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

Washington, D.C. 20549

FORM 6-K

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

Securities Exchange Act of 1934

For the month of March 2012

Commission File Number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of registrant as specified in its charter)

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

(Address of principal executive office)

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

Form 20-F x Form 40-F o

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

Yes o No x

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Portugal Telecom

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

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Telecommunications in Portugal

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

Telecommunications in Brazil(1)

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

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

Other telecommunications businesses

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

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

Other businesses

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

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

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

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01 Macroeconomic environment

1. International economic background

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

Source: World Economic Outlook,IMF, September 2011

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

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

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Source: Bloomberg

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

Source: Bloomberg

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Source: Bloomberg

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

Source: Bloomberg

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Source: Bloomberg

1.1. United States

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

Source: Bloomberg

Annual inflation ended the year at 3.0%, up from 1.5% in 2010 and above the 2% target set by the US monetary authority, but with a clearly downward trend in the last quarter of 2011. In this context, the Federal Reserve (FED)

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

Source: Bloomberg

1.2. Economic and monetary union Eurozone

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

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Source: World Economic Outlook,IMF, September 2011

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

Source: Bloomberg

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

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

Source: Bloomberg

2. Economic activity in PT s main geographies

2.1. Portugal

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

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

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

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

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

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

Source: Ministry of Finance

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

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

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

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

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

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

2.2. Brazil

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

Source: World Economic Outlook,IMF

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Source: Bloomberg

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

Source: Bloomberg

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

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Source: Bloomberg

2.3. Africa

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

2.3.1. Angola

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

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

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(4) IMF estimate 24 January 2012

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Source: World Economic Outlook,IMF

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

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

Source: Bloomberg

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2.3.2. Namibia

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

Source: World Economic Outlook,IMF

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

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

2.3.3. Cape Verde

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

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

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

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

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

Source: World Economic Outlook,IMF

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

2.3.3. São Tomé & Príncipe

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

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Source: World Economic Outlook,IMF

2.4. Other geographies

2.4.1. East Timor (Timor-Leste)

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

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

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

Source: World Economic Outlook,IMF

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02 Regulatory background

Portugal

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Law No. 51/2011, of September 13.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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03 Strategic profile

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

Global telecommunications sector

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

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

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

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

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

Source: Screen Digest; Yankee

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695 thousand status updates per second in Facebook

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

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

2.9 million e-mails sent per second

Source: Powering growth through digital advantage , McKinsey & Company

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

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

Telecommunications context in Portugal

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

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

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

PT s positioning: a customer-oriented innovative company

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

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

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

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

Portuguese operations

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

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

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

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

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

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

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

International operations

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

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

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

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

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Focus on innovation and execution

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

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

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

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

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

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04 Research and development

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

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

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

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

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

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

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

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

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

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

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

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

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

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

A. Incremental innovation

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

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

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

- **Portal Idade Maior:** development of a SAPO web portal with dedicated contents and services for the senior segment (more than 700 registered users and around 650 thousand visitors);

- **Rationalization of packaging material:** reduction in the volume of material used in the packaging of PT products, such as mobile broadband and mobile phones, for instance through the use of resistant recyclable material. This initiative has already generated savings of over 2 million Euros;

- **Efficient gardens:** use of decorative pebbles in several company gardens which enabled annual savings of 100 thousand euros, by reducing water consumption and maintenance costs. Additionally, the reutilization of rain water and water used in bathrooms for irrigation systems allowed the company to save more than 5 thousand euros per year;

- **Efficient lighting in buildings:** switch off of corridor lights in every main building, during weekends and bank holidays. This measure translated into annual savings of 50 thousand Euros;

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

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B. Planned innovation

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

1. Products and Services

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

a. New MEO services

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

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

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

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

b. Multi-platform services

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

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

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

c. New mobile solutions

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

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

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

d. B2B offering

IT/IS services and solutions

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

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

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

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Sector-specific solutions

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

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

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

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

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

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

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

Machine-to-Machine

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

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2. Technological Infrastructure

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

a. Network Infrastructure

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

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

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

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

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

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

b. Data Centres

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

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

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

3. Operational Efficiency

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

- **SAP RMCA Project:** consolidation and development of an integrated collections management system for every company of the Group;
- **CRM Project:** single CRM solution for all the companies of the Group based in Portugal (PTC, PT Prime and TMN), enabling improvements in the quality of service provided, in the relationships established with customers, in the focus of commercial efforts and in the capabilities of the sales force (cross-selling, acquisition and retention of customers);
- **SIT-E Project:** evolution of the order entry software that supports B2B services to a new platform, with impact in terms of time-to-market of new products and services, ensuring a better record of business products and services;
- **Selfcare Global and PT Client Projects:** convergence of the several self-care portals of the different customer segments in a unique, multiplatform interface, where customers can access and manage, in an integrated manner, the entire portfolio of PT services;
- **Order Management:** this system increases the flexibility in the provisioning of services, supporting the operational departments.

4. Environmental sustainability

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

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

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

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

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

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

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

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

C. Exploratory Innovation

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

1. Exploratory Innovation driven by internal units

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

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

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

a. PT Inovação

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

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

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

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

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

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

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

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

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

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

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

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

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

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

b. SAPO

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

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

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2. R&D Ecosystem of Partnerships

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

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

a. Technological Partnerships

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

b. Partnerships with Telecom Operators

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

c. Partnerships with Universities

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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d. Partnerships with Research Institutions

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

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

3. Innovation in International Operations

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

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

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

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

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

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

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

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

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

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

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05 Financial Review

Consolidated income statement

Consolidated income statement (1) **Euro million**

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

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

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Consolidated operating revenues

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

EBITDA

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

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

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

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

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

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

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

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

Net Income

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

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

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

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

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

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

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

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

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

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

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

Capex

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

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

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

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

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

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

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

Cash Flow

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

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

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

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

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

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

Consolidated Net Debt

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

Change in net debt **Euro million**

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

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

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

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

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

Post Retirement Benefits Obligations

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

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

Post retirement benefits obligations **Euro million**

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

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

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

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

Change in gross unfunded obligations **Euro million**

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

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

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

Equity

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

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

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

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

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

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

Strategic Investment in Oi

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

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

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

Consolidated Statement of Financial Position

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

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

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

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

Consolidated statement of financial position **Euro million**

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

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06 Business performance

Portuguese Telecommunication Businesses

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

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

Portuguese operating data

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

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

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

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

Residential

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

Residential operating data

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

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

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

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

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

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

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

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

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Personal

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

Personal operating data

	2011	2010	y.o.y
Mobile Customers (000)	5,932	5,963	(0.5)%
Postpaid	1,064	1,021	4.1%
Prepaid	4,868	4,942	(1.5)%
Net additions (000)	(31)	157	(119.6)%
Postpaid	42	62	(31.7)%
Prepaid	(73)	96	(176.6)%
MOU (minutes)	89	84	5.3%
ARPU (Euro)	9.7	11.0	(11.6)%
Customer	8.7	9.6	(8.9)%
Interconnection	1.0	1.4	(30.4)%
SARC (Euro)	27.8	29.0	(3.9)%
Data as % of service revenues (%)	30.9	29.1	1.7pp

PT s strategy for the Personal customer segment is anchored on mobile data offers based on high quality network offering best in class coverage and high capacity to meet customer demand for increasingly higher bandwidth and provide the best quality of service in the market. TMN s commercial offers include: (1) voice and data tariff plans designed to integrate seamlessly unlimited voice and data plans targeted at the high value postpaid segments and, in the prepaid segment, to prevent migration to the low value tariff plans by offering additional voice and data services; (2) distinctive smartphone offering leveraging on a comprehensive portfolio of circa 30 smartphones, including exclusive handsets, and on innovative value added and convergent services to use on-the-go (mobile TV, music on demand, social network aggregator, etc), and (3) mobile broadband competitive offers of up to 100Mbps speed, on 4G, and offering free access to PT s leading national WiFi nework.

In 2011, TMN accomplished significant progress in its new commercial offer. These include the launch of the e nunca mais acaba and of the unlimited tariff plans, which are targeted at upselling mobile Internet, leveraging on an increased popularity of smartphones, and promoting usage of voice and value added services. In particular, the e nunca mais acaba tariff plan continued to show solid growth having reached 755 thousand customers by the end of 2011, including all segments. This reflects a clear success only 11 months after the commercial launch. TMN also introduced changes in the roaming tariff structures. In August, TMN launched two new daily tariff plans for internet no telemóvel , TMN s internet offering for smartphones, aimed at increasing the number of customers that use mobile internet while in roaming. Additionally, TMN launched convergent offers aimed at reducing churn. These offers include Pontos TMN a dobrar , which doubles the benefits (air miles) attributed to those customers who are simultaneously customers of TMN and Meo. Finally, TMN launched a new offering in March targeted at the kids segment, which is positioned upon the concept of security and cost control thus addressing the main concerns of parents in choosing the first mobile phone for their children. This offer became available with the

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launch of a new tariff plan with free calls and sms to parents and with an authorised contact list for a monthly fee of Euro 5. As a result TMN is clearly improving its market share in this segment.

On March 2012 PT unveiled its 4G strategy, by launching a mobile broadband offer that structurally changes the market as it: (1) allows speeds of up to 100Mbps; (2) includes access to live TV channels, through Meo Mobile, and to music streaming service, through MusicBox, and (3) allows to share the traffic among various devices, including the PC, through a wireless dongle, the tablet and the smartphone. As from launch, PT s 4G service is available to 20% of the Portuguese population. This coverage will be enlarged to 80% of the population by April, when the 800MHz spectrum will be made available, and will be increased further to 90% by the end of 2012. PT will market its 4G mobile broadband services through the TMN 4G and Meo 4G brands, aiming at leveraging on the various attributes and strengths of each brand. The commercial offers will have speeds from 50Mbps to 100Mbps and monthly retail prices that start at Euro 49.99 and include the MusicBox service for free. TMN 4G or Meo 4G customers that are also Meo customers will have free access to 50 live TV channels through the Meo Go service for free. Otherwise the Meo Go service will have a retail price of Euro 7.99 per month. Also in March 2012, as part of a strategic focus on innovation, TMN announced a new mobile payment service, branded TMN Wallet , which allows customers to pay small purchases through one of the following means: (1) SMS; (2) USSD; (3) NFC Near Field Communication, and (4) QR code. This service is available for all types of mobile phones, including smartphones, and is currently under a trial period.

