecting, installing and managing the communications and information services of the tournament. The increase in data communications was partly offset by the decrease in leased lines and network management and outsourcing revenues, as a result essentially of the increase in the competitive environment namely on prices.

EBITDA remained broadly flat in 2004, amounting Euro 902 million. The EBITDA margin registered a slight increase to 39.8%, benefiting from the ongoing cost rationalisation programme, the reduction in post retirement benefit costs and the decline in telecom costs (due to lower traffic volumes and interconnection rate cuts), that more than offset the increase in provisions in 2004.

Capex amounted to Euro 206 million in 2004, an increase of 24.9% y.o.y, primarily as a result of the aggressive rollout of broadband. Capex in the period was equivalent to 9.1% of operating revenues. Quality of service in 2004 was maintained with a call completion rate of 99.8% and 9.7 faults per 100 access lines.

EBITDA minus Capex in 2004 amounted to Euro 696 million, a decrease of 6.2% over the same period of last year and equivalent to 30.7% of operating revenues.

Wireline Income Statement ⁽¹⁾

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Euro million	2004	2003	y.o.y
Operating Revenues	2,266.3	2,287.9	(0.9%)
Services Rendered	2,099.0	2,114.8	(0.7%)
Telephone Directories	129.7	136.1	(4.7%)
Sales and Other	37.6	37.0	1.7%
Operating Costs excluding D&A	1,363.9	1,380.6	(1.2%)
Wages and Salaries	295.0	314.6	(6.2%)
Post Retirement Benefits	137.7	219.9	(37.4%)
Costs of Telecommunications	383.8	428.9	(10.5%)
Own Work Capitalised	(28.0)	(36.1)	(22.5%)
Marketing and Publicity	44.6	26.6	67.5%
General & Administrative	270.1	211.7	27.6%
Provision for Doubtful Receivables	69.3	22.3	211.3%
Other Net Operating Costs	191.4	192.7	(0.7%)
EBITDA	902.4	907.3	(0.5%)
Depreciation and Amortisation	381.2	404.3	(5.7%)
Operating Income	521.2	502.9	3.6%
EBITDA Margin	39.8%	39.7%	0.2pp
Capex	206.4	165.3	24.9%
Capex as % of Revenues	9.1%	7.2%	1.9pp
EBITDA minus Capex	696.0	742.0	(6.2%)

(1) Includes intragroup transactions.

Domestic Mobile Business - TMN

At 31 December 2004, PT owned 100% of the domestic mobile business (TMN).

The domestic mobile business - TMN - reported a solid performance in 2004, consolidating its leading position, with around half of active customers in the market, and strongly increasing cash flow generation. Total subscribers at the end of the year topped the five million mark.

As the potential for customer growth becomes more limited, given the high level of mobile penetration, the focus shifts towards customer retention and segmentation in order to increase the value of the existing customer base. In order to achieve these objectives, TMN seeks to continually adjust its offer to meet customer needs, while at the same time attempting to improve the value derived from each customer. In 2004, TMN tackled this challenge in two ways. Firstly, by attempting to increase the mobility premium in the market (among the lowest in Europe), by increasing prices; and secondly, by striving to raise the percentage of revenues derived from data services. The aim to increase the customer bill is all the more important when set against a backdrop of falling fixed-to-mobile interconnection rates.

In 2004, all three operators in the market launched 3G services, with TMN being the first operator to offer a service of videocalls. The 3G handsets available to customers are dual-mode, functioning both on UMTS and GSM/GPRS, and thus allowing customers to use all the voice, multimedia and data services already offered by TMN. UMTS coverage now extends to the largest cities in Portugal and is in the process of being expanded to cover the entire country.

The Euro 2004 Football Championship held in June provided an excellent opportunity to explore the potential of 3G from a marketing and service application point of view. Leveraging on the exclusive content for Portugal obtained from sponsoring the event, TMN used its multimedia portal - i9 - to launch a large numbers of services around the event, such as video downloads of goals, tourists helpdesk, among others. The event also had an important contribution in terms of roaming revenues in the second quarter of the year.

With the objective of improving customer retention and segmentation, TMN redesigned its entire offer of prepaid pricing plans. In what was known as the "TMN puts everything in black and white" campaign, the customers had the possibility of choosing the pricing plan that was most appropriate for their needs by launching a special advisory service for the effect. The take-up of the new pricing plans was very encouraging.

Another example of the drive to meet new customer needs was the launch of the "Serie K" sub-brand that targets the 10 to 15 year old segment. The results of this initiative have been very positive, with TMN improving its market share in the youth segment during 2004.

In terms of data services, TMN increased the price of SMS by 30% in July 2004 and simultaneously launched a campaign of large SMS bucket plans for heavy users. In effect, this allowed for an increase in the average yield per SMS, which, combined with higher overall usage, resulted in an increase of data revenues to 10% of service revenues.

ARPU decreased by 3.4% in 2004 to Euro 24.4, mainly as a result of the reduction in interconnection fees, the traffic promotions launched aimed at stimulating usage, and the rising weight of on-net traffic. Customer bill remained broadly flat at Euro 18.3 in 2004, with the increase in the yield per minute being offset by the rising weight of on-net calls. Interconnection bill fell by 10.5% in 2004 as a result

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of the several cuts in fixed-to-mobile interconnection fees over the past quarters. On 1 July 2004, fixed-to-mobile interconnection rates were cut by 10% to Euro 0.185. Minutes of usage (MOU) decreased by 1.7% in 2004 to 121 minutes, primarily as a result of the rising weight of double SIM card penetration and a subdued economic environment.

Operating revenues of TMN in 2004 reached Euro 1,588 million, an increase of 4.3%, primarily reflecting the growth of the customer base. Service revenues increased by 4.1% to Euro 1,440 million, underpinned by the 6.9% increase in billing revenues that more than offset the reduction in interconnection revenues due to the fall in the interconnection rates. Revenues from handset sales increased by 6.9% to Euro 148 million in 2004.

The focus on continually improving operating efficiency and contain subscriber acquisition and retention costs allowed for an expansion of the EBITDA margin in 2004 to 47.0% . As a result, EBITDA increased by 8.2% to Euro 747 million.

Capex in 2004 decreased by 5.8% y.o.y to Euro 159 million, equivalent to 10.0% of operating revenues. Capex was mainly directed towards the expansion of network capacity and coverage, improvements in quality of service and customer care, and UMTS investments (approximately a third of TMN's capex).

As a result of the strong expansion of EBITDA and the reduction in capex, the cash flow generated, measured as EBITDA minus Capex, increased by 12.8% in 2004 to Euro 588 million.

Domestic Mobile Income Statement ⁽¹⁾

Euro million	2004	2003	y.o.y
Operating Revenues	1,588.3	1,522.6	4.3%
Services Rendered	1,440.2	1,384.1	4.1%
Billing	1,081.1	1,011.5	6.9%
Interconnection	359.0	372.6	(3.6%)
Sales	148.1	138.5	6.9%
Operating Costs excluding D&A	841.6	832.7	1.1%
Wages and Salaries	56.3	59.2	(4.9%)
Costs of Telecommunications	296.6	295.5	0.4%
Own Work Capitalised	(1.6)	(4.4)	(64.4%)
Cost of Products Sold	170.9	154.7	10.4%
Marketing and Publicity	28.5	26.3	8.5%
General & Administrative	198.6	210.8	(5.8%)
Provision for Doubtful Receivables	31.4	31.4	0.1%
Other Net Operating Costs	60.9	59.3	2.6%
EBITDA	746.7	689.9	8.2%
Depreciation and Amortisation	200.9	189.9	5.8%
Operating Income	545.8	500.0	9.2%
EBITDA Margin	47.0%	45.3%	1.7pp
Capex	158.8	168.5	(5.8%)
Capex as % of Revenues	10.0%	11.1%	(1.1pp)
EBITDA minus Capex	587.9	521.4	12.8%

(1) Includes intragroup transactions.

Brazilian Mobile Business - Vivo

At 31 December 2004, PT owned 50% of Brasilcel, which in turn owned an interest in TCP (65.12%), TSD (90.89%), CRT (68.33%) and TBE (50.59%) . TCP owned an interest in TCO (51.42%) and GT (100%).

Vivo experienced its best ever year in 2004, continuing its leading position in the explosive Brazilian mobile market. By the end of 2004, there were 65.6 million mobile subscribers in Brazil - an increase of 42% on 2003, with a record 19 million net additions. Mobile penetration in the country increased by over 10pp to almost 37%, 14pp higher than fixed line penetration in Brazil.

By the end of 2004 Vivo had more than 26.5 million active customers, an increase of 28.5%, adding almost 6 million subscribers during the year. The company again confirmed its position as the uncontested leader in this exciting market. Vivo now has 40.5% of the mobile market in Brazil, double that of its nearest competitor, and has now become the 10th biggest mobile operator in the world. All this achieved against a backdrop of intense commercial activity and competition.

The company continues to lead the way in gaining net additions, developing brand awareness, innovation, quality of service and achieving profitability. Although the Vivo brand is a relative newcomer in Brazilian mobile communications, operating for less than two years, it is already one of the most recognised brands in the sector, winning several prizes and supporting the growth of the business.

The fact that the Brazilian population recognises and trusts the Vivo brand has been crucial in increasing penetration, namely as the acceleration of the Brazilian mobile market has been largely driven by prepaid customers, which represented at December 2004 already 80.5% of Vivo's customer base (plus 4pp than in 2003). This growth in the proportion of prepaid subscribers has been the main reason behind the decline in ARPU and MOU. In 2004, Vivo's blended ARPU decreased by 16.8%; over 75% of this decline is due to the increased number of prepaid customers and the impact of SMP rules (namely the introduction of bill & keep and loss of long distance traffic). MOU, and subsequently ARPU, was also impacted by the negative development of incoming traffic.

In 2004, Vivo launched new services, products and promotions in a successful effort to stand out from the crowd. Creative services such as locating services, virtual games and videostreaming were offered to ensure that the customer could differentiate Vivo from its competitors.

Attracting significant numbers of subscribers away from Vivo's competitors saw the company increase its focus on the customer and customer needs in 2004. Improvements include the launch of innovative customer services, supported by the investment in the network capacity, and the rollout of more sophisticated technologies such as CDMA. Capex, which amounted to R\$ 1.924 million in 2004, included the development of the CDMA 1xRTT 2.5G network, providing a larger bandwidth, therefore supplying a platform for more exciting services in the future. Vivo also invested in the first steps to fully launch EV-DO (Evolution Data Optimised), a system that supports third generation services.

Technological leadership and innovation has already had an important impact on the proportion of data included in total service revenues. In 2004, total data represented 4.0%, which compares with 2.2% in the

previous year. Approximately 20% of data revenues were related to multimedia services, internet access and locating services, supported on the 1xRTT platform. It has also reduced churn by 0.5pp in 2004, reflecting improved customer satisfaction.

Vivo's operating revenues, stated in Brazilian Reais, in accordance with Portuguese GAAP and including pro forma information from TCO in 2003, increased by 8.7% in 2004 to R\$ 10,929 million. In 2004, EBITDA declined 4.3% in the period to R\$ 3,609 million, while the EBITDA margin reached 33%, a higher level than the majority of the mobile industry in Brazil. The decline in EBITDA margin is explained by the rapid expansion of the customer base, increasing competition due to the reduction of equipment entry levels, aggressive marketing campaigns and new entrants launching mobile operations. Against this backdrop, the EBITDA performance was extremely encouraging and represented around 60% of the EBITDA of the total Brazilian mobile market.

Excluding customer acquisition costs, the EBITDA margin would have increased by 1.6pp to 49.2%, reflecting the initiatives to control, reprocess and consolidate the group structure, namely in terms of the management, accounting and sales force. In 2004, Vivo also created a data process unit and initiated the consolidation of IT platforms, helping to improve efficiency and economies of scale across the company. The underlying trends of profitability remain extremely healthy and intact, enforcing confidence in the future of the business.

Vivo's operating cash flow, measured as EBITDA minus capex, reached R\$ 1,686 million in the year, making the company the only operator in the Brazilian mobile industry that was able to achieve positive operating cash flow in 2004.

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Brazilian Mobile Income Statement ⁽¹⁾

R\$ million	2004	2003 ⁽²⁾	y.o.y
Operating Revenues	10,929.3	10,053.5	8.7%
Services Rendered	8,605.4	8,132.6	5.8%
Sales	2,324.0	1,920.8	21.0%
Operating Costs excluding D&A	7,320.0	6,281.7	16.5%
Wages and Salaries	677.3	558.4	21.3%
Costs of Telecommunications	638.1	872.0	(26.8%)
Costs of Products Sold	2,699.2	2,126.8	26.9%
Marketing and Publicity	496.4	372.0	33.5%
General & Administrative	2,126.3	1,841.7	15.5%
Provision for Doubtful Receivables	396.1	419.9	(5.7%)
Other Net Operating Costs	286.6	91.0	214.8%
EBITDA	3,609.3	3,771.7	(4.3%)
Depreciation and Amortisation	1,947.6	1,832.5	6.3%
Operating Income	1,661.7	1,939.2	(14.3%)
EBITDA Margin	33.0%	37.5%	(4.5pp)
Capex	1,923.7	1,147.3	67.7%
Capex as % of Revenues	17.6%	11.4%	6.2pp
EBITDA minus Capex	1,685.6	2,624.4	(35.8%)

(1) Information prepared in accordance with Portuguese GAAP.

(2) Pro forma information including 12 months of TCO.

Multimedia Business - PT Multimedia

At 31 December 2004, PT owned directly 57.56% of PTM and through equity swap contracts had access to an additional share capital of 9.74%. Furthermore, PT has also signed derivative contracts, which give the option to acquire up to an additional 4.8% of PTM under certain terms and market conditions.

Operating revenues increased by 6.6% in 2004 to Euro 730 million, primarily as a result of the growth in the Pay-TV and cable internet business. Traditional media revenues also recovered in 2004, benefiting from the recovery in the Portuguese advertising market, which was boosted by events like Euro 2004. The audiovisuals business was negatively impacted by the loss of the Sony distribution contract.

EBITDA margin improved by 6.6pp in 2004 to 26.3%, supported on improvements across all three businesses. This resulted in an increase of EBITDA of 42.3% to Euro 192 million. Despite an increase in total capex to Euro 81 million, EBITDA minus Capex improved by 43.8% in 2004 to Euro 111 million.

Multimedia Income Statement ⁽¹⁾

Euro million	2004	2003	y.o.y
Operating Revenues	729.8	684.3	6.6%
Pay-TV and Cable Internet	495.4	432.8	14.5%
Audiovisuals	80.0	107.7	(25.8%)
Media	154.0	143.8	7.1%
Other	0.5	0.0	n.m.
Operating Costs excluding D&A	538.2	549.6	(2.1%)
Wages and Salaries	86.7	83.8	3.5%
Costs of Telecommunications	26.8	25.2	6.4%
Costs of Products Sold	25.7	59.1	(56.6%)
Marketing and Publicity	39.6	30.2	30.9%
General & Administrative	312.0	306.6	1.8%
Provision for Doubtful Receivables	12.6	14.2	(11.8%)
Other Net Operating Costs	34.9	30.6	14.0%
EBITDA	191.6	134.7	42.3%
Depreciation and Amortisation	58.6	63.0	(7.0%)
Operating Income	133.0	71.7	85.5%
EBITDA Margin	26.3%	19.7%	6.6pp
Capex	80.5	57.4	40.2%
Capex as % of Revenues	11.0%	8.4%	2.6pp
EBITDA minus Capex	111.1	77.2	43.8%

(1) Includes intragroup transactions.

Pay-TV and Cable Internet Business

The Pay-TV business successfully addressed several key challenges in 2004. These challenges were to continue growing the customer base, to improve the service offering and quality of service, to reposition the brand, and to further improve operating efficiency.

With the network rollout practically complete, the focus was placed on increasing the Pay-TV customer base, through cable and DTH, and the penetration of premium services and broadband. Homes passed totalled 2.6 million at the end of the year, of which approximately 95% were bi-directional and, therefore, broadband enabled.

Pay-TV customers increased by 7.7% in 2004, reaching a total of 1.6 million by the end of the year, supported by growth in both the cable and DTH platforms. Given the relatively high penetration of Pay-TV in certain cabled areas, added focus is being given to DTH in order to continue driving customer growth. In August, the upfront cost of buying a DTH dish was cut by a third, which led to a meaningful pickup in sales. Additionally, the DTH distribution network was reorganised in order to improve sales momentum. The launch of an enriched digital offer also contributed towards customer growth in 2004.

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In terms of the premium offer, the sports channel continued to grow at a healthy pace, with 21 new subscriptions being added to a total of 441 thousand. As for the movie channels, the focus was on expanding and improving the quality of the offer to subscribers. With that in mind, a third channel, focused on action movies, was added to the existing two premium movie channels. The overall pay-to-basic ratio at the end of 2004 stood at 55.6% .

In line with the group strategy, cable broadband was a priority during 2004. The broadband customer base continued to grow strongly, reaching 315 thousand accesses at the end of the year, which represents an increase of 36.9% over the previous year. Cable broadband penetration at the end of 2004 reached 27.2% of total cable customers. The launch of the first prepaid broadband product in Portugal, under the brand *Zzt!* , was a major success that clearly underpinned continued growth in broadband. Furthermore, it paved the way to rejuvenate the *Netcabo* brand, used for the other cable broadband products. The investments made to improve the packages and other materials of *Netcabo* 's points of sale, also helped improve the quality of service.

The repositioning the Pay-TV brand, *TV Cabo* , towards a more sophisticated and hi-tech service was an important challenge during 2004. However, it necessarily had to be backed-up by an important effort to improve quality of service and customer care.

During the course of 2004, important investments were made in terms of new CRM and billing systems, which should allow in the future for improved customer care and better market segmentation. The systems migration occurred primarily in the last four months. Once the new systems are stable, the quality of service should improve significantly.

Blended ARPU increased by 6.6% in 2004 to Euro 25.4, supported on the 4.5% increase in Pay-TV ARPU and the higher penetration of broadband services. Broadband ARPU fell by 13.4% to Euro 24.7, on the back of the normal dilution resulting from a higher weight of prepaid customers.

Operating revenues continued to grow strongly in 2004, rising by 14.5% to Euro 496 million, as a result of the increase in revenues from Pay-TV, broadband Internet and advertising.

Revenue growth and a continued focus on operating efficiency resulted in an EBITDA margin of 39.6% in the fourth quarter of 2004, positioning PT's Pay-TV business firmly in the top tier in the industry. This achievement marks a path of margin improvement in excess of 20pp over the past three years. For the whole year, the EBITDA margin reached 36.9%, with EBITDA amounting to Euro 183 million.

In 2004, capex increased by 59.0% to Euro 71 million, equivalent to 14.3% of revenues, primarily as a result of increased spend in IT and in the network redundancy to improve the programming offer and the quality of service. In 2004, capex also included the investment in the right to use satellite capacity of a fourth transponder. EBITDA minus Capex, increased by 33.9% in 2004 to Euro 112 million.

Pay-TV and Cable Internet Income Statement

Euro million	2004	2003	y.o.y
Operating Revenues	495.6	432.8	14.5%
Pay-TV	378.1	334.3	13.1%
Broadband	81.4	64.7	25.8%
Advertising	20.5	14.9	37.6%
Sales and other	15.6	18.8	16.9%
EBITDA	182.8	128.2	42.6%
Depreciation and Amortisation	43.4	46.2	(5.9%)
Operating Income	139.4	82.0	69.9%
EBITDA Margin	36.9%	29.6%	7.3pp
Capex	70.6	44.4	59.0%
Capex as % of Revenues	14.3%	10.3%	4.0pp
EBITDA minus Capex	112.2	83.8	33.9%

Audiovisuals Business

Operating revenues of the audiovisuals business decreased by 22.7% in 2004 to Euro 90 million. This performance was negatively impacted by the end of the distribution contract with Sony and the decline of 13.0% y.o.y in video revenues, as a result of the combination of a less appealing movie portfolio, with the increase in piracy and the decrease in DVD reference prices.