Following improvements throughout the year until September 2011, Personal revenue trends stabilised in 4Q11 impacted by economic conditions, including lower available income against a backdrop of reductions in the wages and salaries of the civil servants and pensioners, which also is being translated to lower consumer confidence. Customer revenues declined by 8.2% y.o.y to Euro 618 million in 2011 (-7.7% y.o.y in 4Q11, -6.8% y.o.y in 3Q11, -8.9% y.o.y in 2Q11 and -9.4% y.o.y in 1Q11) penalised by revenues derived from mobile broadband services against a backdrop of high popularity of fixed broadband. It is worth highlighting the growth of internetnotelemóvel revenues, particularly in prepaid services, and the sequential improvements in voice revenues. Service revenues in the Personal customer segment declined by 10.9% in 2011, as a result of the decline in interconnection revenues (-29.9% y.o.y to Euro 68 million in 2011), which reflect the regulated declines in MTRs. ARPU of the personal segment stood at Euro 9.7 (-11.6% y.o.y). The weight of non-voice revenues in service revenues stood at 30.9% in 2011 (+1.7pp y.o.y).

Enterprise

The Enterprise customer segment includes mobile and fixed, voice and data and IT convergent and integrated offers provided to large corporates and to small and medium size businesses. In this customer segment PT aims at growing its revenue base beyond connectivity by seizing the ICT opportunity on the back of cutting-edge solutions for companies and future-proof data centre investments to meet demand for high bandwidth services and virtualisation.

The value proposition for corporate customers is anchored on the following pillars: (1) maximise value from traditional telecommunication services by upselling additional services, including fixed-mobile convergence on FTTH to push for VPN, LAN management and video services; (2) IT transformation accelerated by cloud computing, where PT aims at leveraging on partnerships with key suppliers to enable business process transformation and significant cost reductions to the enterprise customers; (3) leverage on specialisation to seize gains from scale, including focus on outsourcing and BPO to improve productivity, and (4) introduce a business consulting approach in order to extend the services provided to corporations to video, multiscreen and highly differentiated convergent

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services. As a result of this focus, the weight of non-connectivity services, including IT/IS and outsourcing, increased by 5.8pp over the triennium already representing 19.6% in 2011, and the weight of non-voice services increased by 12.8pp to 67.9% over the same period.

In the SME customer segment, PT aims at integrating its service offerings, including bundling fixed and mobile and voice and data offers with access to subsidised equipment (PCs, PBX, smartphones and tablets), while at the same time making available vertical solutions to specific sectors (ex: restaurants and coffee-shops, retail, healthcare). In the SME segment, the main strategic priority during 2011 was to increase the commercial proactivity focusing on the growth of core products. As a result, average weekly commercial activity, including proactive contacts and effective proposals, were up by 82% between the first quarter and the end of 2011. In addition, PT also continued to pay significant attention to quality of service. Within this context, it should be underlined that the general customer satisfaction index reflected important improvements in 2011, having increased by 13% between 3Q10 and 3Q11 to a rating of 78%.

During 2011, PT also continued to invest significantly on its cloud computing offering both for corporates and SMEs, making now available structured offers, branded SmartcloudPT, that include infrastructure as a service (IaaS), platform as a service (PaaS) and software as a service (SaaS).

Enterprise operating data

	2011	**2010**	**y.o.y**
Fixed retail accesses (000)	1,087	1,117	(2.6)%
PSTN/ISDN	826	873	(5.3)%
Broadband customers	193	190	1.2%
Pay-TV customers	68	54	26.7%
Retail RGU per access) (2)	1.32	1.28	2.8%
Mobile Customers (000)	1,445	1,390	4.0%
Net additions (000)			
Fixed retail accesses	(30)	(23)	(28.3)%
PSTN/ISDN	(46)	(45)	(2.9)%
Broadband customers	2	8	(71.2)%
Pay-TV customers	14	14	4.5%
Mobile Customers	56	16	250.1%
ARPU (Euro)	25.8	28.7	(10.0)%
Non-voice revenues as % of revenues (%)	46.4	43.5	3.0pp

In 2011, revenues from Enterprise customer segment declined by 9.0% to Euro 982 million, showing a marked sequential improvement throughout the year. In effect, operating revenues declined by 6.6% y.o.y in 4Q11, which compares to -9.0% y.o.y in 3Q11, -10.4% y.o.y in 2Q11 and -10.1% y.o.y in 1Q11. In 2011, non-voice services weighted 46.4% in retail revenues, up by 3.0pp y.o.y.

Consolidated financial performance in Portugal

In 2011, revenues from portuguese telecommunication businesses declined by 7.4% y.o.y to Euro 2,892 million. This performance reflected, as discussed previously, the revenue decline at the Personal and Enterprise customer segments (Euro 97 million in each of those segments), against challenging economic conditions, and lower revenues from the directories business (Euro 20 million), that more than compensated the 5.4% y.o.y increase in the Residential customer segment.

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In 2011, revenues in Portugal were also penalised by adverse regulation movements, including lower MTRs (Euro 34 million), roaming (Euro 2 million) and other (Euro 3 million). Excluding regulation effects, revenues would have decreased by 6.2% y.o.y in 2011 and by 5.6% y.o.y in 4Q11.

Against revenue pressure in the Portuguese telecommunication businesses, the measures implemented to control costs and the transformation initiatives that are taking place are allowing PT to reduce costs and stabilise margins.

Portuguese telecommunication operations income statement (1) **Euro million**

	2011	2010	y.o.y
Operating revenues	**2,892.0**	**3,124.5**	**(7.4)%**
Residential	682.3	647.0	5.4%
Service revenues	670.2	635.9	5.4%
Sales and other revenues	12.0	11.1	8.5%
Personal	768.4	865.0	(11.2)%
Service revenues	685.4	769.2	(10.9)%
Customer revenues	617.7	672.6	(8.2)%
Interconnection revenues	67.7	96.6	(29.9)%
Sales and other	83.0	95.9	(13.4)%
Enterprise	982.1	1,079.6	(9.0)%
Wholesale, other and eliminations	459.2	532.8	(13.8)%
Operating costs	**1,586.5**	**1,746.9**	**(9.2)%**
Wages and salaries	252.5	275.0	(8.2)%
Direct costs	480.3	535.1	(10.2)%
Commercial costs	318.3	345.0	(7.7)%
Other operating costs	535.4	591.8	(9.5)%
EBITDA (2)	**1,305.5**	**1,377.6**	**(5.2)%**
Post retirement benefits	53.9	38.1	41.3%
Depreciation and amortisation	703.2	681.6	3.2%
Income from operations (3)	**548.4**	**657.8**	**(16.6)%**
EBITDA margin	45.1%	44.1%	1.1pp
Capex (4)	647.0	657.2	(1.6)%
Capex as % of revenues	22.4%	21.0%	1.3pp
EBITDA minus Capex	658.5	720.4	(8.6)%

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(1) Operations in Portugal include former wireline and TMN. **(2)** EBITDA = income from operations + post retirement benefits + depreciation and amortisation. **(3)** Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs. **(4)** Capex does not include Euro 136 million in 2011 and Euro 133 million in 4Q11, respectively, related primarily to the recognition of the LTE and DTT licenses, while in 4Q10 excludes the acquisition of real estate from the pension funds (Euro 236 million).

In 2011, operating costs excluding D&A declined by 9.2% y.o.y (Euro 160 million) to Euro 1,586 million against a backdrop of intense commercial activity. Wages and salaries declined by 8.2% y.o.y (Euro 23 million) to Euro 252 million, as a result of the focus on cost cutting, including: (1) lower variable and overtime remunerations; (2) higher efficiency levels in certain internal processes, and (3) lower personnel costs as a result of the restructuring plan implemented in 4Q10. Direct costs were down by 10.2% y.o.y in 2011 (Euro 55 million) to Euro 480 million, reflecting: (1) lower traffic costs at TMN, following the impact of the regulatory MTR cuts and lower roaming interconnection costs; (2) lower costs associated with the directories business, and (3) lower costs associated with the provision of LAN services to schools. In 2011, programming costs increased by 3.7% y.o.y to Euro 120 million, while programming costs per customer declined by 21.0% y.o.y. Commercial costs were down by 7.7% y.o.y in 2011 (Euro 27 million) to Euro 318 million, reflecting the racionalisation of TMN s handset portfolio and lower equipment sales which are driving down cost of goods sold in mobile business, which more than compensated higher commissions on the back of higher commercial activity, namely in 2H11. Other operating expenses decreased by

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9.5% y.o.y in 2011 to Euro 535 milion, despite higher support services and provisions, that where compensated by lower maintenance and repairs, following the rollout of PT s FTTH network. Structural costs benefits of the FTTH network and the extensive field force transformation programme are now visible with improved quality of service and lower cost structure. Additionally, cost initiatives such as renegotiation of collection fees and car pooling for sales force and field force are already delivering visible results. In 2011 EBITDA in Portugal stood at Euro 1,306 million (-5.2% y.o.y). EBITDA margin stood at 45.1% in 2011 (+1.1pp y.o.y), reflecting a very solid focus on cost cutting and profitability.

Capex in 2011 was down by 1.6% y.o.y to Euro 647 million. In 2011 customer related capex stood at Euro 185 million (-16.6% y.o.y), representing 29% of total capex in Portugal, as a result of lower unitary equipment costs and innovation, namely the roll out of the RF overlay that is bringing down the number of set-top-boxes per customer and a higher level of refurbished equipments that are reinstalled in new customers. Infrastructure capex was up by 9% y.o.y to Euro 359 million as a result of: (1) investment in new technologies, including the FTTH rollout related to the increase of fibre customers penetration; (2) increased coverage of TMN s base stations with fibre, and (3) the swap of TMN s 2G network to 4G enabled equipment. EBITDA minus capex in 2011 stood at Euro 659 million. Going forward, and particularly in 2012, PT s Portuguese telecommunication businesses capex will tend do decline double digit as PT s FTTH rollout will be concluded and notwithstanding the full rollout of PT s LTE networks in 2012.

International Businesses

Oi

In this section, Oi s financial and operational information is presented for the 12 months ended on 31 December 2011. PT acquired its 25.6% stake in Oi on 28 March 2011, therefore PT s financial statements for the year 2011 only proportionally consolidate Oi s results as from 1 April 2011. Following the conclusion of Oi s capital restructuring on 27 February 2012 and for comparative purposes, Oi s revenues are presented on a pro-forma basis, as prepared by Oi, as if the new Oi S.A. would had consolidated Telemar Norte Leste S.A. and Tele Norte Leste S.A. as from 1 January 2011.

Oi operating data

	2011	2010	y.o.y
Residential			
RGU (000)	17,796	18,277	(2.6)%
ARPU (R$) (4Q11)	64.8	67.5	(4.0)%
Personal Mobility			
RGUs (000)	43,264	37,757	14.6%
Postpaid customers	3,127	3,248	(3.7)%
Prepaid customers	37,978	32,605	16.5%
Oi controle	2,158	1,905	13.3%
Monthly churn (%) (4Q11)	3.0%	2.8%	0.2pp
ARPU (R$) (4Q11)	22.3	23.5	(5.1)%
Enterprises			
RGUs (000)	7,848	7,094	10.6%
Other			

TUP (000)	771	827	(6.8)%
RGUs (000)	**69,680**	**63,956**	**8.9%**

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In 2011, Oi s revenue generating units (RGUs) stood at 69,680 thousand, up by 8.9% y.o.y, including: 17,796 thousand residential RGUs (-2.6% y.o.y), 43,264 thousand personal mobile customers, which grew by 14.6% y.o.y and 7,848 thousand enterprises RGUs, up by 10.6% y.o.y.

Oi presented an improved performance in the trend of line loss, namely in 4Q11, the best performance since 2Q10. This performance was achieved on the back of the restructuring of fixed tariff plans in 2H11. These plans stimulate the use of fixed line by expanding its benefits including: (1) free minutes for local fixed calls; (2) free minutes for national long distance fixed calls using Oi s long distance codes; (3) free minutes for local calls to Oi Mobile, and (4) digital calling services. Oi continues to provide atractive commercial conditions for existing and new customers to subscribe to Oi Velox , aiming at strengthening customer loyalty and increasing penetration of its services in its customer base. Oi continued to invest in the quality of its fixed broadband service, which offers speeds of up to 20Mbps for prices starting at R$39.90 per month. Oi also increased the speeds it provides to customers, in order to differentiate and strengthen its offering. As a result, the average fixed broadband speed stood at 2.5Mbps in 4Q11, which compares to 2.33Mbps at the end of 3Q11, 2.13Mbps in June 2011 and 1.91Mbps in March 2011. Additionally, by the end of the year, 24% of Oi Velox customer base had services with speeds of more than 5Mbps, of which 47% had speeds higher than 10Mbps. Moreover, Oi launched a new offer convergent offer Oi Conta Total , in the Christmas period, with competitive prices and including mobile broadband and Velox 3G , that contributed to a 14% increase in sales in December. In November 2011, Oi launched Oi Internet Total , a broadband service, which allows internet access with more mobility, at home with Oi Velox or outside with 3G or wi-fi networks. In September 2011, Oi initiated a partnership with the Government for the implementation of Plano Nacional de Banda Larga), aiming at increasing the penetration of broadband in Brazil. During 2011, Oi expanded coverage reaching 450 cities covered by the end of the year. Oi intends to cover 4,800 cities until 2014. During 2011, Oi focused on strengthening Oi TV, by launching new offers and implementing operational improvements. In October 2011, Oi launched 21 new offers aimed at increasing the penetration of TV plans with premium movies channels, namely Telecine and HBO. In 4Q11, Oi launched its new service in Rio de Janeiro including GloboSat and TV Globo channels. TV Globo channel was also included in 189 municipalities in 5 different states. During 4Q11, Oi TV expanded its offer to an additional 19 cities, covering 24 states by the end of 2011. In the residential segment, in 2011, unique residential customers stood at 13,064 thousand.

Oi s mobile customers stood at 45,506 thousand (+15.8% y.o.y), with net additions of 6,204 thousand in 2011. Gross additions in 2011 stood at 24.7 million, while in 4Q11 stood at 6.5 million, a solid pace that represents the best performance since 2008. The increase in churn level in the period is primarily explained by the decision to adopt a more restrictive policy relative to inactive customers in the customer base, particularly in the prepaid segment, aiming at minimising regulatory fees and improving Oi s profitability. In the Personal segment Oi s mobile customers stood at 43,264 (+14.6% y.o.y) with net additions of 5,506 thousand in 2011. During 4Q11, in the postpaid segment, Oi has launched several initiatives aimed at increasing customer growth, such as: (1) offer simplification process; (2) distribution channels reestructuring, and (3) price repositioning. As a result, 42% of net additions in 2011 were achieved in 4Q11. During 4Q11, as a complement to the new offers launched during 3Q11, Oi Dados e Oi Velox 3G , Oi launched a new offer that allows free access to Oi s wi-fi network and to Vex, the largest Brazilian wi-fi network aquired by Oi, and also 2 months of free traial of Oi Radio. During 2011, in the prepaid segment, Oi continued to market the new offers launched in the end of 2010, that allow daily bonuses, which are dependent on the amount of the recharges, that may be used for on-net and off-net SMS, local calls to fixed lines and Oi Mobile and long distance calls using Oi s long distance codes to Oi fixed and mobile customers. In 4Q11, as a complement to these new offers, Oi launched SMS packages, allowing customers to send on-net and off-net messages with up to 88% discount. To increase mobile internet access in the handset in the prepaid segment, Oi launched 3 new data packages: (1) a daily offer, with 5MB at R$0.50; (2) a weekly offer, with 20MB, at R$2.99, and (3)

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a montlhy offer, with 50MB at R$9.99. During 2011, Oi has been increasing its minimum recharge in certain regions, aiming at improving profitability, while at the same time offering improved bonuses to maintain the attractiveness of commercial offers. As a result of these initiatives and stronger commercial competitiveness, Oi s personal mobile customer base grew 14.6% y.o.y. Prepaid customers stood at 37,978 thousand, representing 87.8% of Oi s mobile customer base, while postpaid customers stood at 3,127 thousand in 2011and Oi Controle customers grew by 13.3% to 2,158 thousand customers.

Anticipating the growth opportunity in the corporate segment, against a favourable economic backdrop, Oi established a new business area focused in this segment. In February 2012, Oi launched Smart Cloud Oi , becoming the first operator in Brazil to launch a cloud computing offer for the corporate segment. This new service offers customised infrastructure and storage capacity and access to state-of-the-art data centres. It also makes available end-to-end solutions, including data networks, ensuring high performance and data security. Oi s enterprises customers stood at 7,848 thousand in 2011, increasing by 10.6% y.o.y.

During 2011, Oi launched several initiatives to improve operational performance and increase customer loyalty: (1) in December 2011, Oi opened 60 new own stores, aiming at strengthening its distribution channels; (2) Oi has also created new regional commercial structures to improve its commercial flexibility and effectiveness, and (3) has initiated smarphone subsidisation for postpaid mobile customers.

In 2011, Oi s pro-forma consolidated net revenues, as prepared by Oi, declined by 5.3% y.o.y to R$ 27,907 million.

Oi consolidated revenues **R$ million, 100%**

	2011	2010	y.o.y
Residential	**10,501**	**11,949**	**(12.1)%**
Personal Mobility	**8,190**	**8,021**	**2.1%**
Services	8,154	7,917	3.0%
Voice	5,137	4,958	3.6%
Network Usage	2,398	2,305	4.0%
Data / Value Added	620	654	(5.3)%
Sales of handsets, sim cards and others	36	104	(65.0)%
Enterprises	**8,470**	**8,620**	**(1.7)%**
Other services	**746**	**890**	**(16.2)%**
Pro-forma consolidated net revenues	**27,907**	**29,479**	**(5.3)%**

Oi s residential revenues declined by 12.1% y.o.y to R$ 10,501 million. Residential revenue performance is mainly explained by lower fixed voice revenues, due to lower flat fee and local traffic revenues, on the back of declining fixed lines in service. The decline of fixed voice revenues more than compensated an increase of broadband and pay-TV revenues, due to an increase of Oi Velox and Oi TV customers.

Oi s personal mobility revenues stood at R$ 8,190 million, having increased by 2.1% y.o.y on the back of higher revenues from outgoing calls, network usage and subsbscriptions. This revenue performance is primarily due to: (1) increased traffic revenues (+9.1% y.o.y) on the back of customer growth, namely prepaid customers, and (2) network usage, which increased by 4.0% y.o.y, due to higher mobile traffic, primarily following the inclusion of free SMS in bundled offers. In 2011, data and value added revenues represented 7.6% of personal mobility service revenues.