In spite of the strong decrease in operating revenues, EBITDA in the audiovisuals business increased by 4.4% in 2004 to Euro 11 million, underpinned by a major cost rationalisation programme. The combination of a significant reduction in capex to Euro 4million, notwithstanding the investment in refurbishing and opening of several movie theatres,

resulted in a strong improvement in the cash flow of this business, with EBITDA minus Capex totalling Euro 8 million in 2004.

Media Business (Lusomundo Media)

Lusomundo Media revenues increased by 7.0% in 2004 to Euro 154 million, on the back of the advertising market recovery initiated at the end of 2003 and the hosting by Portugal of events like Euro 2004 and Rock in Rio.

A combination of top line growth and EBITDA margin expansion, which almost doubled to 6.5%, resulted in EBITDA growth of 95.5% in 2004. EBITDA in the year amounted to Euro 10 million. The strong growth in EBITDA allowed for a meaningful improvement in cash flow, with EBITDA minus Capex increasing from less than Euro 1 million in 2003 to almost Euro 4 million in 2004.

Research and Development

Applied research activity is concentrated in the Innovation Plan, which comprises projects ensuing from the Innovation Contract, collaborative R&D projects co-funded by the EU, EUROSCOM, and a set of national programmes intended to boost innovation. The 2004 Innovation Contract included 13 projects, covering areas such as the environment, home services, Wimax broadband radio accessing, IPV6, video on demand, interactive multimedia services, IP network signalling, and the supplying of telecommunication network resources and new business models.

In the domain of the IST (Information Society Technologies) Programme, the guidelines related to the projects belonging to the 5th Framework Programme were pursued, namely in the Seacorn and Opium projects, the area of development for 3G mobile networks, and the IST@Home project, which tested and presented access network solutions and home networks capable of supporting remote social services of the e-Care sort.

In early 2004, among the five projects from the first call for proposals of the 6th Framework Programme that were launched, the following can be highlighted: the integrated MUSE projects -advancements in the broadband access network -, and DAIDALOS -development and presentation of a Beyond 3G network architecture -, where PT is responsible for the technical guidelines.

The development, production and integration of NETB@ND technology telecommunication solutions showed a significant increase in 2004, and a concomitant growth in revenues, notably in the case of PT Comunicações. Among the most significant achievements stand the consolidation of the performance assessment solution for operators Vivo and Unitel, by type of service, and for fixed, mobile and IP networks; the try-and-buy trials conducted on operators TMN, PT Comunicações and Mediatecom; the awarding of a supply contract for SDH systems for Vivo's access network; the installation of a fiber optic cabinets for Vivo; the deployment of MicroDslam Solutions (ADSL) at the Euro 2004 Stadiums and Rock-in-Rio Lisbon; the preparation of TMN's UMTS trial network (try-and-buy), based on MABEL/AGORA_NG solutions, and the development of the broadband component in the GEREX System, which granted it unmatched ability and functionalities for the pre-qualification for network lines (annex A/B) for ADSL.

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In the area of intelligent networking services and solutions and of service platforms, the year of 2004 was marked by the contract award for the technical solution which will allow the unification of the pre-paid system on Vivo. Based on an innovative architecture, the NGN (Next Generation Network), which was made available still during 2004, will be able to support 50 million clients, up to the year of 2007. During 2004, the twenty NGN platforms deployed in the Group's mobile operators have supplied services to over 22 million clients worldwide and processed over 18,000,000,000 calls, which is to say 573 calls per second.

Still in 2004, PT also won two international tenders launched by Vivo: one for the deployment of a global network management solution at the new National Centre for Network Management, jointly with HP and Telefónica Soluciones; and the other for a Datawarehouse solution, jointly with Telefónica Research and Development, which will most likely constitute the largest Datawarehouse in the whole of South America.

As for other service platforms, the following stand out: the coming into operation of the SMS real time pricing platform at Médiatecom, the implementation of UniBox (Unified Messaging Platform) at Cabo Verde Telecom, the development and deployment of MMS-C (Multimedia Messaging) on PT Comunicações' fixed network, and the new achievements regarding TMN's i9 portal.

In regard to voice services, certain advancements effected on behalf of TMN on the VoxTMN Platform are noteworthy - namely services such as TMN News, City Guide, VIP Call (telephonic content broadcasting service used during Euro 2004), VMS (recording and sending of voice messages to any phone network in Portugal), as well as the InfoAzores and collect call services. During the year of 2004, TMN delivered over 6 million calls using PT's VoxTMN Platform.

The Group's R&D costs totalled Euro 10.6 million in 2004, in comparison with last year's Euro 14.3 million.

SUSTAINABILITY

Corporate sustainability: sharing a long term value

Sustainability is an integral part of the corporate strategy of Portugal Telecom, as a means of creating value for all stakeholders in the long term. PT's economic and financial development was always accompanied by the concern for the development of society and the protection of the environment.

The sustainability strategy of Portugal Telecom rests on three main elements: economic, environmental and social. In order to correctly evaluate a company, it is important not only to study the financial performance, but also to analyse the social, environmental and economic components. The wealth creation for all stakeholders is only achievable through a sustainable and integrated development of the company.

PT has been developing, over the years, a set of internal and external processes and practices that illustrate its corporate responsibility and represent good sustainability practices.

PT will publish its first CSR (Corporate Social Responsibility) report, in the second quarter of 2005, where the procedures as well as economic, social and environmental indicators will be presented, allowing for the analysis of the company's performance in terms of the three elements of sustainability. This report will also contain the commitments that PT assumes with its stakeholders. With a domestic scope, this report will follow the guidelines of the Global Reporting Initiative (GRI) and will be audited by an external firm.

Social Element: sharing value with the community

The social element can be separated in the internal component which is related with the human resources management, and in the external component, social responsibility, related with the company's life and integration in the community.

Human Resources

The commitment letter for strategic management of the Human Resources of Portugal Telecom, signed in 2004, illustrates the investment that PT intends to continue making regarding one of its main assets: the employees. These commitments include the establishment of objectives, a periodic performance analysis, the development of the perspectives of professional enrichment, the regular communication of strategic decisions, the development of mechanisms to improve the communication between employees and the management, as well as the implementation of employees' satisfaction surveys.

Training continues to be very important for PT, having been reached a significant increase in terms of total number of hours of training and number of hours of training per employee, with a reduction of the cost per hour. During 2004, PT undertook the following hours of training:

- Wireline, mobile and multimedia
- 206 000 hours of training (an increase of 48% y.o.y)
- 20 hours of training per employee (an increase of 45% y.o.y)
- Training costs per hour: Euro 20.5 (a decrease of 23% y.o.y)

In addition, PT promotes several volunteer programmes, contributing to a number of corporate benefaction initiatives. Under these programmes, PT supports the necessary costs for the employees to co-operate in volunteer work, having established a maximum annual limit of 5 days per worker. The strategic areas of the volunteer programme include: training, consultancy and business, web, entertainment, culture and environment.

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During 2004, 709 volunteer initiatives were undertaken, involving 547 employees in a total of 3 939 hours. 601 institutions and 60 940 people were benefited.

PT's support also extends to the families of the employees. At the end of 2004, PT launched a scholarship programme for the employees' children, subject to their income level. PT also launched a programme to promote broadband, through the selling in special conditions of PCs with broadband access.

In the health sector, PT offers health insurance to all its employees and their families, reaching around 110 000 beneficiaries. It is managed by PT ACS, a non-profit organisation, whose objective is to promote and protect health, through the direct or indirect rendering of preventive, curative and rehabilitative medical.

As a result, there is a positive trend in terms of employee satisfaction, which rose to 6.7 in 2004 from 6.5 in 2003, on a scale of 10. Also encouraging is the fact that the participation in the survey improved from 42% in 2003 to 56% in 2004. Areas such as communication, regarding expectations and leadership, had the most significant improvement, within the analysed vectors.

Social Responsibility

Externally, PT has developed over the years a vast number of social responsibility initiatives. The development of products and services for clients with handicaps, as well as services especially tailored for people with low income, such as the elderly, characterise the responsible nature of the company.

This commitment with the society is patent in the creation of the Fundação PT, an institution to implement and manage the social intervention policy, as well as to support the development of social responsibility. Its activities comprise many domains, namely:

- Information and knowledge society
- Reduction info-exclusion
- Programmes for citizens with special needs
- Development of personal and professional skills (through scholarships and awards)
- Preservation of PT's history and heritage
- Cultural patronage
- Social benefaction

In 2004, the investment in social intervention and patronage of the Fundação PT (founded in July 2004) amounted to Euro 4 million.

Environmental Element: sharing value with the environment

Environmental policy is fundamental in the various companies of the Group. It translates, for example, in the environmental certification ISO 14001 of PT Comunicações and TMN (which represent around 80% of the domestic revenues of PT).

This certification involves the existence of an integrated environmental management model and the intervention at the value chain level: for example, the environmental element is one of the criteria in supplier selection.

Environmental policies are developed around different strategic lines such as:

- Waste management
- Efficient consumption of energy, water and fuel.

- The control of impacts, namely those of antennas
- Continued training

During 2004, PT signed the letter of sustainability of ETNO, European Telecommunication Network Operators Association, where it was recognised that sustainability must be at the centre of PT's activity. In this letter, PT compromises to develop and include the issues pertaining to sustainability and the environment in its daily business activities.

Other subsidiaries such as PT Inovação, PT Contract, PT PRO and TV Cabo are also promoting business models based on environmental best practices.

Economic Element: sharing value with the shareholders

In the economic element, which is related to the internal practices and processes of managing the company, PT is today a reference, in line with international best practices, through the fulfilment of the requirements for transparency and information disclosure to the capital markets and the supervisory bodies.

Issues related to the economic element were developed in the sections of capital market and corporate governance.

PROSPECTS

PT will continue to focus on exploring the growth potential of its existing asset portfolio in 2005, namely its integrated telecommunication and multimedia operations in Portugal and its mobile business in Brazil. Competitive and regulatory pressures, as well as the maturity of certain businesses, will demand a constant focus on operating efficiency across the company. PT intends to continue to promote customer retention, simultaneously seeking to increase the value of each customer through the offer of new and innovative services.

Wireline

The wireline business intends to continue to place a strong focus on minimising traditional line loss, through the aggressive promotion of broadband and a range of tailored pricing plans. Regulation should remain a key driver of business performance, with the announced decision on fixed-to-mobile interconnection rates having a visible impact on operating revenues. Regulatory decisions on local loop unbundling prices and wholesale line rental may also present added challenges to business performance. To face these challenges, PT will proceed with its cost rationalisation efforts, underpinned by a staff redundancy programme that should lead to continued headcount reduction in 2005. PT's objective for the wireline business is to preserve operating margins and cash flow generation.

Mobile

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The ongoing rollout of 3G services in Portugal will be a key strategic initiative of the domestic mobile business in 2005. UMTS coverage will continue to be expanded, while the launching [and promotion] of new services and applications based on 3G should result in a growing number of customers using this technology. Regulatory-imposed cuts on interconnection prices should place added pressure on revenue and EBITDA growth. PT plans to offset this pressure by focusing on increasing the mobility premium in the market, which is among the lowest in Europe, and by continuing to improve the operating efficiency of the business.

The focus in Brazilian mobile in 2005 should continue to be on profitable growth and retention of value customers. The market continues to offer an attractive growth opportunity that PT will continue to explore, consolidating its leading position in the market. A challenging competitive environment is likely to remain in place, which combined with expected strong customer growth, should continue to influence operating margins. The ongoing rollout of 1xRTT and the launch of EV-DO in new coverage areas should reinforce the company's positioning as the first and leading 3G operator in Brazil.

Multimedia

The multimedia business plans to continue to take advantage of the significant growth potential that the Pay-TV market in Portugal still offers. To that end, the company intends to focus on growing the customer base, with particular emphasis being given to the DTH platform. The strong push in broadband and the increase in premium services, levered on the set top boxes digitalisation, should underpin ARPU expansion in 2005. PT Multimedia plans to step up its efforts in terms of quality of service and customer care, leveraging on important investments made during 2004, and by increasing the initiatives to further certificate its service providers. The focus on digital services as a means of improving the offer and enhancing customer segmentation should be an important strategic initiative during 2005.

Financials

In terms of financial condition, PT intends to preserve its solid financial indicators, which give it significant financial flexibility to continue pursuing its stated strategy. PT plans to continue to invest in the growth opportunities presented by its business portfolio, with particular emphasis on broadband, mobile and Pay-TV services, observing strict investment criteria.

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Shareholder Remuneration

Pursuant to the commitment of creating and delivering shareholder value, the Board of Directors shall submit a proposal to the company's Annual General Meeting for the payment of a dividend per share of Euro 0.35 for the year ended 31 December 2004, which represents an increase of almost 60% over the previous year. Additionally, the Board of Directors has announced the proposal to execute a new share buyback of 3% to be completed by the end of 2005, depending on market conditions.

Lisbon, 2 March 2005.

The Board of Directors

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PORTUGAL TELECOM, SGPS, S.A. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2004 AND 2003

	Notes	2004 US Dollar	2004 Euro	2003 Euro
Current Assets:				
Cash and cash equivalents		597,281,611	441,188,958	258,903,507
Short-term investments and cash equivalents	5	2,029,228,318	1,498,912,925	2,272,188,060
Accounts receivable-trade, net:				
Third parties	6	1,578,807,958	1,166,204,726	1,118,013,145
Accounts receivable-other, net:				
Third parties	7	571,830,925	422,389,515	365,374,895
Affiliates	7	45,757,052	33,798,975	33,910,549
Inventories, net	8	239,754,082	177,097,121	102,884,982
Deferred Taxes	29	1,047,585,417	773,811,063	748,141,425
Prepaid expenses and other current assets	9	208,007,196	153,646,917	140,241,889
Total current assets		6,318,252,561	4,667,050,200	5,039,658,452
Investments, net	10	585,671,041	432,612,676	448,079,192
Fixed Assets, net	11	5,500,300,242	4,062,860,276	4,267,958,038
Intangible Assets, net - Other	12	4,349,562,968	3,212,854,903	3,150,122,385
Non-Current Deferred Taxes	29	666,040,542	491,978,536	583,471,389
Other Non-Current Assets, net	7	130,035,968	96,052,569	68,525,804
Total assets		17,549,863,321	12,963,409,160	<u>13,557,815,260</u>
Current Liabilities:				
Short term debt and current portion of medium and long-term debt	13	1,891,046,780	1,396,843,537	1,191,078,724
Accounts payable-trade:				
Third parties		963,411,992	711,635,391	672,392,961
Affiliates		17,146,015	12,665,102	11,470,569
Accounts payable-other:				
Third parties	14	766,358,206	566,079,337	535,007,267
Affiliates		147,800,161	109,174,295	7,007,560
Accrued expenses	15	864,415,369	638,510,392	589,394,613
Taxes payable	16	112,111,484	82,812,442	102,925,601
Deferred Taxes	29	37,830,631	27,944,032	32,793,924
Deferred income	17	321,506,712	237,484,645	212,413,495
Total current liabilities		5,121,627,350	3,783,149,173	3,354,484,714

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Medium and Long-Term Debt	13	4,963,326,528	3,666,218,443	4,555,614,003
Accrued Post Retirement Liability	30.3	1,719,147,629	1,269,868,244	1,256,038,995
Non-Current Deferred Taxes	29	390,877,738	288,726,354	300,731,656
Provisions for other risks and costs	18	623,934,347	460,876,309	361,379,666
Other Non-Current Liabilities	18	282,631,247	208,768,834	144,771,333
 Total liabilities		 13,101,544,840	 9,677,607,357	 9,973,020,367
 Minority Interests	 19	 786,591,145	 581,024,631	 643,967,968
 Shareholders' Equity:				
Share capital	20	1,579,187,461	1,166,485,050	1,254,285,000
Capital issued premium	20	124,150,081	91,704,891	91,704,891
Treasury shares		-	-	(210,040,062)
Legal reserve	20	208,789,907	154,225,075	144,184,287
Other reserves and retained earnings		4,105,612,071	3,032,657,757	3,682,035,130
Cumulative foreign currency translation adjustments		(3,033,081,944)	(2,240,420,996)	(2,261,577,622)
Net income		677,069,760	500,125,395	240,235,301
 Total equity		 3,661,727,335	 2,704,777,172	 2,940,826,925
 Total liabilities and shareholder's equity		 17,549,863,321	 12,963,409,160	 13,557,815,260

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

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PORTUGAL TELECOM, SGPS, S.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF PROFIT AND LOSS FOR THE YEARS ENDED DECEMBER 31, 2004,
2003 AND 2002

	Notes	2004	2004	2003	2002
		US Dollar	Euro	Euro	Euro
Operating Revenues:					
Services rendered	21	7,142,826,657	5,276,131,376	5,056,469,413	4,950,845,832
Sales of merchandise and products	21	835,235,333	616,956,222	583,532,339	492,030,480
Telephone directories	21	175,677,716	129,766,373	136,109,823	139,156,808
Total operating revenues		8,153,739,706	6,022,853,971	5,776,111,575	5,582,033,120
Operating Costs and Expenses:					
Wages and salaries	22	1,010,160,412	746,166,651	705,902,478	694,775,367
Post retirement benefits	30.4	187,517,504	138,511,969	222,942,179	183,213,062
Costs of telecommunications	23	747,637,982	552,251,427	587,145,058	622,938,664
Depreciation and amortization	11 and 12	1,296,043,468	957,337,471	953,978,392	962,824,885
Subsidies		(20,465,526)	(15,117,097)	(20,627,776)	(31,519,859)
Maintenance and repairs		161,856,478	119,557,156	126,536,660	129,248,379
Own work capitalized		(121,180,723)	(89,511,540)	(74,499,765)	(114,033,783)
Raw materials and consumables		92,622,629	68,416,774	73,999,927	97,182,987
Costs of products sold		805,079,832	594,681,513	550,154,948	462,664,452
Telephone directories		117,605,143	86,870,397	90,419,679	92,049,002
Marketing and publicity		255,497,772	188,726,379	141,945,303	108,812,870
Concession rent	1	-	-	-	16,278,750
Other general and administrative	24	1,456,610,898	1,075,942,457	966,525,817	925,561,923
Provision for doubtful receivables, inventories and other	28	232,489,875	171,731,330	130,806,217	132,763,318
Other net operating income		(91,101,871)	(67,293,449)	(89,988,262)	(45,258,357)
Taxes other than income taxes		170,570,352	125,993,760	97,143,507	77,840,569
Total operating costs and expenses		6,300,944,225	4,654,265,198	4,462,384,362	4,315,342,229
Operating Income		1,852,795,481	1,368,588,773	1,313,727,213	1,266,690,891
Other Expenses (Income):					
Net interest expenses		274,629,263	202,858,076	201,838,301	197,060,843
Net foreign currency exchange losses/(gains)		44,332,332	32,746,589	41,905,966	(87,776,346)
Other net financing costs/(income)	25	16,914,521	12,494,106	(95,372,242)	111,736,185
Goodwill amortization	12	131,484,426	97,122,489	110,612,770	142,909,438
	10	(37,530,019)	(27,721,982)	19,156,675	160,873,350

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Equity in (earnings)/losses of affiliated companies, net					
Net losses/(gains) on sales and disposals of fixed assets	26	16,261,476	12,011,727	(28,630,291)	(3,966,594)
Work force reduction program costs	30.4	231,281,630	170,838,846	314,084,702	53,701,919
Non-recurring items, net	27	118,348,034	87,419,142	52,784,472	38,622,625
Income Before Income Taxes		1,057,073,818	780,819,780	697,346,860	653,529,471
Provision for income taxes	29	(242,499,860)	(179,125,321)	(377,886,629)	(337,094,337)
Net Income Before Minority Interests		814,573,959	601,694,459	319,460,231	316,435,134
Loss/(income) applicable to minority interests	19	(137,504,199)	(101,569,064)	(79,224,930)	74,620,664
Net Income		677,069,760	500,125,395	240,235,301	391,055,798
Earnings per Share and ADS (USD/EUR)		0,58	0,43	0,19	0,31

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY FOR
THE YEARS ENDED DECEMBER 31, 2002, 2003 AND 2004