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Oi income statement **R$ million, 100%**

	2011	2010	y.o.y
Pro-forma consolidated net revenues	**27,907**	**29,479**	**(5.3)%**
Operating costs	**19,141**	**19,184**	**(0.2)%**
Interconnection	4,651	5,070	(8.3)%
Personnel	1,884	1,620	16.3%
Materials	191	215	(11.1)%
Cost of goods sold	232	149	55.6%
Third-Party Services	7,607	6,976	9.1%
Marketing	559	537	4.1%
Rent and Insurance	1,658	1,523	8.8%
Provision for Bad Debts	826	979	(15.6)%
Other Operating Expenses (Revenue), Net	1,532	2,114	(27.5)%
EBITDA (1)	**8,766**	**10,295**	**(14.8)%**
EBITDA margin	31.4%	34.9%	(3.5)pp

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

EBITDA, as reported by Oi, amounted to R$ 8,766 million (-14.8% y.o.y), with a margin of 31.4% . EBITDA performance reflected primarily lower residential revenues. In 2011, operating costs remained broadly flat at R$19,141 million, while in 4Q11 increased by 1.9% y.o.y, reflecting the increase in sales and the improvement in service quality. In 2011, operating costs performance was mainly driven by: (1) lower interconnection costs (-8.3% y.o.y), as a result of higher proportion of on-net traffic, as well as increased weight of SMS in total off-net usage; (2) lower provisions for bad debt (-15.6% y.o.y), due to higher collection eficiency, namely in wireline business; and notwithstanding the increase in: (1) higher personnel costs (+16.3% y.o.y), as a result of increased staff levels, namely 700 new employees for 60 new own stores to revamp commercial positioning and the organisational reorganisation, including new regional commercial structures, as part of the strategy to improve regional operational performance as referred to above; (2) third-party services (+9.1% y.o.y), mostly due to higher maintenance costs, aimed at improving service quality, higher commissions, focused on the postpaid mobile segment as well as on Oi Conta Total and fixed broadband and higher consulting and legal advice costs; (3) cost of goods (+55.6% y.o.y), as a result of the decision to implement subsidisation on the modem of Oi Velox and smartphones for postpaid customers, coupled with higher sim cards sold.

The Board of Directors of Oi has proposed the distribution of a R$2.0 billion dividend. This amount relates to the net income generated in 2011 and an additional amount from the reserves. This proposal is subject to approval at the annual general meeting.

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Other international assets

In 2011, other international assets, on a pro-forma basis, increased their proportional revenues by 15.3% y.o.y to Euro 446 million and increased EBITDA by 7.7% y.o.y to Euro 216 million, as a result of a solid operational and financial performance by the majority of PT s international assets and notwithstanding a high level of penetration in some markets and foreign exchange negative impacts.

Proportional income statement of other international assets (1) **Euro million**

	2011	2010	y.o.y
Operating revenues	**445.7**	**386.7**	**15.3%**
EBITDA (2)	**215.6**	**200.2**	**7.7%**
Depreciation and amortisation	47.5	41.4	14.6%
Income from operations (3)	**168.1**	**158.8**	**5.9%**
EBITDA margin	48.4%	51.8%	(3.4)pp

(1) Pro-forma consolidation of other international assets using the percentage of ownership held by PT. **(2)** EBITDA = income from operations + depreciation and amortisation. **(3)** Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs.

Highlights of main assets in Africa and Asia (2011) (1) **Million (financials)**

	Stake	Rev. local	y.o.y	EBITDA local	y.o.y	Margin	Rev. Eur	EBITDA Eur
Unitel, Angola (2) (4)	25.00%	1,784	18.8%	1,004	16.1%	56.3%	1,282	721
MTC, Namibia (3) (4)	34.00%	1,608	11.4%	804	4.6%	50.0%	159	80
CVT, Cape Verde (3) (4)	40.00%	9,224	(0.4)%	4,342	2.3%	47.1%	84	39
CST, S.Tomé & Principe(3) (4)	51.00%	292,561	(5.8)%	70,615	(4.5)%	24.1%	12	3
CTM, Macao (2)	28.00%	3,979	44.2%	1,313	10.0%	33.0%	356	118
Timor Telecom, East Timor (3)	41.12%	66	16.0%	37	14.6%	55.7%	48	27

(1) Figures account for 100% of the company. PT has management contracts in CVT, CST and Timor Telecom. **(2)** Equity consolidation method. **(3)** Full consolidation method. **(4)** These stakes are held by Africatel, which is 75% controlled by PT.

In 2011, Unitel s revenues and EBITDA, in Angolan Kwanzas, increased by 20.8% y.o.y and by 18.0% y.o.y, respectively, and, in USD, increased by 18.8% y.o.y and by 16.1% y.o.y, to USD 1,784 million and 1,004 USD million. In 2H11 Unitel presented strong operational and financial figures on the back of successful campaigns aimed at promoting voice and increasing penetration of mobile broadband. Unitel also launched several initiatives targeted at strengthening of its distribution channels and increasing the quality of its network.

In 2011, MTC s revenues and EBITDA increased by 11.4% y.o.y and 4.6% y.o.y, reaching NAD 1,608 million and NAD 804 million, respectively. This revenue performance was achieved against a backdrop of a significant decline in MTRs (average tariff down by 26.5% y.o.y). Adjusting for this effect, revenues and EBITDA would have increased by 13.0% y.o.y and by 6.3% y.o.y, respectively. In 2011, EBITDA margin stood at 50.0% . Data revenues accounted for 20.8% of service revenues, one of the highest in the continent. In 2011, MTC focused its marketing efforts and commercial activity on: (1) enhancing its smartphone offer; (2) launching campaigns aimed at promoting usage, and (3) boosting growth of broadband customers, under the brand Netman, with download speeds of up to 7.2 Mbps.

In 2011, CVT s revenues slightly decreased by 0.4% y.o.y to CVE 9,224 million, while EBITDA increased by 2.3% y.o.y to CVE 4,342 million. EBITDA margin stood at 47.1% . Revenues and EBITDA were impacted by international accounting rules related to concession contracts (IFRIC 12). Excluding these effects, revenues and EBITDA would have increased by 3.7% y.o.y and by 3.2% y.o.y, respectively. In 2011, mobile revenues were positively impacted by

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data and roaming revenue growth, while wireline revenues were positively impacted by broadband growth. In 2011, CVT launched: (1) new commercial offers for corporate segment, under the new brand CVT Negócios; (2) several campaigns to stimulate data usage, and (3) new TV channels to strengthen further IPTV market momentum. Broadband and IPTV customers increased significantly, representing 27.5% and 11.4% of the wireline customer base, respectively.

In 2011, CST s revenues decreased by 5.8% y.o.y to STD 292,561 million and EBITDA decreased by 4.5% y.o.y to STD 70,615 million. EBITDA margin stood at 24.1% . Excluding some accounting reclassifications recognised during 2011, revenues would have increased by 7.2% y.o.y. EBITDA performance was negatively impacted by an increase in commercial costs and a new tax on foreign supplies. Excluding these effects, EBITDA would have increased by 3.0% y.o.y. In 2011, São Tomé e Príncipe reached circa 70% of penetration of mobile services.

In 2011, CTM s revenues and EBITDA increased by 44.2% y.o.y and by 10.0% y.o.y, to MOP 3,979 million and MOP 1,313 million, respectively. EBITDA margin was at 33.0% . Revenue growth was driven by an increase in equipment sales and telecom services to corporate customers. Mobile service revenues increased by 9.5% y.o.y impacted by growth in data revenues, which accounted for 21.0% of mobile service revenues. In 2011, CTM launched several marketing campaigns aimed at increasing penetration of smartphones and wireless broadband.

In 2011, Timor Telecom s revenues and EBITDA increased by 16.0% y.o.y and by 14.6% y.o.y, to USD 66 million and USD 37 million, respectively, mainly as a result of the strong increase in customer base. EBITDA margin stood at 55.7% . At the end of December, Timor Telecom reached 600 thousand mobile customers. Data revenues accounted for 17.9% of mobile service revenues. In 2011, Timor Telecom launched several voice and data stimulation campaigns and strengthened its distribution network.

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07 Employees

Number of employees

	2011	2010	y.o.y	y.o.y %
Portugal	11,180	10,985	195	1.8%
Telecommunications	7,535	7,206	329	4.6%
Other businesses	3,645	3,779	(134)	(3.5)%
Brazil	59,621	21,072	38,549	182.9%
Telecommunications	7,892	0	n.m.	n.m.
Other businesses	51,729	21,072	30,657	145.5%
Other geographies	1,546	1,467	79	5.4%
Group employees	**72,347**	**33,524**	**38,823**	**115.8%**

As at 31 December 2011 PT s employees were 72,347, of which 15.5% were in the Portuguese businesses. The total number of employees increased 38,823 reflecting the impact of the proportional consolidation of Oi and Contax as from 1 April 2011.

Aiming for the renewal of its employees, PT has a structured recruitment process for young talents Trainees - the best students from the best Portuguese universities.

In 2011, 65 students were integrated in the Trainees program. This is a two year program that involves about 50 departments of the company and has a very close monitoring from the Board.

Focusing on resident talents, PT reinforced its retention programmes, on two perspectives:

- Developing future leaders;
- Retaining specific know-how.

During 2011, a trial program was implemented for 40 high potential employees that had several development actions, namely training and coaching initiatives. The end results and satisfaction (from individuals and direct supervisors) revealed that the program had a very positive impact on motivation and productivity. This program is being rolled out during 2012.

Regarding the development of leadership competencies, during 2011 PT sponsored an executive training program for 1st and 2nd line directors. This initiative involved 120 employees with key responsibilities within the group and the main objective was to strengthen the team s culture on topics such as leadership, innovation and change.

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08 Capital markets

Shareholder remuneration

In terms of shareholder remuneration, PT returned in June 2011 approximately Euro 1,118 million to shareholders, through a combination of the following:

- Ordinary dividend related to fiscal year 2010 of Euro 65 cents per share; and,
- An exceptional dividend of Euro 65 cents per share.

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* Euro 0.215 per share was attribuited as an anticipated dividend in December 2011.