(Amounts stated in Euros)

	Share Capital	Capital Issued Premium	Treasury Shares	Legal reserve	Other reserves	Cumulative foreign currency translation adjustments	Retained earnings
Balance as of December 31, 2001	1,254,285,000	2,149,565,000	-	128,814,507	1,935,039,113	(944,948,774)	144,028,2
Earnings allocated to reserves	-	-	-	15,369,780	-	-	(15,369,7
Foreing currency translation adjustments (Note 3.s))	-	-	-	-	-	(1,321,467,418)	
Gains on the sale of own shares	-	-	-	-	(2,400,223)	-	
Dividends paid	-	-	-	-	-	-	(125,428,5
Provision for impairment	-	-	-	-	-	-	(500,000,0
Other adjustments	-	-	-	-	87,358,287	-	(84,576,8
Net income - 2002	-	-	-	-	-	-	391,055,7
Balance as of December 31, 2002	1,254,285,000	2,149,565,000	-	144,184,287	2,019,997,177	(2266,416,192)	(190,291,0
Acquisition and sales of treasury	-	-	(210,040,062)	-	-	-	

shares, net							
Distribution of PT shares to employees	-	-	-	-	(4,794,502)	-	-
Capital issued premium allocated to retained earnings	-	(2,057,860,109)	-	-	-	-	2,057,860,109
Foreing currency translation adjustments (Note 3.s))	-	-	-	-	-	4,838,570	-
Gains on the sale of own shares	-	-	-	-	(276,767)	-	-
Dividends paid	-	-	-	-	(200,685,600)	-	-
Other adjustments	-	-	-	-	39,628,924	-	(39,403,100)
Net income - 2003	-	-	-	-	-	-	240,235,300
Balance as of December 31, 2003	1,254,285,000	91,704,891	(210,040,062)	144,184,287	1,853,869,232	(2,261,577,622)	2,068,401,100
Acquisition of treasury shares	-	-	(480,912,955)	-	-	-	-
Cancellation of treasury shares	(87,799,950)	-	690,953,017	-	(603,153,067)	-	-
Dividends paid	-	-	-	-	(76,724,707)	-	(190,774,900)
Distribution of PT shares to employees	-	-	-	-	(6,220,610)	-	-
Earnings allocated to the legal reserve	-	-	-	10,040,788	-	-	(10,040,788)
Foreing currency translation	-	-	-	-	-	21,156,626	-

adjustments
(Note 3.s))

Other

adjustments

(1)

-	-	-	-	(688,003,474)	-	685,304,9
---	---	---	---	---------------	---	-----------

Net income -

2004

-	-	-	-	-	-	500,125,3
---	---	---	---	---	---	-----------

**Balance as
of**

December

31, 2004

1,166,485,050

91,704,891

- 154,225,075

479,767,374

(2,240,420,996) 3,053,015,7

- (1) The adjustment made to other reserves and retained earnings, includes basically: (i) an amount of Euro 720,000,000 related to reserves distributed by PT Comunicações and TMN; and (ii) Euro 34,695,049 representing the difference between the 2003 results of the subsidiary and affiliated companies considered in the preparation of the Company's consolidated financial statements, and the dividends distributed by those entities during 2004.

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

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PORTUGAL TELECOM, SGPS, S.A. AND SUBSIDIARIES**CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002**

	2004	2004	2003	2002
	US Dollar	Euro	Euro	Euro
OPERATING ACTIVITIES				
Collections from clients	9,447,649,939	6,978,615,703	6,508,513,684	6,521,776,690
Payments to suppliers	(4,690,922,120)	(3,465,003,782)	(2,796,599,245)	(2,940,476,605)
Payments to employees	(1,147,733,186)	(847,786,369)	(822,506,844)	(763,798,144)
Cash flow from operations	3,608,994,632	2,665,825,552	2,889,407,595	2,817,501,941
Payments relating to income taxes	(89,310,668)	(65,970,356)	144,366,627	(289,131,732)
Other payments relating to operating activities, net	(640,889,937)	(473,400,751)	(566,274,305)	(384,970,914)
Cash flow before non operating activities	2,878,794,028	2,126,454,445	2,467,499,917	2,143,399,295
Receivables relating to non recurring items	1,187,265	876,987	7,157,682	43,098,416
Payments relating to non recurring items	(148,339,765)	(109,572,880)	(140,647,691)	(94,174,202)
Cash flow from operating activities (1)	2,731,641,528	2,017,758,552	2,334,009,908	2,092,323,509
INVESTING ACTIVITIES				
Cash receipts resulting from:				
Financial investments	28,759,097	21,243,239	3,625,011	1,311,634,564
Tangible fixed assets	48,391,921	35,745,251	116,621,650	29,038,119
Intangible assets	4,832	3,569	32,686	-
Subsidies for investments	4,032,913	2,978,958	-	196,288
Interest and related income	357,243,603	263,882,112	283,952,038	245,909,913
Dividends	22,488,318	16,611,256	26,225,115	20,734,668
Other	46,416,517	34,286,096	193,841,327	17,622,306
	507,337,201	374,750,481	624,297,827	1625,135,858
Payments resulting from:				
Financial investments	(437,145,790)	(322,902,785)	(403,988,292)	(321,342,491)
Tangible fixed assets	(844,975,096)	(624,150,610)	(560,712,772)	(855,984,006)
Intangible assets	(21,245,215)	(15,693,023)	(55,036,318)	(358,641,234)
Advance for the acquisition of a financial investment	(67,690)	(50,000)	(42,648,612)	(947,451,821)
Other investments	(49,360,948)	(36,461,034)	(21,429,108)	(151,343,088)
	(1,352,794,739)	(999,257,452)	(1,083,815,102)	(2,634,762,640)

Cash flow from investing activities				
(2)	(845,457,537)	(624,506,971)	(459,517,275)	(1,009,626,782)
FINANCING ACTIVITIES				
Cash receipts resulting from:				
Loans obtained	23,181,256,280	17,123,102,585	6,777,581,209	13,457,226,263
Increases in share capital and paid-in surplus	125,051,402	92,370,662	-	176,434,867
Sale of treasury shares	-	-	39,159,546	34,299,931
Subsidies	498,600	368,297	526,023	699,631
Other	92,862,733	68,594,130	3,517,130	48,484
	23,399,669,015	17,284,435,674	6,820,783,908	13,668,709,176
Payments resulting from:				
Loans repaid	(24,201,134,292)	(17,876,447,254)	(7,397,524,940)	(13,472,717,994)
Lease rentals (principal)	(36,794,152)	(27,178,425)	(9,037,369)	(4,136,597)
Interest and related expenses	(726,905,806)	(536,937,366)	(603,550,509)	(506,569,415)
Dividends	(402,271,293)	(297,142,335)	(227,516,018)	(129,035,959)
Acquisition of treasury shares	(670,553,683)	(495,312,220)	(234,988,926)	(42,197,733)
Other	(52,681,255)	(38,913,617)	(2,292,094)	(126,683)
	(26,090,340,482)	(19,271,931,217)	(8,474,909,856)	(14,154,784,381)
Cash flow from financing activities				
(3)	(2,690,671,466)	(1,987,495,543)	(1,654,125,948)	(486,075,205)
Variation of cash and equivalents				
(4)=(1)+(2)+(3)	(804,487,476)	(594,243,962)	220,366,685	596,621,522
Effect of exchange differences	4,931,329	3,642,583	10,378,990	(45,211,595)
Effect of Brasilcel consolidation	-	-	-	485 410 651
Cash and equivalents at the beginning of the period (a)	3,406,235,699	2,516,055,325	2,297,800,295	1,231,222,245
Cash and equivalents at the end of the period	2,606,679,552	1,925,453,946	2,528,545,970	2,268,042,823

The balance of cash and cash equivalents as of December 31, 2003 and 2002 differs from the balance of cash and equivalents at the beginning of 2004 and 2003, respectively, as a result of changes in the consolidation (a) perimeter.

	2004	2004	2003	2002
	Euro	Euro	Euro	Euro
DETAIL OF CASH AND EQUIVALENTS				
Cash	17,137,273	12,658,645	28,049,854	7,540,373

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Bank deposits	580,144,338	428,530,313	230,853,653	345,862,930
Short-term investments	2,029,228,318	1,498,912,925	2,272,188,060	1,923,104,592
Cash, bank deposits and treasury applications as stated in the balance sheet	2,626,509,929	1,940,101,883	2,531,091,567	2,276,507,895
Other treasury elements				
Bank overdrafts (Note 13)	(19,830,377)	(14,647,937)	(2,545,597)	(8,465,072)
Cash and equivalents	2,606,679,552	1,925,453,946	2,528,545,970	2,268,042,823

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

PORTUGAL TELECOM, SGPS, S.A. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2004

(Amounts stated in Euro, Brazilian Real (BRL) and United States Dollar (USD), except where otherwise stated)

1. Introduction

a) Parent Company

Portugal Telecom, SGPS, S.A. (formerly Portugal Telecom, S.A., Portugal Telecom) was incorporated on June 23, 1994 as a result of the merger, effective January 1, 1994, of Telecom Portugal, S.A. (TP"), Telefones de Lisboa e Porto, S.A. (TLP) and Teledifusora de Portugal, S.A. (TDP).

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

b) Corporate purpose

Portugal Telecom is engaged indirectly through its subsidiary and affiliated companies (the Group or the Company rendering a comprehensive range of telecommunications and multimedia services in Portugal and other countries, including Brazil.

In Portugal the fixed telephone services were rendered directly by Portugal Telecom under the provisions of the Concession Agreement entered into with the Portuguese State on March 20, 1995 in accordance with Decree-Law 40/95, for an initial period of thirty years, subject to renewal for subsequent periods of 15 years. As a result of an internal reorganization of the Group and in accordance with the terms of Decree-Law 219/2000, the Concession Contract was transferred to PT Comunicações, S.A. (PT Comunicações), the Company s wholly owned subsidiary for fixed line telecommunications. In exchange for the concession, PT Comunicações paid, up to 2002, an annual rent to the Portuguese State corresponding to 1% of the gross operating revenues from services covered by the Concession, after deduction of losses incurred in meeting the universal service obligation and certain other items. On December 11, 2002, according to the terms of the Modifying Agreement to the Concession Contract, PT Comunicações acquired the property of the Basic Network of Telecommunications and Telex (Basic Network).

Data transmission services are provided through PT Prime - Soluções Empresariais de Telecomunicações e Sistemas, S.A. (PT Prime). This company is also an Internet Service Provider ("ISP") for large clients.

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ISP services for residential clients are provided by PT.com - Comunicações Interactivas, S.A. (PT.com - former PT Multimedia.com - Serviços de Acesso à Internet, SGPS, S.A.), which also provides services relating to the conception of publicity, publicity space and information on Internet portals.

Mobile services in Portugal are provided by TMN - Telecomunicações Móveis Nacionais, S.A. (TMN) under a GSM license granted by the Portuguese State in 1990 and under a UMTS license obtained in December 19, 2000.

PT Multimedia - Serviços de Telecomunicações e Multimedia, SGPS, S.A. (PT Multimedia) is the Group's sub-holding for multimedia operations. Through its subsidiary TV Cabo Portugal, S.A. (TV Cabo Portugal), PT Multimedia renders cable and satellite television services in mainland Portugal, Madeira and Azores.

PT Multimedia also provides other multimedia services in Portugal, namely editing and selling of DVDs and video games, through Lusomundo Audiovisuais, S.A. (Lusomundo Audiovisuais), the distribution and exhibition of movies, through Lusomundo Cinemas, S.A. (Lusomundo Cinemas), and the publishing of large circulation newspapers and the edition of radio programs, through Lusomundo Media, SGPS, S.A. (Lusomundo Media).

On December 27, 2002 Portugal Telecom and Telefónica Móviles, S.A. (Telefónica Móviles) completed their joint-venture for the Brazilian mobile telecommunications market by contributing 100% of the share holdings that each group owned in mobile telecommunications companies in Brazil to a new incorporated company Brasilcel N.V. (Brasilcel or VIVO). Currently, VIVO provides mobile services in the Brazilian States of São Paulo (through Telesp Celular S.A. - Telesp Celular), Paraná and Santa Catarina (through Global Telecom S.A. - Global Telecom), Rio de Janeiro (through Telerj Celular S.A.), Espírito Santo (through Teleste Celular S.A.), Bahia (through Telebahia Celular S.A.), Sergipe (through Telegirpe Celular S.A.), Rio Grande do Sul (through Celular CRT S.A.) and eleven states in the Midwestern and Northern regions of Brazil (through Tele Centro Oeste Celular Participações S.A. and its subsidiaries - TCO). Telesp Celular, S.A., Global Telecom, S.A. and TCO are controlled by the sub-holding Telesp Celular Participações, S.A. (TCP), Telerj Celular, S.A. and Teleste Celular, S.A. are controlled by the sub-holding Tele Sudeste Celular Participações, S.A. (Tele Sudeste), and Telebahia Celular, S.A. and Telegirpe Celular, S.A. are controlled by the sub-holding Tele Leste Celular Participações, S.A. (Tele Leste).

2. Basis of Presentation

The consolidated financial statements are presented in Euros and have been prepared from the accounting records of Portugal Telecom and its subsidiary companies (listed in Exhibit I to these financial statements), which include adjustments and reclassifications in order to conform to the Company's accounting policies and with generally accepted accounting principles in Portugal (Portuguese GAAP), and for certain situations not specifically addressed by these standards, International Accounting Standards (IAS) are considered. These financial statements also include certain reclassifications in order to conform more closely to the form and content of financial statements prepared in the United Kingdom and the United States of America.

The preparation of the financial statements in conformity with Portuguese GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

a) Consolidation Principles

- The Company has fully consolidated the financial statements of all material subsidiary companies in which effective control is exercised by virtue of ownership of a majority of the voting rights (Exhibit I.1) or management control. All significant inter-company account balances and transactions have been eliminated in the consolidated financial statements and the interests of the minority shareholders have been recognized in the consolidated financial statements. Any gains generated on the sale of financial investments within the consolidation perimeter are reversed inside the consolidation perimeter.
- Investments in associated companies (Exhibit I.3) and certain companies excluded from the consolidation (as indicated in Exhibit I.2) are recorded based on the equity method of accounting. Under this method, investments in associated companies are initially recorded at cost, which is subsequently adjusted to the proportional equity of the related associated company, at the date of acquisition. The difference is recorded as an intangible asset under goodwill, and then amortized during the estimated period to recover the investment. Subsequently, investments in associated companies are periodically adjusted by an amount corresponding to Portugal Telecom's share of the results and other changes in shareholders' equity of those affiliated companies. Dividends received from associated companies are recorded as a reduction of their corresponding book value. In relation to associated companies with a negative shareholders' equity position, the Company records a provision under Provision for other risks and costs in the balance sheet (Note 18). The loans granted to associated companies are recorded at nominal values less a provision for estimated losses, when applicable.
- Investments in other companies (participation of less than 20%) are recorded at cost and loans granted are recorded at nominal value less a provision for estimated losses, when applicable.

b) Changes in the Consolidated Group

The main changes in the consolidated Group in the year ended December 31, 2004 are summarized in Exhibit II.

3. Summary of Significant Accounting Policies

The significant accounting policies used in the preparation of the consolidated financial statements are:

a) Short-term investments

Short-term investments consist of short-term treasury applications and marketable securities and are accounted for at the lower of cost or market value. Additionally,

loans granted to affiliated companies represented by Floating Rate Notes negotiable in the financial markets are also accounted for as short-term investments.

b) Provision for doubtful accounts

The provision for doubtful accounts receivable is stated at the amount considered necessary to cover potential risks in the collection of overdue accounts receivable balances.

c) Inventories

Inventories are stated at the lower of cost or market value; cost is determined on the weighted average cost method. A provision is recorded to cover obsolete inventories and certain items whose net realizable value is lower than cost.

d) Fixed assets

Fixed assets acquired up to December 31, 1991 are carried at restated value (determined in accordance with the revaluation criteria established by the applicable Portuguese legislation). Fixed assets acquired after that date are stated at cost. Depreciation is provided on cost or restated value on a straight-line basis, over the estimated useful lives of the fixed assets, starting as from the month of its acquisition. A portion (40%) of the additional depreciation arising from the revaluation is not deductible for income tax purposes, originating a deferred tax liability of Euro 20,768,988 (Note 29).

The depreciation rates correspond to the following estimated average useful lives:

	Years
Buildings and other constructions	10 - 50
Basic equipment:	
Network installations and equipment	5 - 25
Switching equipment	5 - 10
Telephones, switchboards and other	5 - 10
Submarine cables	15 - 20
Satellite stations	15
Other telecommunications equipments	3 - 10
Other basic equipment	4 - 20
Transportation equipment	4 - 8
Tools and dies	4 - 10
Administrative equipment	3 - 10
Other tangible fixed assets	3 - 10

A provision is recorded to reduce the carrying amount of basic equipment, which is to be disposed before the end of its useful life, to net realizable value (Note 18).

The cost of recurring maintenance and repairs is charged to income as incurred. Significant renewals and betterments are capitalized.

e) Intangible assets

This caption consists primarily of goodwill, telecommunications licenses, software development costs and research and development costs. Except for goodwill, telecommunications licenses and the amount paid to the Portuguese State for the acquisition of the Basic Network (Note 12), intangible assets are amortized as from the month of its acquisition on a straight-line basis over periods ranging from three to six years.

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Goodwill, arising from the difference between the cost of the investments in subsidiaries and the related fair value of the subsidiaries' net assets on the date of acquisition, is capitalized and amortized on a straight-line basis during the expected period to recover the investment, as indicated in Note 12.

The excess amount paid by the Company for the net assets of Brasilcel's subsidiaries includes a portion related with the licences owned by those subsidiaries. This portion is presented separately from goodwill in the caption "Industrial property and other rights" and is amortized based upon the projected revenues of those subsidiaries, during the corresponding estimated useful lives of those assets.

The UMTS license obtained by TMN and other related intangibles (Note 12) are being amortized on a straight line basis over the remaining period of the license (until 2015), as from May 2004 following the start of operations of the UMTS system.

The amount paid to the Portuguese State for the acquisition of the Basic Network (Note 12) is being amortized on a straight-line basis over the remaining period of the concession (until 2025).

Additionally, this caption includes rental contracts of satellite capacity contracted by TV Cabo (Note 12) which are being amortized over the corresponding period of each contract. These contracts were considered as capital leases.

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f) Pension benefits

(i) Under the provisions of articles 5, 6 and 7 of Decree-Law 122/94, which were the legal basis for the incorporation of Portugal Telecom in 1994, the employees in service and those retired from the merged companies maintain all the rights and obligations to which they were entitled. Decree Law 219/2000 established that these obligations of Portugal Telecom were transferred to PT Comunicações on its incorporation. Therefore, PT Comunicações has the obligation to grant:

	Benefits
. To retirees and employees of PT Comunicações coming from and hired by CTT up to May 14, 1992	<i>Pension Supplemental pension</i>
. To retirees and employees of PT Comunicações coming from TLP and TDP	<i>Pension Supplemental pension</i>
. To retirees and employees of PT Comunicações coming from and hired by CTT after May 14, 1992	<i>Not covered</i>
. To employees hired directly by Portugal Telecom or PT Comunicações	<i>Not covered</i>

There are three autonomous pension funds to cover these liabilities, one for each company merged into Portugal Telecom. These pension funds are managed autonomously by the pension fund management companies.

In addition, employees of PT Comunicações hired by Companhia Portuguesa Rádio Marconi, S.A. (a company fully incorporated in PT Comunicações in 2002 - Marconi) until February 1, 1998 have a special social security scheme through Caixa de Previdência do Pessoal da Companhia Portuguesa Rádio Marconi ("Caixa"), an independent entity reporting to the Ministry of Social Security. The employees hired after that date are covered by the Portuguese State Social Security system. PT Comunicações' liabilities with these employees hired by Marconi are covered by three autonomous Pension Funds.

(ii) Lusomundo Media, through its subsidiary Global Notícias - Publicações, S.A. (Global Notícias - former Diário de Notícias, S.A. and Jornal de Notícias, S.A.) has the obligation to grant a supplemental pension to retirees and employees hired up to 1979 by Diário de Notícias and up to 1994 by Jornal de Notícias.

(iii) PT - Sistemas de Informação, S.A. ("PT SI") has the obligation to grant supplemental pensions to employees who were transferred from PT Comunicações.

The amount of the Company's liabilities with respect to pensions and pension supplements of PT Comunicações, Lusomundo Media and PT SI is estimated based on actuarial valuations prepared annually by an independent actuary. The liabilities that are not covered by any existing pension fund are covered by the accrued post retirement liability. Actuarial gains and losses arising from differences between the actuarial assumptions and financial and demographic information collected in the period are recorded in the balance sheet net of the accrued post retirement benefits, and are recognized in the profit and loss statement from the following year, on a straight line basis during the remaining average working life of active employees, in accordance with IAS 19. The adoption of IAS 19 was made since the Company considered that this standard is more adequate than the Portuguese Accounting Directive 19 to reflect the post retirement liabilities.

(iv) Up to December 31, 1999 Telesp Celular, TCO and the companies controlled by Tele Leste and Tele Sudeste were jointly responsible, with the other companies resulting from the Telebrás split, for a pension fund managed by Fundação Sistel de Seguridade Social ("SISTEL"). On December 28, 1999 these companies negotiated conditions for the

creation of autonomous pension funds applicable to all active employees of each company and to retired employees after January 31, 2000. This statutory change was approved by the Brazilian Federal Government on January 13, 2000.

As a result of this agreement, Telesp Celular, TCO and the companies controlled by Tele Leste and Tele Sudeste implemented on October 31, 2000 defined contribution plans ("TCP PREV", TCO PREV and Plano de Benefícios Visão Celular, respectively), that provide a supplemental pension, managed by SISTEL, covering the majority of the employees of these companies which will operate through contributions from both the employees and companies. The contributions of the employers for this plan are equivalent to the contributions of the employees, which correspond from 1% up to 9% of the salary based on the percentage chosen by the employee. The costs related with these contribution plans are recorded by the companies on the dates the related contributions are due.

In relation to the active employees previously covered by the SISTEL pension fund, Telesp Celular, TCO and the companies controlled by Tele Leste and Tele Sudeste proposed the migration to their new defined contribution plans which was accepted by 99% of the employees of Telesp Celular and TCO and 94% and 83% of the employees of the companies controlled by Tele Leste and Tele Sudeste, respectively. In relation to the employees that have not accepted the migration and as a result of the split in the SISTEL pension fund described above, Telesp Celular, TCO and the companies controlled by Tele Leste and Tele Sudeste established defined benefit plans ("PBS Telesp Celular", PBS TCO, PBS Tele Leste Celular and PBS Tele Sudeste Celular, respectively). These companies contribute with an amount determined based on actuarial studies (in accordance with Brazilian actuarial rules) made by an independent actuary. Presently, the contributions made by these companies correspond to 12% of the employees salaries.

(v) CRT Celular was responsible for a private retirement benefit plan. As this private retirement plan is a multi-employer plan, the related pension costs were recognized when contributions were due. In December 2003, CRT Celular obtained its release from this multi-sponsored plan and established a new defined contribution plan (Plano de Benefícios Visão CRT), which will operate through contributions from both the employees and companies. The costs related with this contribution plan are also recorded by the companies on the dates the related contributions are due.

(vi) The individuals employed by the Company's remaining subsidiaries are included in the social security system of each respective country and are not covered by the benefits mentioned above.

g) Other employee benefits

(i) In accordance with the terms of Article 8 of Decree-Law 122/94 relating to the harmonization of medical benefits applicable to the employees of PT Comunicações, a medical plan was designed applicable to its employees, active and retired (excluding the employees hired after July 31, 2003 and the employees hired by Marconi), and eligible relatives, which is managed by Portugal Telecom - Associação de Cuidados de Saúde (PT-ACS).

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The plan referred to above became effective on January 1, 1996. As from that date the health care services previously provided by *Instituto das Obras Sociais* ("IOS") and *Caixa de Previdência do Pessoal dos TLP* ceased to be used.

The following parties contribute to fund this health care plan:

- The principal beneficiaries (beneficiaries of one of the aforementioned health schemes) - 1.5% of salaries;
- Serviço Nacional de Saúde ("SNS") with Euro 281 per beneficiary of the plan; and
- Portugal Telecom with the balance required to fully cover the costs.

The retired and active employees of PT Comunicações hired by Marconi up to February 1, 1998 and eligible relatives are also entitled to medical benefits, which are provided through PT-ACS.

Certain employees of PT SI who were transferred from PT Comunicações are also covered by the health care benefits described above.

The health care liabilities and costs are calculated in a similar manner to the pension liabilities and costs referred to above, in accordance with employees past services.

The actuarially determined costs of health care to be provided as from retirement age are recorded in the statement of profit and loss in the caption "Post retirement benefits" and the Company's obligations are recorded in the balance sheet in the caption "Accrued post retirement liability". Actuarial gains and losses arising from differences between the actuarial assumptions and financial and demographic information collected in the period, are recorded in the balance sheet, net of the accrued post retirement benefits, and are recognized in the profit and loss statement from the following year, on a straight line basis during the remaining average working life of active employees, in accordance with IAS 19.

The contributions from SNS and contributions of the employees of PT Comunicações (including the employees hired by Marconi) and PT SI are recorded as reductions in the cost for the year to which they relate.

(ii) The employees of Telesp Celular, TCO and the companies controlled by Tele Leste and Tele Sudeste, together with the employees of the other telecommunications operators in Brazil resulting from the Telebrás split, are entitled to medical benefits through "*Fundo de Assistência Médica Sistel*" ("Sistel Medical Fund"), which is a multi-employer fund. Accordingly, post retirement medical costs are recognized when contributions are due to the fund.

(iii) The individuals employed by the Company's remaining subsidiaries are included in the social security system of each applicable country and are not covered by the benefits mentioned above.

h) Pre-retirements, early retirements and suspended contracts

The Company records liabilities for the payment of salaries up to the date of retirement and for pensions, pension supplements and other employee benefits payable after that date, in relation to all employees that are under a suspended contract agreement, that have pre-retired or entered into the early retirement programs (Notes

30.1 and 30.2), at the time that the Company signs the suspended contract, pre-retirement or early retirement benefits to the affected employees.

i) Vacation pay and bonuses

The Company provides an accrual at the end of each period for bonuses and vacation earned but not yet paid.

j) Current classification

Assets to be realized and liabilities to be settled within one year from the date of the balance sheet are classified as current.

k) Grants and subsidies for fixed assets

Grants and subsidies received from the Portuguese Government and from European Union entities to finance the acquisition of fixed assets are accounted for as deferred income and recognized in profit and loss over the useful lives of the related assets.

l) Own work capitalized (Self - constructed assets)

The value of works performed for own purposes and capitalized as part of fixed assets is included as a reduction in operating expenses. These works, which consist mainly of additions to telecommunications and other installations, are stated at the direct cost of labour, materials and services rendered by outside contractors, but do not include overhead allocations and financing costs.

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m) Leases

Fixed assets acquired under long-term lease contracts are recorded as capital leases, if they meet the criteria to be classified as such. The leased assets are recorded at the lower of the present value of the lease payments or the fair value of the leased assets at the time the arrangement commences and the corresponding liability is recognized in the balance sheet. The leased assets are depreciated over their estimated useful lives and the interest component of the lease payment is expensed in the period to which it relates, using the effective interest method.

n) Statements of cash flows

The statements of cash flows are prepared in accordance with Portuguese GAAP, using the direct method. This methodology is also consistent with IAS 7, except for one difference related with the balance of Cash and cash equivalents from companies acquired or sold during the period. Under IAS 7, the balance of Cash and cash equivalents of such companies should be classified as Cash from investing activities, while under Portuguese GAAP it appears as changes in consolidation.

The statements of cash flows present the annual cash flows of the Company and the cash and cash equivalents at period end. The Company classifies all highly liquid investments purchased with original maturity of three months or less as cash and cash equivalents. Cash flows are classified as to whether they relate to operating, investing or financing activities.

Cash flows from operating activities include collections from clients, payments to suppliers, payments to personnel and other collections and payments relating to operating activities.

Cash flows used in investing activities include the acquisitions and disposals of investments in associated companies and the purchase and sale of property, plant and equipment.

Cash flows from financing activities include the following: (i) borrowings and repayments of debt; (ii) acquisition and sale of treasury securities; and (iii) payments of dividends to shareholders.

o) Provision for income taxes

Portugal Telecom, PT Multimedia and Lusomundo Media adopted the tax consolidation regime in Portugal. The provision for income taxes is determined on the basis of the estimated taxable income for all the companies covered by this regime (all 90% or more owned Portuguese subsidiaries). The remaining group companies, not covered by the tax consolidation regimes of Portugal Telecom, PT Multimedia or Lusomundo Media, are taxed individually based on their respective taxable income, at the applicable tax rates.

The Company adopted in 2000 the Accounting Directive No. 28 related with the computation of the income tax provision and the recognition of deferred taxes. As a result, the Company recognized deferred tax assets and liabilities (Note 29) for differences between the financial reporting and the tax basis of assets and liabilities at each reporting date related to differences arising from Portuguese financial reporting and tax reporting methodologies. Deferred tax assets are recorded only when management believes that these deferred tax assets will be realized to offset future taxable income or deferred tax liabilities.

Income taxes, either current or deferred, arising from transactions or events recognized directly in shareholders' equity are recorded in the same caption.

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p) Financial instruments and risk management

Financial instruments include basically interest rate and currency swap agreements to hedge the impact of changes in interest rates and currency rates on certain of the Company's long-term borrowings denominated in foreign currencies (Note 31).

Gains or losses from financial instruments which are hedging the above mentioned risks or certain assets or liabilities, are recorded symmetrically to the losses or gains arising from the related assets or liabilities. In the case that financial instruments are not hedging any risk, asset or liability, they are recorded based on their fair value at the balance sheet date; gains or losses arising from the change in the fair value of these financial instruments are recorded in the income statement of the period in which they occur.

Up-front premiums or expenses, received or paid, in connection with derivatives contracted by the Company are recognized in results on a straight line basis during the maturity period of those derivatives.

q) Recognition of operating revenues and related expenses

Revenues from telephone and other telecommunications services are recognized when earned. Billings for these services are made on a monthly basis throughout the month. Unbilled revenues from the billing cycle up to the end of each month are estimated based on the previous months traffic and are accrued at the end of the month. Differences between estimated and actual unbilled revenues, which have not been significant, are recognized in the following period.

Operating revenues are reported on a gross basis, with the compensations paid to other telecommunications carriers being accounted for as operating expenses (Note 23) in the same period the revenue is earned.

Revenues from telephone line rentals are recognized in the period to which they apply. Unbilled revenues relating to these rentals are accrued at the end of the period.

Revenues from mobile telephony services result essentially from: (i) fee for use of wireless network; (ii) interconnection fees; (iii) roaming; and (iv) pre-paid phone cards. These service revenues are recognized on the month the service is provided. In relation to the pre-paid phone cards, income is recognized for the pre-paid minutes of traffic used.

Revenues from the sale of terminal telecommunications equipments and the corresponding cost are recognized at the moment of sale.

Revenues from cable and satellite television services result essentially from: (i) amounts invoiced relating to monthly subscriptions for use of the service; (ii) advertising placed in the cable television channels; and (iii) rental and sale of equipment. Revenues from monthly subscriptions and installation are recognized in the period the services are rendered to the clients. Revenues from advertising are recognized in the period the advertising is inserted. Revenues from the rental of equipment are recognized in the period it is rented and revenues from the sale of equipment are recognized at the moment of sale.

Revenues from ISP services result essentially from monthly subscriptions, the provision of access to the internet and telephone traffic generated by clients upon usage of the services. These revenues are recognized when invoiced.

Advertising revenues from telephone directories and related costs are recognized in the period in which the directories are effective.

Advertising revenues from publications of newspapers and magazines are recognized in the period in which the advertising is inserted.

Revenues derived from the sale of newspapers and magazines are recognized at the moment of sale, except for subscriptions fees where revenues are deferred over the subscription period.

Revenues from the exhibition of films results from the sale of cinema tickets and revenues from the distribution of films results from the sale to other cinema operators of distribution rights acquired by Lusomundo Audiovisuais from film distributors or makers. These revenues are recognized in the period of the exhibition or in the period of the sale of the rights.

r) International telecommunications services

Fees from international telecommunications services are remitted to operators in the country in which calls are terminated based on the traffic records of the country of origin and rates established in agreements between the telecommunications operators. The operator of the country of origin of the traffic is responsible for crediting the operator of the destination country and, if applicable, the operators of the transit countries. In circumstances in which PT Comunicações is the originator of an international telecommunications service, PT Comunicações recognizes the amounts remitted to international operators as a cost, and records revenues for the gross amounts billed. In instances in which PT Comunicações terminates an international call, the Company records only the net amount received from the originating carrier as revenues.

s) Foreign currency transactions and balances

Transactions denominated in foreign currencies are translated to Euros at the rates of exchange prevailing at the time the transactions are made. At the balance sheet date, assets and liabilities denominated in foreign currencies are adjusted to reflect the exchange rates published by "Banco de Portugal" (Central Bank) prevailing at such date. The resulting gains or losses on foreign exchange transactions are credited or charged to the profit and loss statement, except for unrealized exchange differences on long term intra-group balances, representing an extension of the related investments and where settlement is not expected in the foreseeable future, which are recorded in shareholders' equity in a specific caption in accordance with IAS 21.

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

- Assets and liabilities: exchange rates prevailing at the balance sheet date;
- Profit and loss statement: period average exchange rates;

- Share capital, reserves and retained earnings: historical exchange rates; and
- Cash flow statement: annual average exchange rates for cash flows where these rates are closer to the effective exchange rates; in the remaining cash flows the exchange rate of the day of operation is used.

The effect of translation differences is recorded in shareholders' equity under the specific caption "Cumulative foreign currency translation adjustments".

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4. Translation of Euro to United States Dollar Amounts

The financial statements are stated in Euros. The translation of the Euro amounts to United States Dollars is included solely for the convenience of the readers, using the noon buying rate certified for customs purposes by the Federal Reserve Bank of New York as of December 31, 2004, which was Euro 1 to US\$ 1.3538. The convenience translations should not be assumed as representations that Euro amounts have been, could have been, or could in the future be, converted into United States Dollars at this or any other rate of exchange.

5. Short term investments

This caption consists of:

	2004	2003
Short-term treasury applications:		
Denominated in local currency (i)	1,393,099,961	2,089,377,517
Other currencies (ii)	105,812,964	182,829,609
	1,498,912,925	2,272,207,126
Less: Provision for marketable securities (Note 28)	-	(19,066)
	1,498,912,925	2,272,188,060

(i) As of December 31, 2003 this caption included Euro 208,025,245 corresponding to 50% of a loan granted to TCP, denominated in local currency, which was not eliminated with the proportional consolidation of VIVO. This loan was repaid in November 2004.

(ii) As of December 31, 2003 this caption included Euro 83,135,392 corresponding to 50% of the loans granted to TCP, denominated in U.S. Dollars, which was not eliminated with the proportional consolidation of VIVO. During 2004, an amount of Euro 33,559,504 was repaid and at year-end the loans outstanding amount to Euro 44,049,629.

As of December 31, 2004 and 2003 this caption also included Euro 39,828,143 and Euro 72,986,139, respectively, related with financial instruments contracted by Brasilcel's subsidiaries, which currently are not covering any specific risk and, accordingly, are recorded at fair value. During 2004 some of these financial instruments were cancelled (approximately Euro 33 million).

6. Trade Receivables

This caption consists of:

	2004	2003
Third parties		
Accounts receivable from customers	1,077,867,979	1,051,761,281
Doubtful accounts receivable	260,755,168	297,345,299
Notes receivable	154,292	211,130
Unbilled revenues	192,230,090	157,976,832
	1,531,007,530	1,507,294,542

Less: Provision for doubtful accounts receivable (Note 28)	(364,802,804)	(389,281,397)
	1,166,204,726	1,118,013,145

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The Company grants credit, in the normal course of business, to governmental and individual customers and, in the case of outbound traffic, to international telecommunications companies. As of December 31, 2004 and 2003 there were no significant concentrations of credit risk.

The Company classifies as doubtful specific accounts receivable balances overdue from customers. As these balances, together with other balances classified as accounts receivable from customers, are not fully collectible, the provision for doubtful accounts receivable reasonably covers the estimated losses relating to those balances.

7. Other Receivables and Other Non-Current Assets

These captions consist of:

	2004	2003
OTHER RECEIVABLES		
Third parties		
Accounts receivable from public entities		
Value added tax	21,827,386	17,427,292
Income tax receivable (Note 16)	2,671,827	3,232,311
Other tax receivable	2,613,264	2,182,043
	27,112,477	22,841,646
Accounts receivable from foreign public entities (1)	153,671,149	98,392,064
Discounts given to retired Portuguese citizens (Note 33.c))	47,597,244	49,657,701
Interest to be received	38,010,025	40,273,623
Contribution from SNS (Note 3.g))	20,786,447	19,051,992
Advances to suppliers	22,016,616	19,141,681
Other billing	6,760,692	8,696,276
Funds from European Union	3,923,129	10,360,925
Unbilled revenues	3,451,657	7,183,739
Other	114,933,090	108,223,695
	411,150,049	360,981,696
Less: Provision for doubtful accounts receivable (Note 28)	(15,873,011)	(18,448,447)
	395,277,038	342,533,249
 Total third party receivables	 422,389,515	 365,374,895
 Affiliated companies		
Subsidiaries of Brasilcel (2)	17,821,820	24,973,763
Médi Telecom	5,026,385	4,098,025
Other	10,950,770	4,838,761
 Total receivables from affiliated companies	 33,798,975	 33,910,549

OTHER NON-CURRENT ASSETS

Taxes receivable (3)	62,623,744	22,922,839
Mobile clients retention plans (4)	5,853,721	7,959,954
Interest paid in advance (5)	4,907,808	7,642,938
Maintenance and repairs	1,521,993	2,433,275
Other	24,744,145	29,566,858
	99,651,411	70,525,864
Less: Provision for doubtful accounts receivable (Note 28)	(3,598,842)	(2,000,060)
	96,052,569	68,525,804

- (1) As of December 31, 2004 this caption includes Euro 147,995,529 related with 50% of direct and indirect taxes to be recovered by Brasilcel's subsidiaries.
- (2) This caption corresponds to 50% of the balances receivable from subsidiaries of Brasilcel, which are not eliminated in the proportional consolidation of these subsidiaries.
- (3) As of December 31, 2004 and 2003 this caption relates to 50% of direct and indirect taxes to be recovered by Brasilcel's subsidiaries in more than one year.
- (4) This caption corresponds to direct costs related to contracts entered into with mobile clients. These costs are expensed during the period of the respective contracts.
- (5) This caption corresponds to expenses incurred in connection with certain loans obtained by the Company, which will be expensed during the maturity period of the respective loans.

8. Inventories

This caption consists of:

	2004	2003
Merchandise	182,979,978	108,321,329
Raw materials and consumables	19,514,308	15,700,420
Work-in-process	6,263,690	5,951,195
Advances for purchases	128,950	356,088
	208,886,926	130,329,032
Less: Provision for obsolete and slow moving inventories (Note 28)	(31,789,805)	(27,444,050)
	177,097,121	102,884,982

9. Prepaid Expenses and Other Current Assets

This caption consists of:

	2004	2003
Telephone directories	47,208,585	50,674,110
Mobile clients retention plans (1)	32,439,005	32,093,416
Advances for the acquisition of distribution rights for the exhibition of movies in Portugal	14,435,959	12,756,002
Rents	6,544,606	6,071,809
ICMS (2)	6,469,692	6,025,514
Interest paid in advance (3)	5,255,592	7,288,011
Advances to employees	2,411,039	2,287,207

Other	38,882,439	23,045,820
	153,646,917	140,241,889

- (1) This caption includes certain expenses relating to client retention plans of TMN and Vivo which are expensed during the period of the respective contracts.
- (2) This caption corresponds to 50% of the deferred value added taxes by Brasilcel's subsidiaries.
- (3) This caption corresponds to expenses incurred in connection with certain loans obtained by the Company, which will be expensed during the maturity period of the respective loans.