For the financial year 2011, in accordance with the dividend policy made public on 3 November 2010, the Board of Directors proposed an ordinary cash dividend of Euro 0.65 per share. On 15 December 2011 PT announced an interim ordinary dividend of Euro 0.215 per share, in accordance with the dividend policy made public on 3 November 2010, an advance payment on the profits of the 2011 financial year, paid on 4 January 2012.

As at 31 December 2011 and as at the date of this report, PT had for accounting proposes 36,522,253 own shares, including: (1) 20,640,000 own shares held through equity swaps at PT SGPS, S.A., and (2) 16,338,229 own shares held through the 25.3% stake in PT s 64,557,566 shares acquired by Oi. As at 31 December 2011, PT s total number of shares outstanding was 859,534,271.

Shareholder structure

At the end of 2011, the holdings of the qualified shareholders represented more than 50% of PT s share capital, as follows:

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Qualified holdings

Date of report	Institutions	No. of shares	% of capital	% of voting rights
30-Dec-11	Espirito Santo Group (1)	101,697,989	11.34%	11.34%
02-Jun-11	RS Holding, SGPS, S.A.	90,111,159	10.05%	10.05%
23-Sep-11	Capital Research and Managment (2)	89,403,498	9.97%	9.97%
30-Nov-11	Telemar Norte Leste, SA	64,557,566	7.20%	7.20%
31-Dec-11	Caixa Geral de Depósitos Group	56,011,952	6.25%	6.25%
27-Dec-11	UBS AG (3)	45,309,635	5.05%	5.05%
13-Dec-11	Norges Bank (4)	44,852,919	5.00%	5.00%
23-Sep-11	The Income Fund of América, Inc. (5)	44,575,845	4.97%	
31-Dec-11	Brandes Investments Partners, L.P.	34,628,566	3.86%	2.87%
12-Dec-11	Barclays Group(6)	23,689,084	2.64%	2.64%
31-Dec-10	Visabeira Group	23,642,885	2.64%	2.64%
14-Dec-11	JP Morgan (7)	21,590,141	2.41%	2.41%
07-Dec-09	BlackRock Inc.	21,025,118	2.35%	2.35%
03-Feb-10	Controlinveste Comunicações	20,419,325	2.28%	2.28%
24-Jun-10	Telefónica, S.A. (8)	18,122,661	2.02%	2.02%
11-Oct-10	Europacific Growth Fund (9)	18,061,608	2.01%	

(1) On 15 February 2012, PT further disclosed that Espirito Santo Group held a qualified holding corresponding to a total of 93,697,989 ordinary shares representing 10.45% of PT s share capital and corresponding voting rights. (2) On 13 February 2012, PT further disclosed that Capital Research and Managment held a qualified holding corresponding to a total of 42,952,953 ordinary shares representing 4.79% of PT s share capital and corresponding voting rights. (3) On 6 February 2012, PT further disclosed that UBS AG held a qualified holding corresponding to a total of 42,024,498 ordinary shares representing 4.69% of PT s share capital and corresponding voting rights. (4) On 6 February 2012, PT further disclosed that Norges Bank Group held a qualified holding corresponding to a total of 44,442,888 ordinary shares representing 4.96% of PT s share capital and corresponding voting rights. (5) On 3 February 2012, PT further disclosed that The Income Fund of America held less than 2% of the voting rights corresponding to the share capital of PT. (6) On 6 March 2012, PT further disclosed that Barclays held a qualified holding corresponding to a total of 22,791,762 ordinary shares representing 2.54% of PT s share capital and corresponding voting rights. (7) On 9 January 2012, PT further disclosed that JP Morgan has reduced its holding to less than 2% of the voting rights corresponding to the share capital of PT. (8) On 22 January 2012, PT further disclosed that Telefónica has reduced its holding to less than 2% of the voting rights corresponding to the share capital of PT and its long position to less than 5% of PT s share capital. (9) On 20 February 2012, PT further disclosed that Europacific Growth Fund held a qualified holding corresponding to a total of 23,045,000 ordinary shares representing 2.57% of PT s share capital and corresponding voting rights.

PT has a diversified shareholder base, with approximately two thirds of its share capital being held by foreign shareholders, mainly in Continental Europe, North America and UK, wich represent approximately 31.5%, 16.3% and 12.7%, respectively of the total shareholder base. The Portuguese market represents 32.1% of PT s outstanding capital.

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Share performance

The sovereign debt crisis and its ramifications were the key factor in market s negative performance in 2011, also affecting the telecom sector, which underperformed general markets. This uncertainty generated a climate of significant instability in the financial markets that resulted in an increase in aversion to risk.

Source: Bloomberg

2011 was marked by a deterioration of the financial conditions faced by the Portuguese economy as a result of increased risk aversion of investors against the periphery of the Eurozone, and especially following the downgrades of the Portuguese Republic. As a result the 10-year spread of Spain, Italy and Portugal bonds against the German benchmark widened throughout 2011.

In this challenging context of market volatility, during 2011 PT shares were also penalised by CDS evolution, having fluctuated between a minimum of Euro 4.399 and a maximum of Euro 8.848, closing the year at Euro 4.450 (with an ex-dividend day at 30 December of Euro 0.215).

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Source: Bloomberg

In terms of total shareholder return, PT posted a 19.0% increase during 2009-2011, which compares to 33.2% posted by the DJ Stoxx Telecom Europe index and 0.0% posted by DJ Stoxx Telecom Euro index over the same period. During 2009-2011, PT had one of the best performances among companies in the eurozone and outperformed the DJ Stoxx Telecom Euro index.

Source: Bloomberg

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Among the major financial markets, the NASDAQ registered the best performance during 2009-2011 (+65.2%), followed by the BOVESPA (+51.1%) and S&P 500 (39.2%) . In 2011, the DOW JONES registered the best performance (5.5%), followed by the S&P 500 (0.0%). The other major financial markets registered negative performances, reflecting the global economic and financial crisis.

The PSI-20 index registered a negative performance during 2009-2011 (-13.4%) and in 2011 (-27.6%) reflecting the financial crisis and economy weakness in Portugal.

Source: Bloomberg

Around 702 million PT shares were traded in 2011, equivalent to a daily average of 2.7 million shares.

In 2011, PT ADRs close the year at US$ 5.77, with an average of approximately 221 thousand traded daily on the New York Stock Exchange. The number of ADRs outstanding at the end of 2011 was 24.8 million, of which 49.7% were owned by the top 5 institutional shareholders.

Bond performance

The key credit strength of PT in 2011 continued to be its ability to generate a strong operating free cash flow, as a result of leading market positions in both fixed and mobile businesses in Portugal and in its international operations, as well as the implementation of continued cost cutting programmes. In 2011, PT maintained a solid liquidity position, given its significant level of cash, its debt profile (with an average maturity of approximately 6 years as of the year-end) and the additional flexibility provided by its committed stand-by lines and underwritten commercial paper lines.

Rating

In 2011, Fitch has confirmed the long-term rating on Portugal Telecom at BBB, with negative outlook. Fitch does not apply a direct or linear correlation between sovereign and corporate ratings for issuers in pressured Eurozone countries. The sovereign rating of the Republic of Portugal assigned by Fitch is BB+.

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On the other hand, as per Moody s and Standard & Poor s (S&P) methodology, companies ratings are restricted by sovereign rating. Thus, in 2011, downgrades of the sovereign rating by Moody s and S&P led to changes of the credit rating assigned to Portugal Telecom by these rating agencies:

- As of 3 June 2011, S&P announced the downgrading of PT s long-term rating from BBB to BBB-, with negative outlook;
- As of 7 June 2011, Moody s downgraded PT s long-term rating from Baa2 to Baa3, while maintaining it on review for possible downgrade;
- As of 29 July 2011, Moody s confirmed PT s credit rating at Baa3 with negative outlook;
- As of 23 December 2011, Moody s announced the downgrading of PT s long-term rating from Baa3 to Ba1, with negative outlook.

As of 21 January 2012, S&P downgraded PT s long-term rating from BBB- to BB+, with negative outlook. PT s credit rating assigned by S&P is one notch higher than the sovereign rating on the Republic of Portugal, which is the maximum rating differential that can apply between the rating on a corporate and a non-investment grade sovereign rating, according to S&P s criteria.

As of 16 February 2012, Moody s affirmed the Ba1 credit rating assigned to Portugal Telecom, despite having further downgraded the Republic of Portugal´s sovereign rating on 13 February 2012 to Ba3 with a negative outlook. As per Moody s methodology, companies rating cannot be more than two notches higher than that of the country in which the majority of their business is located.

Bonds

On 8 February 2011, Portugal Telecom, through its wholly-owned subsidiary PT International Finance BV, issued a Euro 600 million Eurobond, with a maturity of 5 years and a coupon rate of 5.625% .

In 2011, the performance of PT s bonds was significantly influenced by market concerns on sovereigns creditworthiness, namely with respect to Portugal, which affected the perceived credit risk of corporates. For that reason, PT s credit spreads and yields increased significantly during the year, although substantially less than Portuguese sovereign yields, due to PT s own financial strength and relevant exposure to different geographic markets, which has been growing considerably.

In 2011 PT bought back Euro 62 million of its bonds, with a notional amount of Euro 64 million, generating a financial gain of Euro 2 million. These acquisitions were carried out during 4Q11.

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Source: Bloomberg

In 2011, PT s exchangeable bonds price followed PT s share price performance, mainly due to the sovereign problems mentioned above. Price of these exchangeable bonds reached a maximum of 104% in March and its lows in the fourth quarter, at 82%. On 31 May 2011, the exchange price of these exchangeable bonds was adjusted to Euro 9.40, under the terms and conditions of the bonds.

Investor relations activities

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

During 2011, the Company participated in several investor events, including investor roadshows, analyst and investor presentations, one-on-one meetings and conference calls, as well as investor conferences in Europe and in the US.

In 2011, PT held two roadshows, one in Europe and the other in the US, and participated in 6 investor conferences in Europe and in the US. Additionally, PT held over 300 meetings and conference calls with analysts and investors.