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10. Investments, net

This caption consists of:

	2004	2003
Loans granted to associated companies and other companies (i)	297,963,869	250,295,256
Investments in associated companies (ii)	108,122,553	157,988,308
Investments in other companies:		
Banco Espirito Santo, SA. ("BES")	55,300,000	55,300,000
Intelsat	13,127,252	13,127,252
Grupo Media Capital, SGPS, S.A. ("Media Capital") ⁽¹⁾	6,960,000	-
Cypress Entertainment, Inc. ⁽²⁾	3,016,754	3,016,754
INESC - Instituto de Engenharia de Sistemas e Computadores ("INESC")	2,992,787	2,992,787
Telefónica de España, S.A.	2,156,034	2,156,034
Tagusparque-Sociedade de Promoção e Desenvolvimento do Parque de Ciência e Tecnologia da Área de Lisboa, S.A.	1,296,875	1,296,875
New Skies Satellites, NV ⁽³⁾	-	4,674,500
Eutelsat ⁽³⁾	-	3,055,710
Other	4,255,141	3,531,217
Real estate investments	54,248,363	30,194,199
Advances for investments	2,185,233	1,688,320
Other long-term investments	848,144	1,086,480
	552,473,004	530,403,692
Less: Amortization for investments	(25,835,340)	(12,195,806)
Less: Provision for investments (Note 28)	(94,024,988)	(70,128,694)
	432,612,676	448,079,192

(1) During 2004, Portugal Telecom acquired a 1.93% interest in Media Capital, for an amount of Euro 6,960,000 (Exhibit II).

(2) The investment in this company is fully provided for.

(3) These companies were sold in 2004.

(i) Loans granted to associated companies and other companies are basically to finance its operations and to develop new businesses, and consist of:

	2004	2003
UOL, Inc ("UOL") ⁽¹⁾	77,989,260	84,108,607
Sport TV Portugal, S.A. ("Sport TV")	66,213,937	17,475,958
Médi Telecom, S.A. ("Médi Telecom")	64,442,408	64,699,898
Sportinveste Multimédia, SGPS, S.A. ("Sportinvest") ⁽²⁾	35,318,668	29,318,668
Idealyze, S.A. ("Idealyze") ⁽³⁾	29,420,510	31,728,959
Web-Lab, SGPS, S.A. ("Web-Lab")	6,684,761	4,886,562

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Marconi Suisse Telecommunications, S.A.R.L. ("Marconi Suisse")	5,732,692	2,502,684
INESC	3,292,066	3,292,066
Sportstat - Informação Desportiva Independente, Lda. ("Sportstat")	1,610,068	1,610,068
EJV - Plataforma de Comércio Electrónico, S.A. ("EJV") ⁽⁴⁾	-	5,422,112
Other	7,259,499	5,303,269
	297,963,869	250,348,851

- (1) This loan corresponds to 6,017,141 convertible bonds issued by UOL, which were subscribed for by the Company during 2002. As of December 31, 2004 there is a provision of Euro 39,371,875 to cover risks related with the recoverability of these bonds. In addition, there is a provision of Euro 18,432,125 regarding the Company's share in the accumulated losses of

UOL, as presented below in this Note. As a result, the company's exposure to the investment in UOL amounts to approximately Euro 20 million as of December 31, 2004.

- (2) This caption includes Euro 30,023,168 of additional paid-in capital contributions (Note 32.f) and Euro 5,295,500 of shareholders loans granted to this affiliated company.
- (3) This loan is fully provided for.
- (4) This company was merged into PT.com during 2004.

- (ii) Investments in associated companies (with a positive equity position), accounted for by the equity method except where otherwise stated, consist of:

	2004	2003
Unitel, S.A. ("Unitel")	28,461,383	14,160,640
CTM - Companhia de Telecomunicações de Macau, SARL ("CTM")	27,965,749	31,509,064
Warner Lusomundo Sogecable Cines de España, S.A.	7,603,000	8,054,333
Idealyze ⁽¹⁾	7,417,741	7,417,741
Banco Best, S.A.	7,362,700	10,420,519
Lisboa TV - Informação e Multimédia, S.A.	5,572,558	4,631,845
Páginas Amarelas, S.A. ("Páginas Amarelas")	5,149,371	3,353,544
Guiné Telecom - Companhia de Telecomunicações da Guiné-Bissau, SARL ("Guiné Telecom") ⁽¹⁾	3,716,555	3,716,555
Vasp - Sociedade de Transporte e Distribuição, Lda. ("Vasp")	2,019,110	1,414,445
Hungaro Digitel KFT (HDT)	1,990,635	1,677,245
Simarc - Promoções Imobiliárias, S.A. ("Simarc") ⁽²⁾	-	30,385,669
Lusomundo - Sociedade de Investimentos Imobiliários, SGPS, S.A. ⁽²⁾	-	16,034,501
Web-Lab ⁽³⁾	-	8,192,526
Banco1.net, S.A. ("Banco1.net") ⁽⁴⁾	-	3,742,997
Naveprinter, S.A. ⁽²⁾	-	3,111,239
Previsão - Sociedade Gestora de Fundos de Pensões, S.A. ("Previsão") ⁽⁵⁾	-	1,531,864
TPT-Telecomunicações Públicas de Timor, S.A. ⁽²⁾	-	1,316,726
Other	10,863,751	7,316,855
	108,122,553	157,988,308

- (1) As of December 31, 2004 the investments in these associated companies are not recorded by the equity method, as they are fully provided for.
- (2) These companies were fully consolidated as of December 31, 2004.
- (3) At the end of 2004, Portugal Telecom increased its interest in Web-Lab to 90% of its share capital (Exhibit II) and, as a result, the investment in this company in 2004 was recorded by the equity method of accounting. As of December 31, 2004 the investment in Web-Lab is recorded under Provision for losses in affiliated companies, since it has a negative equity position. At December 31, 2003 this investment was fully provided for.
- (4) This company was sold during 2004 (Exhibit II).

- (5) During 2004, the Company increased its interest in Previsão to 78.12% of its share capital and, as a result, this company was fully consolidated as of December 31, 2004 (Exhibit II).

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As described in Note 2.a), investments in associated companies with a negative equity position are recorded under Provision for losses in affiliated companies . As of December 31, 2004 and 2003 this provision amounts to Euro 129,315,472 (Note 18) and is made up as follows:

	2004	2003
Sport TV	43,945,196	28,544,528
Médi Telecom	38,225,006	33,240,081
UOL	18,432,125	22,048,099
Web-Lab ⁽¹⁾	14,864,355	-
Marconi Suisse	4,763,659	2,564,064
TV Cabo Macau, S.A.	2,551,594	1,205,689
Tradecom International, N.V.	1,968,387	1,259,761
Sportstat	1,439,496	1,405,945
Other	3,125,654	9,389,299
	129,315,472	99,657,466

- (1) As described above, the investment in Web-Lab was only recorded by the equity method of accounting starting January 1, 2004.

During the years ended December 31, 2004, 2003 and 2002 equity accounting in earnings and losses of affiliated companies is made up as follows:

	2004	2003	2002
Losses:			
Médi Telecom	5,553,004	24,923,719	55,508,346
Banco Best	3,094,000	3,502,000	3,630,865
TV Cabo Macau	1,538,934	2,168,055	2,691,976
Sport TV	834,032	5,053,730	7,163,244
Tradecom International, N.V.	738,913	1,554,947	4,295,880
Global Telecom ⁽¹⁾	-	-	88,641,563
PrimeSys, S.A. (PrimeSys) ⁽²⁾	-	-	5,401,078
Other	5,047,735	7,452,613	18,863,184
	16,806,618	44,655,064	186,196,136
Earnings:			
Unitel	16,820,236	6,457,074	3,597,925
CTM	11,379,327	13,080,811	14,468,022
Mascom Wireless Proprietary Limited ("Mascom") ⁽³⁾	7,561,155	-	-
Páginas Amarelas	3,526,629	3,037,003	4,165,056
UOL ⁽⁴⁾	1,735,353	-	-
Other	3,505,900	2,923,501	3,091,783
	44,528,600	25,498,389	25,322,786

(27,721,982) 19,156,675 160,873,350

- (1) Pursuant to the acquisition by TCP on December 27, 2002 of a controlling position in Global Telecom and the contribution of Portugal Telecom's investments in Brazilian mobile telecommunications companies to Brasilcel, this company has been proportionally consolidated since January 1, 2003.
- (2) After July 1, 2002 this company has been fully consolidated.
- (3) During 2004, Mascom was excluded from full consolidation, as the investment in this subsidiary was in the process of being sold only pending regulatory approval from the Botswana authorities. This approval was granted in September 2004. During the first nine

months of 2004, this company was consolidated by the equity method of accounting (Exhibit II).

- (4) During 2004, Portugal Telecom increased its interest in UOL and, as result, the investment in this associated company was recorded by the equity method of accounting.

11. Fixed Assets

This caption consists of:

December 31, 2004

	Cost or restated values	Accumulated Depreciation	Net book value
Land	98,665,850	12,641,436	86,024,414
Buildings and other constructions	1,010,280,304	557,984,837	452,295,467
Network installations and equipment	5,740,339,452	3,868,504,823	1,871,834,629
Switching equipment	2,301,311,278	1,848,025,931	453,285,347
Telephones, switchboards and other	668,126,193	355,603,465	312,522,728
Submarine cables	261,013,291	119,655,532	141,357,759
Satellite stations	61,474,179	60,681,377	792,802
Other telecommunications equipment	1,039,721,278	752,222,391	287,498,887
Other basic equipment	189,643,394	106,283,438	83,359,956
Transportation equipment	62,619,195	37,397,694	25,221,501
Tools and dies	18,946,431	16,764,528	2,181,903
Administrative equipment	850,003,596	701,448,734	148,554,862
Other tangible fixed assets	69,103,113	54,187,820	14,915,293
Construction in progress	182,754,242	-	182,754,242
Advances to suppliers of fixed assets	260,486	-	260,486
	12,554,262,282	8,491,402,006	4,062,860,276

December 31, 2003

	Cost or restated values	Accumulated Depreciation	Net book value
Land	95,394,159	13,203,045	82,191,114
Buildings and other constructions	892,553,549	484,404,549	408,149,000
Network installations and equipment	5,212,181,367	3,335,410,458	1,876,770,909
Switching equipment	2,283,107,233	1,734,293,826	548,813,407
Telephones, switchboards and other	847,422,769	493,501,942	353,920,827
Submarine cables	264,134,524	106,673,232	157,461,292
Satellite stations	61,686,679	60,199,100	1,487,579
Other telecommunications equipment	1,079,846,086	733,751,467	346,094,619
Other basic equipment	126,230,474	77,622,073	48,608,401
Transportation equipment	54,479,713	36,602,246	17,877,467

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Tools and dies	18,563,005	16,390,291	2,172,714
Administrative equipment	862,152,069	661,311,307	200,840,762
Other tangible fixed assets	64,489,260	51,464,199	13,025,061
Construction in progress	209,991,608	-	209,991,608
Advances to suppliers of fixed assets	553,278	-	553,278
	12,072,785,773	7,804,827,735	4,267,958,038

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Fixed assets, net by geographic area are as follows:

	2004	2003
Domestic market	3,078,752,942	3,269,888,319
International market:		
Brazil	918,071,511	887,590,706
Other	66,035,823	110,479,013
	4,062,860,276	4,267,958,038

Submarine cables represent the Company's pro-rata share of the submarine cable circuits jointly constructed, operated, maintained and owned with other telecommunications operators located in other countries, based on the respective contracts and/or construction and maintenance agreements.

Depreciation charged to operations during the years ended December 31, 2004 and 2003 amounted Euro 818,888,679 and Euro 863,451,434, respectively.

As a result of technological enhancements and urban improvements, the Company retired some fixed assets in the years ended December 31, 2004 and 2003. The losses recorded as a result of those retirements amounted to Euro 3,631,366 and Euro 4,176,106, respectively (Note 26).

In previous years PT Comunicações, PT Prime, TV Cabo and TMN contracted cross border leases, which comprised the sale of certain telecommunications equipments to foreign entities for an amount of Euro 771,637,016. Simultaneously, those entities made leasing contracts of the equipment with special purpose entities, which made conditional sale agreements to sell the related equipments to PT Comunicações, PT Prime, TV Cabo and TMN, by an amount equivalent to the value of the initial sale. Group companies maintained the legal ownership of the those equipments, continuing to be able to sell or substitute any equipment. These transactions correspond to an operation of sale and lease back and, in accordance with Portuguese GAAP, the sale of the equipment was not recorded and the equipment continued to be recorded in the Company's consolidated balance sheet.

12. Intangible Assets

This caption consists of:

December 31, 2004

	Cost	Accumulated Amortization	Net book value
Goodwill	1,690,967,518	280,581,279	1,410,386,239
Industrial property and other rights	2,064,141,119	340,480,289	1,723,660,830
Research and development costs	82,461,046	55,359,084	27,101,962
Incorporation expenses	30,247,688	22,618,751	7,628,937
Other intangible	11,853,363	5,471,663	6,381,700
In-progress intangibles	37,695,235		37,695,235
Advances to suppliers of intangible assets			
	3,917,365,969	704,511,066	3,212,854,903

December 31, 2003

	Cost	Accumulated Amortization	Net book value
Goodwill	1,466,990,764	182,831,526	1,284,159,238
Industrial property and other rights	1,910,209,538	241,833,618	1,668,375,920
Incorporation expenses	86,048,875	76,341,814	9,707,061
Research and development costs	66,706,649	39,633,780	27,072,869
Other intangibles	12,139,734	3,689,400	8,450,334
In-progress intangibles	152,356,963	-	152,356,963
	3,694,452,523	544,330,138	3,150,122,385

As of December 31, 2004, the caption "Industrial property and other rights" includes certain intangible assets related with concessions or licenses held by subsidiaries which are being amortized as described in Note 3.e), as follows:

- (a) Euro 339,964,723 related to the acquisition of the ownership of the Basic Network from the Portuguese State. This amount corresponds to the difference between the amount paid in 2002 (Euro 365 million) and: (i) the concession rent of 2002 (Euro 16,604,413), which was still recorded in the income statement as a cost of the year 2002; and (ii) the gain obtained from a cross border lease operation (Euro 8,430,864) made in 2003 with equipment allocated to the basic network, as this gain was considered in the determination of the value attributable to the basic network.

- (b) Euro 992,058,080 related with 50% of the value allocated to the band A licenses owned by VIVO s subsidiaries (Note 3.e)), and Euro 135,070,208 related to 50% of the cost of mobile telecommunications licenses obtained by Global Telecom and TCO to operate in certain Brazilian states.
- (c) Euro 99,759,579 related with a UMTS license obtained by TMN and an amount of Euro 33,333,333 paid to Oniway in connection with an agreement signed in 2002 between that company and the others three mobile operators in Portugal (including TMN). These intangibles were included in the caption In-progress intangibles as of December 31, 2003, but with the beginning of the UMTS operations in May 2004 they were transferred to the caption Industrial property and other rights .
- (d) Euro 106,769,032 related with rental contracts of satellite capacity signed by TV Cabo in the second half of 2004, which have a maturity of 12 years and were considered as capital leases.

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Intangible assets, net by geographic area are as follows:

	2004	2003
Domestic market	1,376,701,844	1,319,887,830
International market:		
Brazil	1,832,838,693	1,827,700,956
Other	3,314,366	2,533,599
	3,212,854,903	3,150,122,385

Amortization charged to operations, excluding amortization of goodwill, in the years ended December 31, 2004 and 2003 amounted to Euro 138,448,792 and Euro 90,526,958, respectively.

Goodwill, net of accumulated amortization, is related with the acquisition of the following investments:

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	2004	2003
VIVO ⁽¹⁾	610,920,846	463,143,545
Wireline business:		
PT.com (ISP and Portals businesses)	153,950,736	162,624,017
PT Comunicações (international carrier business)	68,758,535	75,634,389
PT Prime (Data & Corporate business)	30,435,654	32,126,523
Other	293,341	1,003,014
	253,438,266	271,387,943
PT Multimedia:		
Pay TV and Cable Internet ⁽²⁾	187,965,579	176,647,950
Audiovisuals:		
Lusomundo Audiovisuais, S.A. ("Lusomundo Audiovisuais")	62,717,816	66,577,374
Lusomundo Cinemas, S.A. ("Lusomundo Cinemas")	36,606,543	38,751,006
Media:		
Lusomundo Serviços, SGPS, S.A. ("Lusomundo Serviços")	85,293,080	90,541,885
Global Notícias - Publicações, S.A. ("Global Notícias")	13,064,974	14,694,252
Lusomundo Media, SGPS, S.A. ("Lusomundo Media")	7,618,540	8,041,793
Ocasão - Edições Periódicas, S.A.	4,946,105	-
Rádio Press - Comunicação e Radiodifusão, S.A. ("Rádio Press")	1,729,289	1,930,245
Vasp - Sociedade de Transporte e Distribuição, S.A. ("Vasp")	1,226,475	1,717,064
Other	2,035,915	1,054,055
	403,204,316	399,955,624
Other businesses:		
Páginas Amarelas, S.A. ("Páginas Amarelas")	79,287,531	83,754,434
Unitel, S.A. ("Unitel")	21,567,869	26,217,691
PrimeSys	20,302,243	23,363,425
PT Sistemas de Informação, S.A. ("PT SI")	6,473,516	8,931,685
Cabo Verde Telecom, S.A. ("Cabo Verde Telecom")	7,012,058	7,404,891
Web-Lab, SGPS, S.A.	8,179,594	-
	142,822,811	149,672,126
	1,410,386,239	1,284,159,238

(1) The increase in this caption is primarily related with the goodwill generated in the acquisitions of further investments in Brasilcel's subsidiaries (Exhibit II).

- (2) This caption also includes the goodwill generated in the acquisition of a further investment of 16.67% in the share capital of Sport TV made during 2004, amounting to Euro 22,126,657 (Exhibit II).

Goodwill is amortized on a straight line basis during the following periods (Note 3.e)):

Company	Period
Brasilcel s subsidiaries	Period expected to recover the investment (20 years).
PT.com	Period expected to recover the investment (20 years).
PT Comunicações (international carrier business)	Period expected to recover the investment (20 years).
PT Prime	Period expected to recover the investment (20 years).

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PT Multimedia and subsidiaries	Period expected to recover the investment (20 years).
Páginas Amarelas	Period expected to recover the investment (20 years).
Unitel	Period remaining to the end of the license on the date of acquisition of the investment (9 years).
PrimeSys	Period expected to recover the investment (10 years).
Cabo Verde Telecom	Period remaining to the end of the concession on the date of acquisition of the investment (19 years).
Other	Period expected to recover the investment (maximum 20 years).

Amortization of goodwill in the years ended December 31, 2004, 2003 and 2002 was as follows:

	2004	2003	2002
VIVO	38,634,938	53,076,620	48,731,785
Wireline business:			
PT.com	8,673,281	8,673,281	8,974,176
PT Comunicações (international carrier business)	6,875,854	6,875,854	6,875,854
PT Prime	1,690,870	1,690,870	-
Other	276,863	796,233	941,404
	17,516,868	18,036,238	16,791,434
PT Multimedia:			
Pay TV and Cable Internet	10,809,028	9,979,276	8,381,315
Audiovisuals:			
Lusomundo Audiovisuais	3,859,558	2,894,668	-
Lusomundo Cinemas	2,144,463	1,305,066	-
Media:			
Lusomundo Serviços	5,248,805	3,936,604	-
Global Notícias	1,629,279	1,625,420	1,625,420
Vasp	490,590	490,590	-
Lusomundo Media	423,252	423,252	-
Rádio Press	200,957	200,957	201,037
Lusomundo SGPS ⁽¹⁾	-	2,668,172	29,394,937
Other	400,066	500,591	704,661
	25,205,998	24,024,596	40,307,370
Other businesses:			
Páginas Amarelas	4,466,903	4,466,903	413,942
Unitel	4,369,670	4,369,670	4,369,670
PrimeSys	3,363,978	3,509,738	15,661,906
PT SI	1,616,252	1,616,252	-
Other	1,947,882	1,512,753	16,633,331
	15,764,685	15,475,316	37,078,849
	97,122,489	110,612,770	142,909,438

(1) As a result of the corporate restructuring of Lusomundo, made in the second quarter of 2003, the goodwill related with this investment was transferred to Lusomundo Audiovisuais, Lusomundo Cinemas and Lusomundo

Serviços.

The Company, supported on the business plans of the subsidiary and associated companies mentioned above, believes that the carrying value of the financial investments on the above mentioned companies (including goodwill, net of accumulated amortization and provisions for impairments), is lower than its fair value.

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13. Loans

This caption consists of:

	December 31, 2004		December 31, 2003	
	Short-term	Long-term	Short-term	Long-term
Exchangeable bonds (a)	-	390,335,000	450,485,000	440,335,000
Bonds (b)	584,950,000	1,848,162,033	124,699,474	2,669,141,209
Bank loans (c):				
External market loans	452,179,951	1,329,321,190	284,700,985	1,356,219,875
Domestic market loans	7,100,357	7,712,975	6,583,720	7,373,996
Overdrafts	14,647,937	-	2,545,597	
Others loans				
Commercial Paper (d)	318,808,486	8,950,000	285,487,967	10,900,000
External market loans (e)	19,156,806	81,737,245	36,575,981	71,643,923
	1,396,843,537	3,666,218,443	1,191,078,724	4,555,614,003

As of December 31, 2004 the medium and long-term portion of the loans is repayable as follows:

2006	1,524,528,265
2007	458,444,296
2008	507,138,776
2009	959,027,456
2010 and following years	217,079,650
	3,666,218,443

(a) Exchangeable bonds

On June 7, 1999 PT Finance issued exchangeable bonds totalling Euro 509,435,000, convertible into Portugal Telecom shares, as follows:

- Number of exchangeable bonds: 101,887;
- Exchange price: Euro 10,515 per share (as a result of the stock split and the share capital increases occurred up to December 31, 2001);
- Nominal value: Euro 5,000;
- Maturity: June 7, 2004; and
- Fixed interest rate: 1.5% per annum, paid quarterly at the end of each period.

Up to December 31, 2003 the Company had converted 76 of these exchangeable bonds into 35,431 shares of Portugal Telecom and unwinded 11,710 of these exchangeable bonds, with a notional value of Euro 58,950,000. As of June 7, 2004 the remaining exchangeable bonds amounting to Euro 450,485,000 were repaid.

On December 6, 2001 PT Finance issued exchangeable bonds totalling Euro 550,000,000, convertible into Portugal Telecom shares, as follows:

- Number of exchangeable bonds: 110,000;
- Exchange price: Euro 12.3985 per share;
- Nominal value: Euro 5,000;
- Maturity: December 6, 2006; and
- Fixed interest rate: 2% per annum, paid quarterly at the end of each period.

On December 2003 and October 2004 the Company unwinded, respectively, 21,933 of these exchangeable bonds, with a notional value of Euro 109,665,000, and 10,000 of these exchangeable bonds with a notional value of Euro 50,000,000. As of December 31, 2004 the notional value of these exchangeable bonds outstanding amounts to Euro 390,335,000.

(b) Bonds

On April 7, 1999 PT Finance issued notes totaling Euro 1,000,000,000, under a Global Medium Term Note (GMTN) program, with an annual fixed interest rate of 4.625% . These notes mature in 10 years. In November 2004, the Company cancelled the bonds from this program held as marketable securities with a notional value of Euro 120,500,000.

On February 21, 2001 PT Finance issued notes totaling Euro 1,000,000,000, under a second GMTN program, with an annual fixed interest rate of 5.75% . These notes mature in five years. In the second half of 2004, the Company cancelled the bonds from this program held as marketable securities with a notional value of Euro 100,500,000.

On November 16, 2001 PT Finance issued notes totaling Euro 600,000,000, under a Floating Rate Note program, at a floating interest rate corresponding to the three months Euribor plus a 0.75% spread. These notes mature in three years and three months. In November, 2004 the Company cancelled the bonds from this program held as marketable securities with a notional value of Euro 15,050,000.

On August 1, 2003, TCP obtained a bond amounting to BRL 500 million, with a maturity of five years and bearing an annual interest rate corresponding to 104.4% of the CDI.

On November 17, 2004 Portugal Telecom repaid the PT/97 bond amounting to Euro 124,699,474.

(c) Bank loans

As of December 31, 2004 and 2003 bank loans are denominated in the following currencies:

	2004		2003	
	In the currency of the loan	Euro	In the currency of the loan	Euro
Euro	1,240,722,309	1,240,722,309	1,219,645,650	1,219,645,650
U.S. Dollars	55,817,405	40,978,933	41,858,799	33,142,358
Brazilian Reais	1,907,815,568	527,793,612	1,367,019,988	373,033,888
Other		1,467,556		31,602,277
		1,810,962,410		1,657,424,173

As of December 31, 2004 and 2003, the guarantees given by third parties on behalf of the Company, in connection with these loans, were as follows:

	2004	2003
- European Investment Bank loans guaranteed from Portuguese banks	257,406,112	301,402,179

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- Guarantee from the Portuguese State to Kreditanstalt Für Wiederaufbau	9,127,071	10,585,276
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During 2003, the Company obtained a Multicurrency Revolving Credit Facility amounting to Euro 500,000,000, with a maturity of two years. On February 17, 2004, the maturity of this Facility was renegotiated, being 50% of the loan payable in 2007 and the remaining in 2008.

In 2004, Portugal Telecom and PT Finance, obtained three other Multicurrency Revolving Credit Facilities totaling Euro 400,000,000, in the following dates and with the following maturities and amounts:

- In June 24, 2004, with an amount of Euro 150,000,000 and a maturity of four years;
- In October 18, 2004, with an amount of Euro 100,000,000 and a maturity of three years;
- In October 22, 2004, with an amount of Euro 150,000,000 and a maturity of three years and six months.

As of December 31, 2004, the Group has used an amount of Euro 75,000,000 in connection with these facilities.

On December 10, 2004 the Company signed a contract for a new loan with the European Investment Bank (EIB) amounting to Euro 150 million with a maturity as of December 15, 2014. This contract allows an additional financing of Euro 100 million. As of December 31, 2004, the Company had not yet used any funding from this contract.

As of December 31, 2004 and 2003, bank loans bear interest at annual interest rates, equivalent to loans denominated in Euros, that vary between:

	2004	2003
Maximum	4.9%	4.9%
Minimum	2.02%	2.08%
(d) Commercial paper		

As of December 31, 2004 this caption relates basically to commercial paper programmes issued by the following Group companies:

Portugal Telecom (i)	312,858,486
Lusomundo	14,900,000
	327,758,486

- (i) Short term commercial paper programme issued in 2002, amounting to a total of Euro 875,000,000. As of December 31, 2004, the Company was using an amount of Euro 312,858,486, which matured in January 2005 and bears interest at an annual rate of 2.34% .

(e) Other loans - external market

As of December 31, 2004 other loans comprise basically 50% of the loans obtained by VIVO from BNDES (the Brazilian Development Bank) amounting to Euro 82,150,010 at

the Euro/Real exchange rate prevailing at year-end. These loans will be repaid from 2005 until 2011.

(f) Covenants

As of December 31, 2004, the Company had several covenants related with its indebtedness, which have been fully complied. As of that date, main covenants are as follows:

- Credit rating

If at any time, the long term credit rating assigned by the rating agencies to Portugal Telecom is reduced to *BBB+/Baa1*, then Portugal Telecom must present a guarantee acceptable by the EIB. This covenant is applied to certain EIB loans totaling Euro 300 million, of which Euro 150 million were being used as of December 31, 2004.

The Facility obtained in October 18, 2004, amounting to Euro 100,000,000, establishes that Portugal Telecom must have a minimum rating of at least *BBB- /Baa3*.

- Control/Disposal of subsidiaries

Portugal Telecom must, directly or indirectly, maintain majority ownership and control of each material subsidiary. Material subsidiaries are those companies whose total assets are equal or exceed 10% of total consolidated assets or whose total revenues are also equal or exceed 10% of total consolidated revenues. This covenant is applied to the Facility of Euro 500 million and to certain EIB loans totaling Euro 762 million, of which Euro 612 million were used as of December 31, 2004.

- Financial ratios

The legal documentation regarding the Facility of Euro 500 million states that the consolidated ratio Net Debt/EBITDA, should not be higher than 4.5. The two Facilities obtained in October 2004, totaling Euro 250 million, state that the consolidated ratio Net Debt/EBITDA, should not be higher than 3.5, although in one of these Facilities this is only applicable if the rating from Portugal Telecom is reduced. In addition, the conditions (spread and maturity) applicable to the Facility of Euro 500 million and to the Facility of Euro 150 million obtained in June 2004 may be changed if the consolidated ratio Net Debt/EBITDA is higher than, respectively, 2.5 and 2.25. As of December 31, 2004 this ratio stood at 1.34.

In addition, the Global Medium Term Notes, the Exchangeable Bonds, the Facility of Euro 500 million and the Facilities totalling Euro 400 million include certain restrictions to pledge the Company's consolidated assets, in order to secure any loan or obligation to third parties.

14. Accounts Payable Other - Third Parties

This caption consists of:

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	2004	2003
Accounts payable to fixed assets suppliers	336,486,029	237,393,030
Taxes payable in foreign countries (1)	93,907,101	75,635,262
Advances received for the sale of certain		
accounts receivable from the Portuguese State (Note 33.c))	26,392,172	27,399,604
accounts payable to employees	16,477,092	15,226,927
Advances received from customers	5,651,760	4,412,361
Contributions to PT - ACS (Note 3.g))	3,444,945	12,270,401
Contributions payable to the pension funds (2)	-	2,342,959
Other (3)	83,720,238	160,326,723
	566,079,337	535,007,267

- (1) This caption includes primarily 50% of the taxes payable by VIVO, including income taxes and indirect taxes. As of December 31, 2004 the taxes payable by VIVO amount to Euro 78,783,194.
- (2) As of December 31, 2003 this amount includes: Euro 4,672,376 (Note 30.1) related to contributions payable by PT Comunicações to the pensions funds, net of Euro 2,329,417 related with payments on account made throughout the year on behalf of Caixa Marconi.
- (3) As of December 31, 2004 this caption included: (i) Euro 13,390,533 related to 50% of the management fees due to Telefónica Móviles by certain Brasilcel s subsidiaries; (ii) Euro 8,391,439 related with commissions payable to agents; and (iii) Euro 7,547,000 related with 50% of the amount due by TCP in relation with the acquisition of TCO.

15. Accrued Expenses

This caption consists of:

	2004	2003
General and administrative expenses	233,682,857	163,585,775
Interest expense	155,511,043	176,139,490
Vacation pay and bonuses	120,849,761	109,396,438
Discounts to clients (1)	36,987,839	58,818,100
Commissions	18,609,545	18,770,926
Contribution to PT-ACS	4,908,757	6,841,810
Interest on unpaid taxes (Note 32.a))	1,116,083	1,157,276
Other (2)	66,844,507	54,684,798
	638,510,392	589,394,613

- (1) This caption comprises discounts to clients related to sole volume discount, granted to the major fixed live clients. These discounts are accounted as a reduction of the related revenues.
- (2) As of December 31, 2004 this caption includes an accrual of approximately Euro 41 million corresponding to the fair value of certain cross-currency swaps which are not hedging any specific risk, asset or liability (Note 3.p)).

16. Taxes Payable

This caption consists of:

	2004	2003
Value added tax	60,996,378	78,545,853
Social Security contributions	10,863,432	11,830,966
Personnel income tax withholdings	10,594,555	9,590,122
City tax	62,909	1,069,902
Income taxes, net of payments on account (i)	-	1,621,852
Other	295,168	266,906
	82,812,442	102,925,601

- (i) As of December 31, 2004 and 2003, net income taxes receivable is made up as follows:

2004	2003
-------------	-------------

Income taxes receivable (Note 7)	2,671,827	3,232,311
Income taxes payable	-	(1,621,852)
Net income tax receivable	2,671,827	1,610,459

	2004	2003
Payments on account	5,086,990	2,966,267
Withholding income taxes	4,106,310	533,438
Current income taxes	(8,882,069)	(4,853,827)
Other	2,360,596	2,964,581
Net income tax receivable	2,671,827	1,610,459

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Reconciliation between current income taxes in the Company's balance sheet as of December 31, 2004 and 2003 and the current income tax expense for the years then ended is as follows:

	2004	2003
Current income taxes in the balance sheet	8,882,069	4,853,827
Taxes losses carryforward used in the year (Note 29)	237,178,778	250,752,473
Foreign income taxes payable by subsidiaries	38,305,380	39,551,056
Provision for legal actions related with income taxes (Note 28)	4,717,540	-
Other	1,538,014	(344,004)
Total Income tax expense-current	290,621,781	294,813,352

The current income tax expense was recorded in the following captions:

	2004	2003
Income statement (Note 29)	289,300,465	287,122,537
Shareholders' equity:		
Cumulative foreign currency translation adjustments (Note 3.o))	1,812,409	6,108,630
Other reserves (Note 3.o))	(491,093)	1,582,185
	290,621,781	294,813,352

17. Deferred Income

This caption consists of:

	2004	2003
Advance billing (1)	141,944,699	113,190,687
Investment subsidies (Note 3.k))	9,953,460	14,537,473
Financial instruments (2)	8,328,285	22,006,110
Telephone directories	2,151,118	2,118,787
Other	75,107,083	60,560,438
	237,484,645	212,413,495

- (1) As of December 31, 2004 this caption included Euro 110,390,994 related mainly with pre-paid minutes of traffic in mobile networks, not used by customers from TMN and VIVO (Note 3.q)).
- (2) As of December 31, 2004 this caption relates to 50% of the net premium obtained in connection with the equity derivatives over PT Multimedia shares contracted with Banco Espírito Santo Group (Note 31). As of December 31, 2003 this caption included upfront fees received in connection with the restructuring of interest rate swap

contracts, that are recognized in income during the maturity period of those contracts.

18. Other Non-Current Liabilities

1. Provision For Other Risks and Costs

This caption consists of (Note 28):

	2004	2003
Provision for legal actions (a)	67,825,144	14,927,504
Provision for taxes (b)	51,138,186	43,451,561
Provision for fixed assets (Note 3.d))	50,403,228	43,278,576
Other provisions for risks and costs (c)	291,509,751	259,722,025
	460,876,309	361,379,666

(a) The provision for legal actions is to cover potential liabilities arising from legal actions against the Company for which the final outcome as of December 31, 2004 was not yet settled. The amount of the provision is based on information obtained from the Company's legal counsel. During 2004, this provision was increased by approximately Euro 47 million as a result of new judicial and arbitration processes presented against the Company.

(b) The provision for taxes is to cover potential tax liabilities and was estimated based on information obtained from the Company's legal counsel and tax consultants. As of December 31, 2004 its detail by subsidiary, is the following:

VIVO	27,982,100
Portugal Telecom (Note 32.a))	13,975,284
PT Comunicações (Note 32.a))	1,963,893
Other	7,216,909
	51,138,186

The provisions recorded by VIVO are basically related to indirect taxes in Brazil (ICMS), which legality under Brazilian Constitution is being challenged by Brasilcel's subsidiaries.

(c) As of December 31, 2004, the detail of this caption is as follows:

Provision for losses in affiliated companies (Note 10)	129,315,472
Provision for restructuring of TV Cabo (i)	68,350,766
Other provisions (ii)	93,843,513
	291,509,751

- (i) This provision is to cover costs with the retirement of the analogue network. During 2004, the provision was increased by Euro 26,250,000 (Note 27).
- (ii) This caption includes a provision for potential impairments in the audiovisuals business amounting to Euro 40,000,000 (Note 27).

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2. Other Non-Current Liabilities

This caption consists of:

	2004	2003
Accounts payable to fixed assets suppliers	121,489,388	19,154,800
Deferred income - investment subsidies (Note 3.k))	31,208,019	38,744,052
Taxes payable in foreign countries (1)	25,634,200	24,943,234
Other	30,437,227	61,929,247
	208,768,834	144,771,333

- (1) This caption relates to 50% of the ICMS payable by Global Telecom to the Brazilian state of Paraná, which resulted from a tax benefit obtained.

19. Minority Interests

During the year ended December 31, 2004 the movement in minority interests was as follows:

	Opening balance	Acquisitions and disposals	Income / (loss)	Changes in the consolidation perimeter	Dividends	Currency translation adjustments	Other	Closing balan
Brasilcel (1)	419,201,233	(115,229,615)	43,014,109	-	(30,156,059)	7,260,395	408,831	324,498
PT Multimédia (2)	166,169,910	-	46,723,131	-	(5,327,366)	(72,523)	(53,251)	207,439
Cabo Verde Telecom	28,772,842	-	7,165,483	-	(5,273,610)	-	167,335	30,832
Mascom(3)	16,682,849	(16,682,849)	-	-	-	-	-	-
Cabo TV Madeirense, S.A.	5,155,415	-	1,445,421	-	(539,400)	-	-	6,061
Timor Telecom, S.A.	-	-	828,850	1,716,566	-	(262,851)	-	2,282
Cabo TV Açoreana, S.A.	1,872,300	-	502,535	-	(349,197)	-	-	2,025
CST - Companhia Santomense de Telecomunicações, SARL	1,438,850	-	355,784	-	(33,385)	(232,066)	(57,367)	1,471
Kenya Postel Directories, Ltd.	1,127,747	-	234,808	-	(369,088)	(96,281)	(11,182)	,886
LTM - Listas Telefónicas de Moçambique, Lda.	1,299,359	-	544,595	-	(527,288)	161,588	19,314	1,497
Empresa Gráfica	1,080,177	-	-	(1,080,177)	-	-	-	-

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Funchalense, S.A.									
Previsão	-	-	27,821	1,029,851	-	-	-	-	1,057
Lusomundo Media	494,440	-	114,872	-	-	-	296,207	-	905
Naveprinter	-	713,787	3,842	-	-	-	-	-	717
Grafilme - Sociedade									
Impressora de									
Legendas, S.A.	577,237	-	173,987	-	(88,880)	-	-	-	662
Telecomunicações									
Públicas de Timor, S.A.	-	-	193,450	424,942	-	(62,970)	-	-	555
Other	95,609	-	240,376	41,440	(225,368)	(22,225)	341	-	130
	643,967,968	(131,198,677)	101,569,064	2,132,622	(42,889,641)	6,673,067	770,228	581,024	

Income applicable to minority interests in the periods ended December 31, 2004, 2003 and 2002 were as follows:

	2004	2003	2002
PT Multimédia (2)	46,723,131	13,036,880	(61,406,838)
Brasilcel (1)	43,014,109	51,527,882	-
Cabo Verde Telecom	7,165,483	7,405,816	7,055,199
Cabo TV Madeirense	1,445,421	1,072,541	890,458
Mascom (3)	-	6,484,585	4,532,724
TCP (4)	-	-	(23,313,734)
Other	3,220,920	(302,774)	(2,378,473)
	101,569,064	79,224,930	(74,620,664)

- (1) The minority interests in Brasilcel correspond to 50% of the interests of minority shareholders of Brasilcel's subsidiaries in their corresponding amounts of shareholders' equity and net income.
- (2) The minority interests in PT Multimedia correspond to the interests of minority shareholders in their equity and net income, considering the application of the equity method of accounting to their subsidiaries.
- (3) During 2004, Mascom was excluded from the consolidation as the financial investment in this subsidiary was in the process of being sold, only pending regulatory approval from the Botswana authorities (Note 10).

(4) As mentioned in Note 1, this subsidiary was incorporated in Brasilcel as of December 27, 2002.