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09 Main events

Events of the year

Shareholder remuneration

06. May.11 | PT s shareholders approved at the Annual General Meeting held on 6 May 2011 the application of the 2010 net income of Euro 5,124,694,889, as follows:

- The amount of Euro 413,661,880 be used to cover accumulated losses;

- Payment to the shareholders, in addition to the advance of annual profits made in December 2010, of a dividend in the overall amount of Euro 1,165,466,250, corresponding to Euro 1.30 per share in respect of the total number of issued shares: (1) an amount of Euro 582,733,125, corresponding to 65 Euro cents per share in respect of the total number of issued shares, for the balance of the dividend deemed exceptional and not yet paid, and (2) an additional amount of Euro 582,733,125, corresponding to 65 Euro cents per share in respect of the total number of issued shares, as ordinary dividend;

- Transfer of the remaining net profit for the fiscal year to retained earnings.

As such, and taking into account the amount corresponding to the advance of annual profits made in December 2010, the shareholders have approved that the total sum to be paid as dividend in respect of the 2010 fiscal year was fixed in Euro 2,061,981,750, corresponding to a dividend of Euro 2.30 per share.

15. Dec.11 | PT announced that its Board of Directors, in accordance with the dividend policy made public on 3 November 2010, approved an advance payment on the profits of the 2011 financial year. The gross amount of Euro 0.215 per share, was paid on 4 January 2012.

General Meeting of Shareholders

26. July.11 | PT announced that the General Meeting of Shareholders, approved the amendment of the Company s Bylaws as proposed, with the elimination of the special rights until now granted to the 500 class A shares (the so-called golden share).

Corporate bodies

06. Apr.11 | PT announced that, at the meeting of the Board of Directors, Pedro Jereissati and Otávio Marques de Azevedo were appointed as non-executive members of PT s Board of Directors to complete the 2009-2011 term of office, and Alfredo Baptista and Pedro Durão Leitão were appointed as executive members of the PT s Board of Directors to complete the 2009-2011 term of office. Otávio Marques de Azevedo and Pedro Jereissati are, respectively, Chairman and Chief Executive Officer of Telemar Participações S.A., Oi s controlling holding. Alfredo

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Baptista and Pedro Durão Leitão are executive board members of PT Portugal and joined PT in 1979 and 2000, respectively.

PT also announced that Zeinal Bava, its Chief Executive Officer, and Shakhaf Wine, executive board member, were designated by PT to be appointed as members of the Board of Directors of Tele Norte Leste Participações S.A. Additionally, Zeinal Bava and Shakhaf Wine were appointed members of the Board of Directors of Telemar Participações S.A.. Zeinal Bava will also be designated to head Oi s Committee of Engineering & Network, Technology & Innovation and Product Offering that will be created.

Debt

27. Jan.11 | PT announced the successful issuance of a Euro 600 million Eurobond, with a maturity of 5 years, through its wholly-owned subsidiary PT International Finance BV. The coupon of this issue was 5.625%, with a reoffer.

25. Mar.11 | PT announced a new credit facility amounting to Euro 900 million, with maturity in March 2014, which subsequently was increased to Euro 1,200 million.

31. May.11 | PT informed that the exchange price and the threshold amount of Portugal Telecom International Finance B.V. Euro 750,000,000 4.125% Exchangeable Bonds due in 2014 (ISIN XS0309600848, Common code 030960084) and exchangeable into ordinary shares of PT (the Bonds) were adjusted in accordance with Condition 6.2(c)(i) of the Bonds. Details on the adjustment were provided on the release.

03. Jun.11 | S&P announced its review of the credit rating attributed to PT, downgrading the long-term rating from BBB to BBB-, with negative outlook, and the short-term rating from A-2 to A-3.

07. Jun.11 | Moody s announced its review of the credit rating attributed to PT, downgrading the long-term rating from Baa2 to Baa3.

29. July.11 | Moody s announced that it confirmed the Baa3 Issuer Rating of PT and the ratings of its fully owned subsidiary PT International Finance B.V. (PTIF) with negative outlook, concluding the rating review process initiated on 7 June 2011.

21. Dec.11 | Moody s announced its review of the credit rating attributed to PT and the ratings of its fully owned subsidiary PT International Finance B.V., downgrading the long-term rating from Baa3 to Ba1. The outlook remained negative.

Meo

14. Nov.11 | PT announced that Meo surpassed one million customers in just three and half years after it was launched on a nation wide basis, in April 2008.

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Spectrum Auction

30. Nov.11 | PT announced that, in relation to the mobile spectrum auction conducted by the Portuguese telecommunications regulator ANACOM, TMN submitted bids for 9 blocks in 3 frequency bands, for a total consideration of Euro 113 million, equivalent to the minimum prices established by the regulator, having obtained spectrum in the frequency bands of 800MHz (2 blocks of 2 x 5MHz), 1.8GHz (1 block of 2 x 4 MHz and 2 blocks of 2 x 5MHz) and 2.6 GHz (4 blocks of 2 x 5 MHz), the maximum allowed in these frequency bands according to the auction rules.

Oi Group

26. Jan.11 | PT informed that it signed the definitive sales and purchase, subscription and shareholders agreements with Oi and its controlling shareholders.

28. Mar.11 | PT informed that it acquired a direct and indirect stake of 25.28% in Telemar Norte Leste (TMAR) for a cash consideration of R$ 8.32 billion. As previously stated the corporate governance rights attributed to PT allowed the proportional consolidation of its 25.6% direct and indirect stake in Telemar Participações S.A. (TmarPart), which fully consolidates TNL and TMAR. This proportional consolidation took place from 1 April 2011.

24. May.11 | PT announced that Telemar Participações S.A. (TmarPart) approved in its premeeting of shareholders a resolution according to which the Boards of Directors of TmarPart and of its controlled companies, Tele Norte Leste Participações S.A. (TNL), Telemar Norte Leste S.A. (TMAR), Coari Participações S.A. (Coari) and Brasil Telecom S.A. (BRT), together Oi Group or Oi , should initiate the procedures, including any necessary studies, to undertake a corporate restructuring of Oi. This corporate restructuring aims at incorporating jointly the shares of TMAR by Coari and of Coari and TNL by BRT, the listed company that will concentrate all shareholdings in the Oi Group and will be the only publicly listed company. BRT will then be renamed Oi S.A. and will have only two classes of shares (ON, ordinary shares, and PN, preferred shares), which will be traded on the Bovespa and NYSE, through an ADR program. The corporate restructuring is based on the following key principles: (1) TmarPart, the controlling entity of the Oi Group, will retain control; (2) the whole Oi structure is to be simplified through this transaction, and (3) independent committees will be established at each listed company to advise each Board of Directors on the terms of the transaction.

Furthermore, Oi subsequently announced that the proposed exchange ratios would be:

Original share/Replacement share	Exchange Ratio
TNLP3/BRTO3	23.122
TNLP4/BRTO4	21.428
TNLP4/BRTO3	18.581
TMAR3/BRTO3	51.149
TMAR5 and TMAR 6/BRTO4	44.537
TMAR5 and TMAR 6/BRTO3	38.620

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News related to Dedic and Contax

10. Jan.11 | PT informed that it was in negotiations with CTX Participações S.A. (CTX), its subsidiary Contax and its controlling shareholders to define the structure and conditions of a possible corporate restructuring which would result in a potential integration of the businesses and activities of Contax and Dedic and in PT becoming a shareholder of CTX.

Subsequent events

Corporate bodies

29. Feb.12 | PT announced that Jorge Humberto Correia Tomé has resigned from his office as non-executive member of the Company s Board of Directors.

Debt

21. Jan.12 | S&P announced its review of the credit rating attributed to PT, downgrading the long-term rating from BBB- to BB+, with negative outlook, and the short-term rating from A-3 to B.

Oi Group

27. Feb.12 | PT announced that the general meetings of the companies constituting the Oi group, approved Oi s corporate simplification. Following this approval the current corporate structure constituted by Tele Norte Leste Participações S.A. (TNE), Telemar Norte Leste S.A. (TMAR) and Brasil Telecom S.A. (BRT) was integrated in BRT, which will be renamed Oi S.A., and will have only two share classes (common shares, ON, and preferred shares, PN). These shares will be traded in the Bovespa and in the NYSE, through an ADR programme.

As a result of this approval, the new Oi S.A. will issue 395,585,453 new ordinary shares and 798,480,405 preferred shares and its subscribed capital, fully paid, will be R$ 6,816,467,847.01, divided into 599,008,629 common shares and 1,198,077,775 preferred shares, all nominative and without par value. The number of shares outstanding and therefore the final position of Telemar Participações S.A. (TPAR), Oi s controlling vehicle, and PT will be established after the exercise of withdrawal rights by shareholders entitled to such. PT s economic position in Oi, direct and indirect, will be between 21.5% and 25.1%. The period of application of the withdrawal ends on 29 March 2012.

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10 Main risks and uncertainties

PT has defined, as a priority commitment, the implementation of a process to evaluate and manage the risks that might affect its operations and the execution of the business plan and achievement of strategic goals defined by the Board of Directors. Such mechanisms are based on an enterprise wide risk management model, which seeks to ensure, inter alia, the implementation of Corporate Governance practices and transparency in the disclosure of information to the market and shareholders.

As a structured approach, risk management is integrated in the Company s strategic planning and operational management procedures, and relies on the commitment of all employees to adopt risk management as an integral part of their duties, notably by identifying, reporting and implementing risk mitigation measures and behaviors.

Risk Management is sponsored by the Executive Committee in conjunction with the management teams from the various businesses, at national and international level, in such a way as to identify, evaluate and manage uncertainties and threats that might affect the pursuance of the plan and strategic goals. It should also be mentioned that the whole process is monitored by the Audit Committee, an independent supervisory body composed by non-executive board members.

The Risk Management process implemented in PT is based on an internationally acknowledged methodology COSO II, developed by the Committee of Sponsorship Organizations of the Treadway Commission. This approach is based on the identification and analysis of key value drivers and uncertainty factors that might affect value generation and compliance with the plan and achievement of strategic goals.

As a result of the process that manages risks that might adversely affect PT Group s business, the following risk should be highlighted:

Relevant Risks	
Environment Risk Regulation	PT is subject to the risk of regulatory changes or actions of national, European Union or international regulatory entities that may create growing competitive pressure and affect its capacity to conduct its business in an effective manner. The Regulation Department is in charge of the management of regulation risk and must be up to date on new regulations applicable to the sector with an impact on the PT. The risk management strategy and response is coordinated between the Regulation Department and the different operational areas. Within the follow-up of the various risks and opportunities related to regulation, we highlight the following matters: (i) Next Generation Networks; (ii) Digital Terrestrial Television; (iii) Retail offers and pricing; (iv) Wholesale reference offers; (v) Universal Service; (vi) Radio-electric spectrum; (vii) Relevant Broadband Markets; viii) Roaming regulation; and (ix) Digital Dividend and (x) Network Security and Resilience.

Additional detail regarding regulation that might impact the company is included in the Regulatory Background chapter of the annual report.

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There is a possibility of a decline in the PT Group s revenues due to an increase in competition by other operators or new players in the market, notably through (i) development of new products and services; (ii) aggressive marketing and sales policies; (iii) improvements in product or service quality; (iv) increase in productivity and cost reduction; and (v) re-configuration of the value chain from the customer s viewpoint.

Competition

On the Portuguese market, PT will continue to be a customer-oriented company focused on innovation and execution, managing its business along customer segments aiming at:

(1) Residential: Consolidate the growth trends in the residential segment by leveraging its successful TV strategy (that has reached a 35% share in the Portuguese pay TV market) through a differentiated and sophisticated multi-screen pay-TV experience. During 2011, PT s offer in this area was enhanced with the launch of the Meo GO service, allowing simultaneous connection of multiple devices through wireless and wireline networks inside the customer home (TVs, games consoles, PCs, laptops, tablets, smartphones). Multi-screen TV is a key lever for differentiation and Meo is already converging towards a seamless offering on the TV, PC and smartphone.

(2) Personal: Develop innovative data and internet access products and convergent services and apps for the personal segment and on key partnerships, supported by the strong presence of its Sapo online portal, while simultaneously redesigning its tariff structure to improve the underlying trends in the mobile business, and

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

At the international level PT will remain focused on the operational performance of its assets and on the sharing of best practices across the various businesses. The expansion of international operations to multiple geographies is one of the most important catalysts of value creation in the telecommunications sector and PT has been building a relevant portfolio of international operations.

It should also be stressed that these actions are complemented by a constant benchmarking of the PT vis-à-vis its competitors business, in order to ensure leadership and excellence of the offer to its customers.

Technological Innovation

With a background of quick technological changes of the business sector in which PT Group operates, the company is subjected to the risk of failing to leverage technological advances and developments in its business model, in order to obtain or maintain competitive advantages.

Innovation continued to be a top priority for Portugal Telecom, given its key role in ensuring sustained growth, particularly in a difficult economic context which forces higher competitiveness in product offering and simultaneously demands a higher efficiency in its development and go-to-market processes.

The PT Group is historically one of the Portuguese companies with a larger volume of investment R&D. In this field, PT holds strategic assets that allow it to ensure the implementation of innovative projects, including:

- PT Inovação: a company aimed at the technological development of the Group s businesses, in terms of applied research, engineering services and development of innovative solutions and services, both in the domestic and the international market.

- OPEN development and innovation program: having as its purpose the implementation of systematized research practices and information processing, involving the whole organization, for the materialization of innovative projects.

- Strategic planning of network infrastructures and rollout of new technologies, which implies the preparation of reports and periodic analysis on the evolution, standardization and adoption of new technologies by the sector, including the carrying out of international benchmarks.

- Strategic partnerships with technological, equipment and content suppliers and service providers.

Additional detail regarding Technological Innovation that might impact the company is included in the Research and Development chapter of the annual report.

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Environment Risk	**Economic Environment**	The international financial crisis may extend the recession at Portuguese and world economy level and delay economic recovery, which might have an impact on the level of product and service demand, and as a result on the level of the operational and financial performance of PT. In this sense, management continuously monitors impacts on the operational and financial performance of the PT Group. The management team acts proactively in identifying threats and opportunities at the level of the industry, sector and geographies were it is present, in order to diversify the asset portfolio and ensure the growth and profitability of the business.
	Exchange Rates	Portugal Telecom holds financial investments in foreign countries which currency is not the euro, including Brazil and a few African countries. Exchange rate fluctuations of those currencies against the euro affect the translation of the results attributable to Portugal Telecom, and therefore impact the PT Group s results and asset position. Additionally PT is also exposed to exchange rate risks in regards to debt in a currency other than Euro. The Company does not have a hedging policy regarding the value of these Investments; however the Executive Committee analyses the execution of cash flow hedging of the dividends and other capital income. Additional detail regarding Exchange Rate risks that might impact the company is included in the Financial Instruments chapter of the annual report.
Financial Risks	**Interest Rates**	Interest rate risk basically impact our financial expenses on the floating interest rate debt. With increased uncertainty and volatility in financial market. Risk premium in the markets and the fluctuation of the interest rates of the Portuguese sovereign debt have increased significantly, which amplify the probability of occurrence of this risk. In this way, the current conditions of the financial markets might have an adverse effect on the PT Group s ability to access the capital it needs to support its growth, its strategies, and to generate future financial returns. The management of the financial market risk is ensured by the Corporate Finance Department.

Additional detail regarding Interest Rates risks that might impact the company is included in the Financial Instruments chapter of the annual report.

Portugal Telecom contracts a set of derivative financial instruments so as to minimize the risks of exposure to interest and exchange rate variations. The execution of agreements concerning financial instruments is made after a careful analysis of risks and benefits inherent in this kind of transactions and in consultation with various institutions acting in this market. These transactions are subject to prior approval by the Executive Committee and involve a permanent follow-up of the evolution of the financial markets and of the positions held by the Company. The fair value of these derivatives is determined on a regular basis, essentially based on market information, in order to assess the economic and financial implications of different scenarios.

Additional detail regarding Financial Instruments and their impact the company is included in the Financial Instruments chapter of the annual report.

Credit risk

Credit risk relates mainly to the risk that a third party fails on its contractual obligations, resulting in a financial loss to the Group. Portugal Telecom is subject to credit risks in its operating and treasury activities.

Credit risks in operations relate basically to outstanding receivables from services rendered to our customers. These risks are monitored on a business-to-business basis, and Portugal Telecom s management of these risks aims to: (i) limit the credit granted to customers, considering the profile and the aging of receivables from each customer; (ii) monitor the evolution of the level of credit granted; (iii) perform an impairment analysis of its receivables on a regular basis; and (iv) assess the market risk where the customer is located.

Risks related to treasury activities result mainly from the cash investments made by the Group. In order to dilute these risks, Portugal Telecom s policy is to invest its cash for short time periods, entering in agreements with highly rated financial institutions and diversifying counterparties.

Additional detail regarding Credit Risk and their impact the company is included in the Financial Instruments chapter of the annual report.

Liquidity risk

These risks may occur if the sources of funding, including cash balance, operating cash inflows, divestments, credit lines and cash flows obtained from financing operations, do not match the Group s financing needs, such as operating and financing outflows, investments, shareholder remuneration and debt repayments.

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In order to mitigate liquidity risks, the Group seeks to maintain a liquidity position and an average maturity of debt that allows it to repay its short-term debt and, at the same time, pay all its contractual obligations.

Additional detail regarding Credit Risk and their impact the company is included in the Financial Instruments chapter of the annual report.

Additionally the capital structure of Portugal Telecom is managed in order to ensure that its businesses will be able to continue as a going concern and maximize the return to shareholders. The company reviews periodically its capital structure considering the risks associated with each of the classes of the capital structure.

Additional detail regarding Liquidity Risk and their impact the company is included in the Financial Instruments chapter of the annual report.

Operational Risk

Infrastructure Capacity

The capacity and availability of network infrastructures are essential features for the PT Group to ensure continued critical operations within high quality parameters, aimed not only at customer satisfaction, but also in compliance with regulatory requirements.

In this way, the PT Group has strongly emphasized the management process of this risk, not only at infrastructure availability and resilience level, but also in the increase of infrastructure capacity, in such a way as to support new product and service offers to its customers. Additionally, PT s ownership of a network infrastructure located in the public domain increases the PT Group s exposure to the occurrence of breakdowns and incidents. Within this scope, follow-up and risk mitigation actions are carried out as follows:

- Securing the telecommunications core network;
- Preparation of risk maps for the various technological platforms, identifying dependencies and single failure points;
- Definition and implementation of disaster recovery plans;
- Implementation of systems and procedures aimed at ensuring determined QoS (Quality of Service) and QoE (Quality of End user Experience) levels;
- Investment in new generation networks and preventive maintenance actions;
- Investment in information systems to support the activity of technical teams;
- Investment in new state of the art Datacenter in order to ensure the resilience and capacity of the infrastructure.

During 2011 it should also be highlighted the consolidation on a single Business Continuity office of all the processes and operations that guarantee the resilience of the core services of PT Group, in order to increase their efficiency and effectiveness of the company s response in the following areas:

- Prevention: Planning and preparation in order to reduce the impact of incidents in the critical processes that support the business;

- Emergency Response and Recovery: Business continuity and disaster recovery plans that reduce the time of recovery of critical processes in case of catastrophic events.