20. Share Capital and Reserves

On December 28, 2004 Portugal Telecom cancelled 87,799,950 treasury shares, with a nominal value of one Euro each, that were held, following a decision taken in the Annual General Meeting of April 2, 2004 regarding an announced share buyback. As a result, the Company's share capital was reduced from Euro 1,254,285,000 to Euro 1,166,485,050.

As of December 31, 2004 Portugal Telecom's fully subscribed and paid share capital amounted to Euro 1,166,485,050 and is represented by 1,166,485,050 shares, with a nominal value of one Euro each, and with the following distribution:

- 1,166,484,550 ordinary shares;
- 500 Class A shares.

All the Class A shares are held by the Portuguese State.

In accordance with Portugal Telecom's Articles of Associates, the Class A shares have special voting rights as follows:

- Election of one third of the Directors, including the Chairman of the Board of Directors;
- Authorization to require distributions to all shareholders of dividends in excess of 40% of Portugal Telecom's net income;
- Capital increases and other changes in Portugal Telecom's Articles of Association;
- Issuance of bonds and other securities;
- Authorization for a shareholder operating in an area which is in competition with Portugal Telecom to hold more than 10% of the ordinary shares;
- Amending the general objectives, the strategy or the policies of Portugal Telecom; and
- Defining investment policies of Portugal Telecom, including authorizing acquisitions and disposals.

As a result of the privatization of Portugal Telecom, initiated in June 1, 1995 and concluded on December 4, 2000, the interest of the Portuguese Government in the Company's share capital as December 31, 2004 was 6.79%, including the 500 Class A shares indicated above.

Capital issued premium

This caption results from premiums generated in capital increases made by Portugal Telecom. According to Portuguese law, applicable to companies listed in stock exchanges under the supervision of *Comissão do Mercado de Valores Mobiliários* (the Portuguese stock exchange regulator), these amounts can only be used to increase share capital or to cover for accumulated losses (even before the use of other reserves). This amount can not be used to pay dividends or to acquire treasury shares.

Legal reserve

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Portuguese law provides that at least 5% of each year's profits must be appropriated to a legal reserve until this reserve equals the minimum requirement of 20% of share capital. This reserve is not available for distribution to shareholders but may be capitalized or used to absorb losses, once all other reserves and retained earnings have been exhausted.

Equity Available for Distribution

Pursuant to Portuguese legislation, the amount of shareholders' equity available for distribution is determined based on the standalone financial statements of the Company. During 2004, the movements in the Company's shareholders' equity, on a standalone basis, were as follows:

	Opening Balance	Application of Net Income and Other Reserves	Equity adjustments	Aquisition of treasury shares	Cancellation of share capital	Other	Closing Balance
Share capital	1,254,285,000	-	-	-	(87,799,950)	-	1,166,485,050
Capital issued premium	91,704,891	-	-	-	-	-	91,704,891
Treasury shares	(210,040,062)	-	-	(480,912,955)	690,953,017	-	-
Equity adjustments in affiliated companies	995,031,540	-	(666,892,260)	-	-	-	328,139,280
Non-distributable reserves:							-
Legal	144,184,287	10,040,788	-	-	-	-	154,225,075
Treasury shares	210,040,062	-	-	480,912,955	(690,953,017)	-	-
Cancellation of treasury shares	-	-	-	-	87,799,950	-	87,799,950
Distributable reserves:							-
Free reserves	254,853,267	(76,724,707)	-	(172,284,916)	-	-	5,843,644
Retained earnings	(39,403,169)	39,403,169	685,304,951	(308,628,039)	-	(6,220,610)	370,456,302
Net income	240,218,936	(240,218,936)	-	-	-	500,085,704	500,085,704
	2,940,874,752	(267,499,686)	18,412,691	(480,912,955)	-	493,865,094	2,704,739,896

Pursuant to the Annual General Meeting of April 2, 2004, net income for 2003, amounting to Euro 240,218,936, was applied as follows:

Dividends	190,774,979
Retained earnings	39,403,169
Legal reserve	10,040,788
	240,218,936

The Annual General Meeting of April 2, 2004 also approved an additional distribution to shareholders, in the form of dividends, of free reserves amounting to Euro 76,724,707 and a distribution of PT shares to employees amounting to Euro 6,220,610.

The net increase in the caption Equity adjustments in affiliated companies includes an amount of approximately Euro 22 million related with currency translations adjustments generated during 2004.

According to Portuguese legislation, a non-distributable reserve should be set-up to cover for any treasury shares acquired by an amount equivalent to the acquisition value of such shares. This reserve will be freed up upon the sale or cancellation of such treasury shares. However, Portuguese law also establishes that upon cancellation of such treasury shares a non-distributable reserve should be set-up corresponding to the nominal value of such shares.

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Portuguese legislation establishes that the amount of equity available for distribution to shareholders is determined by the lower of the following amounts:

- a) Distributable reserves (95% of Net Income + Retained Earnings + Free Reserves);
- b) Total shareholders equity less the sum of share capital, capital issued premium, treasury shares and non-distributable reserves.

As of December 31, 2004 the amount of equity available for distribution to shareholders amounts to Euro 851 million.

21. Operating Revenues

This caption consists of:

	2004	2003	2002
Wireline business (Note 34.2)(1)	2,123,830,033	2,138,054,627	2,273,636,769
Services rendered	1,957,089,460	1,965,212,406	2,099,712,574
Directories	129,735,137	136,089,291	139,139,288
Sales	37,005,436	36,752,930	34,784,907
Domestic Mobile - TMN (Note 34.3)	1,444,293,249	1,346,740,297	1,266,647,997
Services rendered	1,300,371,237	1,213,221,073	1,132,761,033
Sales	143,922,012	133,519,224	133,886,964
Brazilian Mobile - VIVO (Note 34.4) (2)	1,502,984,689	1,361,513,763	1,217,622,274
Services rendered	1,183,397,482	1,093,778,637	1,048,632,419
Sales	319,587,207	267,735,126	168,989,855
PT Multimédia (Note 34.5) (1)	728,973,662	683,478,362	621,901,893
Services rendered	616,240,929	544,080,630	475,777,581
Sales	112,732,733	139,397,732	146,124,312
Other businesses	222,772,338	246,324,526	202,224,187
Services rendered	219,032,268	240,176,667	193,962,225
Directories	31,236	20,532	17,520
Sales	3,708,834	6,127,327	8,244,442
	6,022,853,971	5,776,111,575	5,582,033,120

- a) As a result of changes occurred in the composition of these business segments (Note 34.1), the amounts related to year 2002 were adjusted accordingly. PT.com's results were included in the wireline business segment and excluded from the PT Multimedia business segment.
- b) Since the contribution to Brasilcel of Portugal Telecom's investment in TCP occurred on December 27, 2002 the amounts for the year ended December 31, 2002 include 100% of TCP's operating revenues and the amounts for the years 2003 and 2004 include 50% of the consolidated operating revenues of VIVO.

22. Wages and Salaries

This caption consists of:

	2004	2003	2002
Salaries	620,674,846	585,494,416	581,537,670
Employee Benefits	97,381,015	86,188,097	74,672,734
Social Charges	17,461,279	20,367,531	19,331,095
Insurance	2,835,384	3,327,329	3,164,379
Other	7,814,127	10,525,105	16,069,489
	746,166,651	705,902,478	694,775,367

23. Costs of Telecommunications

This caption consists of:

	2004	2003	2002
Interconnection charges - mobile / mobile	142,473,045	167,587,697	176,195,727
Interconnection charges - fixed / mobile	110,512,681	127,385,114	151,446,742
International telecommunications operators	86,074,482	72,051,122	83,384,871
Rental of telecommunications circuits	63,415,789	68,328,380	54,278,630
Roaming	34,982,988	31,623,077	33,585,706
Interconnection charges - mobile / fixed	33,335,774	44,348,594	42,525,551
Satellite charges	5,382,288	9,384,808	9,390,213
Other costs of telecommunications services	76,074,380	66,436,266	72,131,224
	552,251,427	587,145,058	622,938,664

24. General and Administrative Expenses

This caption consists of:

	2004	2003	2002
Specialized work and subcontracts	562,464,040	493,846,049	495,187,549
Commissions	162,934,980	138,692,906	104,505,101
Rents	95,440,593	92,947,784	103,471,276
Electricity	50,251,740	44,879,402	46,832,747
Communication expenses	30,346,276	32,615,448	38,601,976
Travel and entertainment	22,773,144	20,071,589	16,534,541

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Security expenses	11,734,179	10,510,399	9,350,331
Insurance	10,347,046	10,249,331	10,297,929
Fuel and gas	8,248,030	7,466,295	7,154,280
Other general and administrative expenses	121,402,429	115,246,614	93,626,193
	1,075,942,457	966,525,817	925,561,923

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25. Other net financing expenses/(income)

This caption consists of:

	2004	2003	2002
Bank commissions and expenses	19,328,565	27,868,829	68,877,740
Increases in provisions for other risks and costs (Note 28) (1)	10,422,355	7,664,225	47,206,380
Financial discounts, net	5,704,466	2,463,886	4,866,436
Gains on investments	(1,521,043)	(1,292,259)	(1,143,322)
Decreases in provisions for other risks and costs (Note 28) (2)	(13,024,673)	(156,770,873)	(15,746,172)
Other net financial expenses/(income) (3)	(8,415,564)	24,693,950	7,675,123
	12,494,106	(95,372,242)	111,736,185

- (1) In 2004 this caption included primarily Euro 7,929,153 related with the increase in the provision for investments.
- (2) In 2004 this caption included primarily Euro 11,305,603 related with the decrease in the provision for risks related with financial instruments, as a result of the cancellation of the corresponding instruments (equity swaps on own shares). In 2003 this caption included: (i) Euro 82,498,690 related with equity swaps; and (ii) Euro 74,272,183 related with financial instruments contracted by VIVO, which as of December 31, 2002 were recorded as investments net of provisions and as of December 31, 2003 were recorded at fair value in the caption Short term investments .
- (3) In 2004 this caption included primarily: (i) a gain amounting to Euro 33,416,640 related to a cancellation of an equity swap over PT Multimedia shares; and (ii) 50% of the taxes paid by Brasilcel s subsidiaries amounting to Euro 13,264,646 related with financial revenues.

26. Net losses/(gains) on sales and disposals of fixed assets, net

This caption consists of:

	2004	2003	2002
Losses on sales and disposals of fixed assets	15,394,469	9,890,091	9,033,216
Losses on the retirement of fixed assets (Note 11)	3,631,366	4,176,106	4,274,208
Gains on sales and disposals of fixed assets (1)	(6,888,934)	(45,746,591)	(17,565,682)
Other	(125,174)	3,050,103	291,664
	12,011,727	(28,630,291)	(3,966,594)

- (1) In 2003, this caption included basically a gain obtained by PT Comunicações on the sale of a building to the Pension Funds.

27. Non-recurring items

This caption consists of:

	2004	2003	2002
Increases in provisions for other risks and costs (Note 28) (1)	34,348,329	62,710,282	-
Losses/(Gains) on disposals of investments, net:			
Disposals of investment in Mascom (2)	(24,764,670)	-	-
Disposals of Telefónica shares	-	-	(30,519,163)
Disposals of investment in Deltapress	-	-	(5,098,510)
Donations	9,766,443	15,613,110	2,518,643
Provision to adjust assets and liabilities in TMN	-	-	50,915,335
Other (3)	68,069,040	(25,538,920)	20,806,320
	87,419,142	52,784,472	38,622,625

- (1) In 2004 this caption included Euro 26,250,000 related to a provision recorded by TV Cabo in connection with the dismantling of the analogue premium service and the implementation of a digital offer (Note 18). In 2003 this caption includes Euro 57,130,000 related to a provision to cover estimated losses resulting from the restructuring of certain activities of TV Cabo, including unrealizable assets and unrecorded liabilities.
- (2) In September 2004 the sale of the investment in Mascom was completed following regulatory approval. As a result, a gain of Euro 24,764,670 was recorded related with this transaction (Exhibit II).
- (3) In 2004 this caption includes: (i) Euro 40,000,000 related with a provision for potential impairments in the audiovisuals business (Note 18); and (ii) Euro 10 million related with the cost of several initiatives implemented by PT Comunicações during 2004 related with an agreement entered into with a consumer protection association (Note 32.c).

28. Movement in the Provisions

During 2004 the movement in the provision accounts was as follows:

	Opening balance	Increases	Reductions	Other movements	Closing balance
Provision for marketable securities	19,066	-	(19,066)	-	-
Provision for doubtful accounts receivable (Notes 6 and 7)	409,729,904	71,374,970	(13,980,389)	(82,849,828)	384,274,657
Provision for inventories (Note 8)	27,444,050	7,976,558	(2,481,476)	(1,149,327)	31,789,805
Provision for investments (Note 10)	70,128,694	7,929,153	(1,700,005)	17,667,146	94,024,988
Provision for other risks and costs (Note 18):					
Legal actions	14,927,504	47,097,555	(552,668)	6,352,753	67,825,144
Taxes	43,451,561	7,600,865	(3,339,521)	3,425,281	51,138,186

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Fixed assets	43,278,576	16,481,519	(8,349,130)	(1,007,737)	50,403,228
Other	259,722,025	107,832,021	(37,696,823)	(38,347,472)	291,509,751
	868,701,380	266,292,641	(68,119,078)	(95,909,184)	970,965,759

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(i) The increases occurred during 2004 in these provision accounts were recorded as follows:

Provisions for doubtful receivables, inventories and other	146,340,064
Depreciation and amortization	56,481,519
Non-recurring items (Note 27)	34,348,329
Other net financing expenses (Note 25)	10,422,355
Equity in losses of affiliated companies	10,181,917
Provision for income taxes (Note 16)	4,717,540
Taxes and other than income taxes	1,300,917
Other non-operating expenses/(revenues), net	2,500,000
	266,292,641

(ii) The reductions occurred during 2004 in these provision accounts were recorded in the following profit and loss captions:

Depreciation and amortization	22,050,581
Provisions for doubtful receivables, inventories and other	17,445,464
Other net financing expenses (Note 25)	13,024,673
Non-recurring items	7,136,680
Taxes and other than income taxes	3,339,522
Subsidies	2,905,293
Equity in earnings of affiliated companies	1,735,353
Wages and salaries	481,512
	68,119,078

In the profit and loss statement for the year ended December 31, 2004, the caption Provisions for doubtful receivables, inventories and other includes the following items:

Increases in these provisions	146,340,064
Direct write-off of accounts receivables	46,273,015
Decreases in these provisions	(17,445,464)
Collections from accounts receivables which were previously written-off	(3,436,285)
	171,731,330

Other movements in provisions account balances include basically the direct use of provisions, the inclusion and exclusion of companies from the consolidation perimeter and currency translation adjustments relating to provisions recorded by foreign subsidiaries.

29. Taxes

Portugal Telecom and its subsidiaries located in Portugal are subject to Corporate Income Tax ("IRC") at a rate of 25% which can be increased up to 10% through a municipal tax. Portugal Telecom, PT Multimedia and Lusomundo Media adopted the tax consolidation regime. The provision for income taxes is determined on the basis of the estimated taxable income for all companies covered by this regime (all 90% or more owned Portuguese subsidiaries). The remaining group companies, not covered by the tax consolidation regimes of Portugal Telecom, PT Multimedia and Lusomundo Media, are taxed individually based on their respective taxable income, at the applicable tax rates.

In accordance with Portuguese tax legislation, corporate tax returns are subject to review and adjustment by the tax authorities during four years following their filing (five years for social security, being ten years for the contributions made up to the year ended December 31, 2001). Management believes that any adjustment, which may result from such reviews or inspections, would not have a material impact on the consolidated financial statements as of December 31, 2004, except for the situations described in Note 32.a) where provisions or accruals have been recorded. Under prevailing Portuguese tax regulations, tax losses may be carried forward for up to six years.

Deferred Taxes

The movement in deferred taxes (Note 3.o)) during the 2004 is as follows:

	Increase/(Decrease)					
	Opening Balance	Net income	Taxes Payable (Note 16)	Foreign currency translation adjustments	Other adjustments	Closing Balance
Deferred tax assets						
Provisions	415,955,871	24,892,065	-	279,975	(17,883)	441,110,028
Tax losses carryforward (i)	651,863,830	116,577,636	(237,178,778)	626,645	4,573,115	536,462,448
Financial instruments	10,815,788	4,570,582	-	-	-	15,386,370
Additional contribution to pension funds	36,436,390	(700,972)	-	-	-	35,735,418
Other (ii)	216,540,935	(52,085,288)	-	2,556,532	70,083,156	237,095,335
	1,331,612,814	93,254,023	(237,178,778)	3,463,152	74,638,388	1,265,789,599
Deferred tax liabilities						
Revaluation of fixed assets (Note 3.d))	24,567,396	(3,864,335)	-	-	65 927	20,768,988
Gains on disposals of investments	286,457,914	(13,597,146)	-	-	-	272,860,768

Distributable reserves of subsidiaries

in foreign countries	13,353,094	540,360	-	-	-	13,893,454
Other	9,147,176	-	-	-	-	9,147,176
	333,525,580	(16,921,121)	-	-	65,927	316,670,386
		110,175,144	(237,178,778)	3,463,152	74,572,461	

- (i) Other adjustments in this caption include basically deductions to income taxes obtained by certain group companies included in the tax consolidation regime of Portugal Telecom, since those amounts can only be recovered after the total use of the existing tax losses carryforward.
- (ii) As of December 31, 2004 this caption included Euro 197,809,182 related with tax benefits obtained from a corporate restructuring in Brazil made by certain subsidiaries of Brasilcel. During 2004, TCO also completed its corporate restructuring, resulting in an increase of Deferred tax assets by Euro 69 million and a decrease of the same amount in the goodwill generated with this acquisition.

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Deferred taxes recorded in the balance sheets as of December 31, 2004 and 2003 were classified as follows:

	2004		2003	
	Assets	Liabilities	Assets	Liabilities
Current	773,811,063	27,944,032	748,141,425	32,793,924
Non-current	491,978,536	288,726,354	583,471,389	300,731,656
	1,265,789,599	316,670,386	1,331,612,814	333,525,580

The reconciliation of the income tax provision for the year ended December 31, 2004 calculated at the statutory Portuguese income tax rate and the effective income tax rate, is as follows:

Income before income taxes	780,819,780
Statutory tax rate (including municipal taxes at a 10% standard)	27,50%
	214,725,440
Permanent differences (a)	42,845,103
Differences in tax rates (b)	2,944,924
Initial recognition of deferred tax assets related with tax losses carryforward from previous years (c)	(104,487,722)
Valuation allowance for certain tax losses carryforward	34,957,108
Reduction of deferred tax liabilities related with deferred taxation on the disposal of certain investments (d)	(12,610,960)
Other	751,428
Income taxes in the profit and loss statement	179,125,321
Effective tax rate	22,94%
The income tax for the year, is as follows:	
Income tax-current (Note 16)	289,300,465
Deferred taxes	(110,175,144)
	179,125,321
(a) This amount relates to the following:	
Goodwill amortization (Note 12)	97,122,489
Provisions (i)	54,830,468
Amortization of Band A licenses (ii)	33,309,382
Equity accounting in gains of affiliated companies, net (Note 10)	(27,721,982)
Other	(1,739,982)
	155,800,375
Tax effect	27,50%

42,845,103

- (i) This caption includes basically a provision recorded in 2004 amounting to Euro 40,000,000 to cover estimated losses in the audiovisuals business, which is not deductible for tax purposes (Note 18).
 - (ii) The amortization of Band A licenses held by Brasilcel's subsidiaries is not tax deductible because these intangibles result from the allocation of goodwill generated in the acquisition of those companies.
- (b) This amount relates to the impact of the different municipal tax rates applicable to the different group companies in Portugal and with the differences between the statutory tax rate in Portugal and the income tax rates applicable to foreign subsidiaries.

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(c) This amount refers to the initial recognition of deferred tax assets related with tax losses from previous years in PT Multimedia, since only in 2004 was obtained evidence that these losses can be realised.

(d) This amount relates to the adoption by the Company of the voluntary taxation regime for certain gains on the disposal of investments obtained in previous years, which taxation was deferred due to the adoption at the time of the reinvestment regime.

30. Post Retirement Benefits

1. Pension Benefits

As referred to in Note 3.f), PT Comunicações, PT SI and Global Notícias (former Jornal de Notícias and Diário de Notícias) are liable for the payment of pensions, supplemental pension benefits to suspended employees and other gratuities to retired and active employees. These liabilities, which are estimated based on actuarial valuations prepared by an independent actuary, are as follows:

a) Former Telecom Portugal employees - Former employees of Telecom Portugal hired by CTT prior to May 14, 1992, or who were retired on that date, are entitled to a Company provided pension benefit. Employees hired after that date are covered by the general Portuguese State social security system. Suspended employees are also entitled to receive a benefit payment equal to 100% of salary prior to leaving service (increased in some cases).

b) Former TLP employees - The retired and active employees who were formerly employees of TLP and who were hired prior to June 23, 1994 are entitled to a pension supplement, which complements the pension paid by the Portuguese State social security system. Pre-retired employees are also entitled to receive benefit payments (equal to 25% to 100% of their present salaries) until they reach the Portuguese State social security retirement age. After this date these former employees become entitled to the pension supplement. Suspended employees are also entitled to receive a benefit payment equal to 100% of salary prior to leaving service (increased in some cases).

c) Former TDP employees - Former employees of TDP hired prior to June 23, 1994 are entitled to a pension supplement, which complements the pension paid by the Portuguese State social security system. Pre-retired employees are also entitled to receive benefit payments (equal to 25% to 100% of their present salaries) until they reach the Portuguese State social security retirement age. Suspended employees are also entitled to receive a benefit payment equal to 100% of salary prior to leaving service (increased in some cases).

d) Former Employees of Marconi - The former employees of Marconi hired prior to February 1, 1998 are entitled to a pension benefit from Caixa and two different supplemental pension benefits (Marconi Fundo de Melhoria and Marconi Complementary Fund). Employees hired after that date are not entitled to these benefits, as they are covered by the general Portuguese State social security system.

e) On retirement PT Comunicações pays a lump sum gratuity of a fixed amount which depends on the length of service completed by the employee.

f) Former Employees of Jornal de Notícias and Diário de Notícias - Employees of Jornal de Notícias, hired prior to November 16, 1994 and of Diário de Notícias, hired prior to December 29, 1979, are entitled to a pension supplement, which complements the pension paid by the Portuguese State social security system.

g) Employees of PT SI - who were transferred from PT Comunicações and Marconi and were covered by pension plans of those companies are entitled to a pension supplement.

The actuarial valuations for these plans as of December 31, 2004, prepared by an independent actuary, used the projected unit credit method and considered the following actuarial assumptions and rates:

	2004	2003
Rate of return on pension fund assets	6.00%	6.00%
Pension liabilities discount rate	5.75%	6.00%
Salaries liabilities discount rate	4.00%	4.00%
Salary growth rate	3.00%	3.00%
Pension growth rate (*)	2.00%	2.00%
Inflation rate	2.00%	2.00%

Mortality table:

Employees (whilst in active service):	AM 92 - males	AM 92 - males
	AF 92 - females	AF 92 - females
	PA (90) m less	PA (90) m less
Pensioners and employees who have taken early retirement:	3 years males PA (90) f less 3 years females	2 years males PA (90) f less 2 years females

Disability table: Swiss Reinsurance Company

Turnover of employees: Nil

(*) Except for Diário de Notícias and Marconi Fundo de Melhoria, where there is no pension growth rate.

The following table sets out the funded status of the PT Comunicações, PT SI and Global Notícias plans as of December 31, 2004 and 2003:

	2004	2003
Projected benefit obligation ("PBO"):		
Retired, pre-retired and suspended employees	1,905,319,000	1,846,468,000
Salaries and gratuities to pre-retired and suspended employees	986,385,800	841,232,000
Active employees	700,674,000	670,020,000
	3,592,378,800	3,357,720,000
Plan assets at fair value	(1,972,620,000)	(1,828,066,000)
Projected benefit obligation, in excess of plan assets	1,619,758,800	1,529,654,000

As of December 31, 2004 and 2003 the plan assets are as follows:

2004	2003
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Equities	681,516,951	615,829,914
Bonds	671,112,135	649,868,442
Property	259,565,035	259,371,373
Real estate investment funds	54,654,566	75,160,719
Cash, treasury bills, short-term stocks and net current assets	305,771,313	227,835,552
	1,972,620,000	1,828,066,000

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As of December 31, 2004 and 2003 the reconciliation between the projected benefit obligation in excess of plan assets and the liability recorded in the consolidated balance sheet as of that dates is presented below:

	2004	2003
Projected benefit obligation, in excess of plan assets	1,619,758,800	1,529,654,000
Actuarial losses, net (i)	(884,263,944)	(769,090,982)
Transition obligation (ii)	(24,737,000)	(26,519,596)
Prior service cost	1,772,000	1,466,730
Pension Liabilities	712,529,856	735,510,152

- (i) Actuarial losses, net result basically from: (a) the lower actual return on fund assets as compared with the expected return on fund assets; (b) the change in some actuarial assumptions; and (c) the higher salary growth rates and higher increase in pensions and pre-retired salaries, than the long term assumptions considered in the actuarial studies. These actuarial gains and losses will be amortized over an average period of 14 years which corresponds to the estimated average working life of active employees. During 2004 and 2003, the movements in actuarial gains and losses were as follows:

	2004	2003
Beginning balance	(769,090,982)	(726,002,450)
Actuarial gains and (losses) arising in the period :		
PBO related	(222,949,962)	(144,596,532)
Plan assets related	36,355,000	38,635,000
Amortization of the period		
Regular	68,587,000	58,114,000
Curtailed related	2,835,000	4,759,000
Ending balance	(884,263,944)	(769,090,982)

Actuarial losses from 2004 are basically related with the change in the discount rate of pension liabilities from 6% to 5.75% and the increase in mortality tables.

- (ii) The transition obligation results from the first time recognition of post retirement benefits, in 1993. This amount will be amortized over the estimated average working life of active employees at that date, which was estimated to be 18 years. In 2004, the amortization of the transition obligation amounts to Euro 1,785,000.

The pension liabilities of PT Comunicações, PT SI and Global Notícias were recorded in the consolidated balance sheet as of December 31, 2004 and 2003, in the following captions:

	2004	2003
Accrued post retirement liability (Note 30.3)	712,529,856	730,837,776
Accounts payable other - Third parties (Note 14 and 30.3)	-	4,672,376
	712,529,856	735,510,152

A summary of the components of the net periodic pension cost for the years ended December 31, 2004 and 2003 is presented below:

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	2004	2003
Service cost	18,617,000	20,618,000
Interest cost	176,485,000	182,188,000
Expected return on plan assets	(111,127,000)	(98,369,000)
Net amortization of deferrals	5,205,969	60,516,000
Sub-total (Note 30.4)	89,180,969	164,953,000
Curtailment costs related to early retirements, pre-retirements and suspended contracts (Note 30.4)	153,315,800	268,032,000
Net periodic pension cost	242,496,769	432,985,000

Curtailment costs were recorded in the caption "Work Force Reduction Program Costs".

The contributions made to the pension funds and payments of salaries to pre-retired and suspended employees in the years ended December 31, 2004 and 2003 were as follows:

	2004	2003
Contributions to pension funds:		
Employers' contributions	125,737,000	153,461,330
Plan participants' contributions	10,991,000	11,032,603
	136,728,000	164,493,933
Payments of salaries to pre-retired and suspended employees (Note 30.3)	143,056,984	146,747,706

Employers' contributions include Euro 121.2 million (Note 30.3), which was recorded as a decrease in the accrued post retirement liability, and Euro 4.5 million which corresponds to the payment of an amount due to the pension funds at the end of 2003. Payments to pre-retired and suspended employees were recorded as a decrease in the accrued post retirement liability (Note 30.3).

As of December 31, 2004 the accrued post retirement liabilities relating to the defined benefit plans of the subsidiaries of Brasilcel amounted to Euro 1,265,772 (Note 30.3).

2. Other Employee Benefits

As referred to in Note 3.g), PT Comunicações and PT SI are liable for the payment of post retirement health care benefits to employees and their eligible relatives.

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The actuarial valuations for these plans prepared by an independent actuary, as of December 31, 2004, used the projected unit credit method and considered the following assumptions and rates:

Health care cost trend rate:	2004	2003
Next 6 years	3.50%	3.50%
Years thereafter	3.00%	3.00%
Discount rate	5.75%	6.00%
Inflation rate	3.00%	3.00%
Salary growth rate	2.00%	2.00%

Mortality table:

Employees (whilst in active service):	AM 92 - males	AM 92 - males
	AF 92 - females	AF 92 - females
Pensioners and employees who have	PA (90) m less 3	PA (90) m less

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taken early retirement:	years males	2 years males
	PA (90) f less	
	3	PA (90) f less
		2 years
Disability table: Swiss Reinsurance Company	years females	females
Turnover of employees: Nil		

Based on this study, the accumulated post retirement health care benefit obligation of PT Comunicações and PT SI as of December 31, 2004 and 2003 was Euro 701,797,100 and Euro 688,763,000, respectively. The reconciliation between the post retirement health care obligations and the liability recorded in the balance sheet at December 31, 2004 and 2003 is presented below:

	2004	2003
Accumulated health care benefit obligation	701,797,100	688,763,000
Actuarial losses, net (i)	(108,483,572)	(120,927,369)
Transition obligation (ii)	(40,669,000)	(46,273,802)
Prior year service gain	3,333,000	3,540,000
Post retirement health care liability	555,977,528	525,101,829

- (i) Actuarial losses, net result basically from the difference between the actual and expected healthcare costs and higher inflation rates than the long-term assumptions considered in the actuarial studies. These actuarial gains and losses will be amortized over 14 years, which corresponds to the estimated average working life of active employees. During 2004 and 2003 the movements in the caption Actuarial losses, net were as follows:

	2004	2003
Beginning balance	(120,927,369)	(112,772,283)
Actuarial gains/ (losses), net arising in the period :		
PBO related	8,772,797	(14,707,086)
Amortization of the period		
Regular	3,302,000	6,036,000
Curtailed related	369,000	516,000
Ending balance	(108,483,572)	(120,927,369)

- (ii) The transition obligation results from the first time recognition of other employee benefits, in 1997. This amount will be amortized over the estimated average working life of active employees at that date, which was estimated to be 18 years. The costs related with the amortization of the transition obligation were recorded in the caption Post retirement benefits (Euro 4,207,000) and in the caption Work force reduction program costs (Euro 1,399,000).

A summary of the components of the net periodic post retirement health care cost for the years ended December 31, 2004 and 2003, is presented below:

	2004	2003
Service cost	5,061,000	5,628,000
Interest cost	36,935,000	38,131,000
Net amortization of deferrals	7,335,000	10,649,000

Sub-total (Note 30.4)	49,331,000	54,408,000
Curtailment costs related to early retirements, pre-retirements and suspended contracts (Note 30.4)	11,120,100	27,363,000
Net periodic post retirement health care costs	60,451,100	81,771,000

Curtailment costs were recorded in the caption "Work Force Reduction Program Costs".

During 2004, the contribution made to PT-ACS, net of the contributions from the SNS (Note 3.g)), amounted to Euro 29,777,489 and were recorded as a reduction to the accrued post retirement liability (Note 30.3) .

As of December 31, 2004, the accrued post retirement health care liabilities include Euro 95,088 relating to healthcare liabilities of Brasilcel s subsidiaries (Note 30.3) .

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3. Balance sheet captions

Accrued Post Retirement Liability

This caption consists of:

	2004	2003
Accrued Post Retirement Liability:		
Pension benefits (Note 30.1)	713,795,628	730,872,244
Other employee benefits (Note 30.2)	556,072,616	525,166,751
	1,269,868,244	1,256,038,995
Accounts Payable (Note 30.1)	-	4,672,376
	1,269,868,244	1,260,711,371

The net increase in the accrued post retirement liabilities during the year of 2004 amounted to Euro 13,829,249, as follows:

	Pension benefits	Other employee benefits	Total
Post retirement benefits (Note 30.4)	89,180,969	49,331,000	138,511,969
Work force reduction program costs (Note 30.4)	156,719,526	11,120,100	167,839,626
Payments to pre-retired and suspended employees (Note 30.1)	(143,056,984)	-	(143,056,984)
Contributions to pension funds and PT ACS (Note 30.1)	(121,242,343)	(29,777,489)	(151,019,832)
Changes in consolidation	288,000	-	288,000
Currency translation adjustments	130	245	375
Other adjustments	1,034,086	232,009	1,266,095
	(17,076,616)	30,905,865	13,829,249

4. Profit and loss captions

	2004	2003
Net Periodic Pension Cost:		
Post retirement benefits:		

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Pension benefits (Notes 30.1 and 30.3)	89,180,969	168,493,045
Other employee benefits (Notes 30.2 and 30.3)	49,331,000	54,449,134
	138,511,969	222,942,179
Work force reduction program costs:		
Extraordinary post retirement benefits (curtailment):		
Pension benefits (Note 30.1)	153,315,800	268,032,000
Other employee benefits (Note 30.2)	11,120,100	27,363,000
	164,435,900	295,395,000
Additional cost related to 2004 curtailment (Note 30.3)	3,403,726	-
Termination payments	2,999,220	13,678,485
Additional cost related to 2002 curtailment	-	7,077,591
Decrease in provisions to restructuring	-	(2,066,374)
	170,838,846	314,084,702

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31. Financial instruments and risk management

Derivative financial instruments are basically used by the Company to manage interest rate and exchange rate exposure.

The contracting of financial instruments is made after careful analysis of the risks and rewards of these instruments based on information obtained from different financial institutions. These operations are subject to authorization from Portugal Telecom's Executive Committee and are permanently monitored through an analysis of the financial markets and the positions held by the Company. The fair-value of these derivatives is assessed several times during the year to determine the economic and financial implications of their cancellation.

Interest rate exposure

Interest rate swaps were contracted by Portugal Telecom in order to diversify interest rate exposure or to take advantage of the possibility of converting from variable rates to fixed rates. During 2004, certain financial instruments reached its maturity which, together with the anticipated cancellation of others, resulted in a reduction of the notional of interest rate swaps. As of December 31, 2004 the notional of these interest rate swaps amounted to approximately Euro 472 million with an average maturity of 6.8 years.

During 2004, VIVO contracted interest rate swaps in Brazilian Reais, which as of December 31, 2004 amounted to BRL1,601 million with an average maturity of 3 days.

Exchange rate and interest rate exposure

Cross currency swaps were contracted primarily to reduce exposure to exchange rate and interest rate risks. As of December 31, 2004 the Company had a cross currency swaps from U.S. Dollars to Euros, with a notional of approximately Euro 74 million and an average maturity of 6.8 years.

Pursuant the cancellation of the interest rate component of certain cross currency swaps, as of December 31, 2004 Portugal Telecom had contracted foreign exchange options and forwards of Euros to U.S. Dollars, with a notional of Euro 200 million and an average maturity of 4.3 years.

Additionally, Portugal Telecom had contracted forwards of Euros to U.S. Dollars in order to cover the risk associated to future cash flow payments. As of December 31, 2004, those contracts had a notional of Euro 12 million and had an average maturity of 6 months.

As of December 31, 2004 VIVO had cross currency swaps to cover accounts payable denominated in U.S. Dollars and Japanese Yens (JPY) with a notional of USD 878 million and JPY 6,827 million and an average maturity of 1.2 years and 8 months, respectively.

As of December 31, 2004 VIVO had also contracted: (i) other cross currency swaps (U.S. Dollars/Brazilian Reais) with a notional of USD 418 million and an average maturity of 1.4 years; and (ii) cross currency swaps (Euros/Brazilian Reais) with a notional of Euro 25 million and an average maturity of 2 months.

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Equity derivatives

As of 31 December 2004 Portugal Telecom had contracted the following equity derivatives:

- (a) Own shares
In order to facilitate the completion of the share buyback program, Portugal Telecom contracted to ABN Amro and Citibank equity swaps over 21,551,006 own shares, representing 1.72% of the share capital prior to the cancellation in December 2004 of the 7% treasury shares held. Considering the difference between the exercise price of those derivatives (ranging from Euro 7.14 to Euro 8.99 per share) and PT's stock price at 31 December 2004, Portugal Telecom did not record any provision to cover estimated losses with these equity swaps. These contracts had maturities ranging from 2 to 12 months.
- (b) PT Multimedia shares
In order to increase its exposure to PT Multimedia, Portugal Telecom contracted with Santander Group equity swaps over 15,287,545 PT Multimedia shares, representing 9.7% of its share capital, as follows:
- (i) 9,187,545 shares, with an exercise price of Euro 17.74 and a maturity of 17 months; and
 - (ii) 6,100,000 shares, with an exercise price of Euro 14.10 and a maturity of 5 months.

Additionally, during 2004 Portugal Telecom contracted with Banco Espírito Santo Group equity derivatives which consist of options to acquire shares of PT Multimedia, representing 5% of its share capital. These options are as follows:

- (i) Portugal Telecom acquired from Banco Espírito Santo de Investimento, S.A. (BESI) a call option over 6.063 million shares of PT Multimedia shares with a strike price of Euro 26.513 at maturity (31 December 2005). Portugal Telecom can exercise this option at any time and BESI can choose between physical or financial settlement (the latter has a 15% discount over the strike price). At the same time, BESI acquired from Portugal Telecom a call option over the same number of shares of PT Multimedia with a strike price of Euro 16, which only offers the possibility of financial settlement. This call option can only be exercised if the stock price of PT Multimedia is above the strike of the call option acquired by Portugal Telecom, being the exercise of the option automatic in the case that Portugal Telecom exercises its call option.
- (ii) Portugal Telecom receives from Banco Espírito Santo a call option over 1.5 million PT Multimedia shares with a strike of Euro 23 at maturity (31 December 2005). Portugal Telecom can exercise this option at any time and Banco Espírito Santo can choose between physical or financial settlement (the latter has a 20% discount on the strike price).

As a result of these contracts, Portugal Telecom will receive from BESI an aggregate premium of Euro 16.657 million, corresponding to the difference between the acquisition prices of the options referred above, with 50% of this amount payable in 31 December 2004 and the remaining 50% on the exercise date of the option acquired by BESI or, if that option is not exercised, in 31 December 2005. This premium can only be claimed if BESI receives a premium in connection to any options contracted with these third parties to hedge BESI's position regarding the

call options acquired and sold to PT over 6.063 million shares of PT Multimedia as referred above. In addition, BESI must clearly demonstrate to Portugal Telecom that these hedging options were contracted with third parties and that there was a default event on the payment of the corresponding premium. Given that BESI will celebrate with third parties an option contract that would permit it to obtain the hedging of the position assumed on the contract referred above, Portugal Telecom and BESI agreed that the latter has the right to reduce the options included in the contract to 3.469 million shares, with the proportional decreases in prices and fees, if those entities do not comply with its contractual obligations. However, BESI committed to develop all efforts to guarantee that those entities will assume its obligations. The amount payable at the end of 2004, amounting to Euro 8,328,285 was recorded under the caption Deferred income (Note 17).

Fair value of financial instruments

As of December 31, 2004 and 2003 the carrying value and fair value of financial instruments are as follows (amounts in millions of Euros):

	2004		2003		2002	
	Carrying Value	Fair Value	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial instruments to manage the risks of:						
Interest rate (Note 3.p))	1.3	(22.0)	(8.5)	(61.9)	1.1	(66.2)
Interest rate and exchange rate (Note 3.p))	(67.7)	(63.5)	80.5	99.5	162.0	75.5
Total	(66.4)	(85.5)	72.0	37.6	163.1	9.3
Equity Swaps:						
Own shares	(0.6)	6.0	(24.4)	3.4	(42.6)	(40.2)
PT Multimédia shares	(1.4)	43.8	(3.9)	15.5	(68.5)	(69.1)
Total	(2.0)	49.8	(28.3)	18.9	(111.1)	(109.3)