Strategic Partnerships

The growth strategy at national and international level is based on a combination of alliances and partnerships that enhance the Company s competitive capacity. The Executive Committee of PT and its subsidiary companies have played a central role in the management of this risk, by leveraging existing opportunities. Such alliances are not restricted to a single field, as they include as partners: (i) technology suppliers; (ii) infrastructure and maintenance providers; (iii) R&D experts; (iv) terminal equipments and handhelds suppliers; and (v) content suppliers, among others.

Environmental

Pursuing an appropriate environmental policy has been a concern for Portugal Telecom, in order to reduce the Company s exposure to environmental damages that might consist in: (i) liability towards third parties for any material damage caused; (ii) liability towards governments or third parties for the cost of waste removal, added by possible compensations.

In this way, the PT Group has reinforced its environmental management principles and actions, thus ensuring the certification of associated systems according to the ISO 14001 standard. Environmental management policies and systems cover the following areas of intervention: (i) Resource consumption; (ii) Waste production and routing; (iii) Atmospheric emissions; (iv) Noise and electromagnetic fields; (v) A supplier s sustainability program; (v) Awareness and training campaigns. Furthermore, it should be stressed that the management models are subjected to periodic audits, both internal and external, and a continuous assessment of any impacts and improvements to be implemented is also carried out.

Talent

The PT Group s capacity to obtain and retain talent is a fundamental vector for the

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Retention	pursuance of the Company s strategic goals, particularly within the competitive context where Portugal Telecom operates, both at national and international level. In this way, the Company has paid special attention to the management of this risk, at the charge of the Human Resources Office, which acts:

- In the recruitment of new employees having the profile and knowledge necessary to ensure the key skills required for the present and future development of the PT Group;
- In the identification of key-elements of the PT Group, and then implement retention strategies as appropriate for the segments defined for its management.

For additional information on internal controls and risk management please refer to the Corporate Governance Report included in this Annual Report.

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11 Outlook

PT will continue to be a growth-oriented company, aiming at exploring the full potential of its assets portfolio, by taking advantage of existing and future opportunities in the telecommunications, multimedia and IT services markets. PT aims to continue to take advantage of the convergence opportunities, by bundling traditional voice and data services with new and sophisticated multimedia and IT services.

Following the restructuring of its Portuguese businesses along customer segments, PT will continue to focus its efforts on the development of fixed-mobile, IT-telecoms and multimedia convergent products and services and integrated offers aimed at acquiring new customers, increasing share-of-wallet, improving customer loyalty and decreasing customer retention costs. PT will maintain the effort to transform PT s residential service offering from a legacy fixed telephone to a triple play offering, which is more competitive and more resilient to adverse economic conditions. In the personal segment, PT will continue to contribute to increase the penetration of smartphones, to develop new services and tariff plans and to differentiate further its mobile offering, benefiting from the deployment of LTE and leading the 4G roll-out in the Portuguese market. In the enterprises segment, PT will continue to provide advanced one-stop-shop IT/IS solutions focusing on BPO and on the marketing of machine-to-machine solutions. These offers leverage on PT s investment in FTTH and cloud computing solutions, which allow the offering of cloud-based services in partnership with software and hardware vendors. Additionally, PT will continue to invest in innovation, research and development aiming at enhancing its services with new, distinctive and customised features, functionalities and content tailored to meet customer needs. PT will continue to leverage on close partnerships with its suppliers in order to reduce time-to-market and further differentiate its value proposition to its customers. PT will continue to invest to develop further new and more effective access and core networks and platforms, in fixed-line as well as in mobile, aimed at offering increased bandwidth to its customers, and in cloud services aimed at taking further advantage of these networks. Furthermore, PT will continue to rationalise its cost structure through productivity increases and business process reengineering.

PT will continue to be a geographically diversified operator, aimed at offering its shareholders a lower risk profile, reduced dependence on a single market and an improved growth profile. In Brazil, following the strategic partnership established with Oi, which includes the acquisition of a joint control stake in Oi, PT aims to further explore the growth potential of Oi s assets, leveraging on Brazil s favourable demographics, economic growth perspectives and penetration upside potential of telecom services, particularly in fixed and mobile broadband and TV, and in leverage fixed-mobile convergence. Additionally, PT also intends to increase its exposure to high-growth markets in Africa by taking full advantage of its existing asset portfolio and partnerships and selectively consider value-creating opportunities. PT will continue to promote the sharing of best practices amongst all of its assets, aiming at ensuring a sustainable competitive position in all markets and getting benefits of scale in terms of access to technology and innovation.

PT will continue to operate in a highly competitive and regulated environment that will pose continued risks and threats to its existing businesses, placing the profitability of its assets under pressure, including aggressive glide paths for mobile termination rates as well as declining roaming prices. PT will also continue to operate in a context of a European economic instability, particularly in Portugal, that will create additional financial and economic challenges and barriers to the development of its businesses.

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PT will continue to contribute to the development of the information society, to promote the info-inclusion of the citizens in all countries where it operates. PT also aims to be a reference in terms of sustainability and will continue to invest in the development of a sustainable business model, embracing policies and developing practices aimed at fully respecting the society and the environment.

PT aims at providing an attractive shareholder remuneration package within the context of the sector combined with improving growth prospects, leveraging on its international exposure to high growth economies and on the optimisation potential of its portfolio.

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12 Statement by the persons responsible

For the purposes of subparagraph 1, c) of article 245 of the Portuguese Securities Code, the members of the Board of Directors of Portugal Telecom, SGPS, SA identified hereunder declare, in the capacity and within their functions as described therein, that, to the best of their knowledge and grounded on the information to which they had access within such Board of Directors and/or Executive Committee, as applicable, while in office:

- The management report, the financial statements, the auditor s opinion and the other financial statements and documents required by law or regulation concerning the financial year ended on 31 December 2011 were prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and profit or loss of Portugal Telecom, SGPS, SA and the undertakings included in the consolidation taken as a whole;

- The management report concerning such financial year includes a fair review of the development of the business and the performance and position of Portugal Telecom, SGPS, SA and the undertakings included in the consolidation taken as a whole, including an accurate description of the principal risks and uncertainties that they face.

Lisbon, 22 March 2012

Henrique Granadeiro, Chairman of the Board of Directors

Zeinal Bava, Chief Executive Officer

Luís Pacheco de Melo, Executive Director, Chief Financial Officer

Alfredo José Silva de Oliveira Baptista, Executive Director

Carlos Alves Duarte, Executive Director

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Pedro Humberto Monteiro Durão Leitão, Executive Director

Manuel Rosa da Siva, Executive Director

Shakhaf Wine, Executive Director

Otávio Marques de Azevedo, Non-Executive Director

Francisco Manuel Marques Bandeira, Non-Executive Director

José Guilherme Xavier de Basto, Non-Executive Director

João Manuel de Mello Franco, Non-Executive Director

Joaquim Anibal Brito Freixial de Goes, Non-Executive Director

Mário João de Matos Gomes, Non-Executive Director

Pedro Jereissati, Non-Executive Director

Gerald Stephen McGowan, Non-Executive Director

Rafael Luís Mora Funes, Non-Executive Director

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Maria Helena Nazaré, Non-Executive Director

Amílcar Carlos Ferreira de Morais Pires, Non-Executive Director

Francisco Teixeira Pereira Soares, Non-Executive Director

Paulo José Lopes Varela, Non-Executive Director

Milton Almicar Silva Vargas, Non-Executive Director

Nuno Rocha dos Santos de Almeida e Vasconcellos, Non-Executive Director

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13 Activities of Non-Executive Directors

In accordance with Article Six of its Regulation, approved on 3 October 2008, PT s Board of Directors has restated its commitment to confer to its non-executive members the effective ability to monitor, evaluate and supervise the executive management of the Company.

During the year of 2011, PT s non-executive directors were able to effectively carry out their functions without any kind of constraints. In light of this, the following activities should be highlighted:

- In addition to the exercise of their duties that have not been delegated to the Executive Committee, PT s non-executive members have performed their supervisory functions over the executive management, according to and for the purposes of no. 8 of Article 407 of the Portuguese Companies Code and no. 1 of Article Six of the Board of Directors Internal Regulation. Indeed, pursuant to those rules, the delegation of powers to the Executive Committee does not prevent the legal duty of general surveillance impending over non-executive directors.

- As set out in Articles Five and Six of the Board of Directors Internal Regulation, PT s non-executive directors have also performed their supervisory functions in the internal committees of this corporate body, i.e.:

- In the Corporate Governance Committee, exclusively comprised by non-executive directors and whose powers and activities in 2011 are described in chapter II, paragraph 3 C of the Company s Corporate Governance Report;

- In the Evaluation Committee, comprised in its majority by non-executive directors whose powers and activities in 2011 are described in chapter II, paragraph 3 C of the Company s Corporate Governance Report.

The effective performance of their functions by PT s non-executive directors was also strengthened by the role of the chairman of the Board of Directors, who, since 28 March 2008, has exclusively carried out the functions of chairman, thus ceasing to perform executive functions in what concerns the functions delegated to the Executive Committee.

This role performed by the chairman is moreover set out in Article Four of the Board of Directors Internal Regulation and has been implemented by the following means:

- Monitoring of the Executive Committee s activities in order to keep the Board of Directors informed about the performance of the duties delegated to such Committee;

- Contribution to the effective performance of the non-executive directors functions and duties, assuring the necessary mechanisms in order to allow them to take informed and independent decisions, in particular, when performing their duty of coordinating the Board of Directors meetings;

- Enhancement of the activities of the Board of Directors internal committees.

During the year of 2011, PT s non-executive directors were able to carry out the abovementioned functions and activities, in particular, through the following practices:

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- Detailed presentations carried out by the Executive Committee in the Board of Directors meetings, regarding the aspects of the performed activities that are deemed relevant, providing the non-executive directors with the requested additional information and enhancing a profound and prolific debate concerning the activity of the enterprise (notably with regard to strategic decisions);

- Sending by the Chief Executive Officer to the Chairman of the Board of Directors of the notices to convene and minutes of the Executive Committee s meetings;

- Regular attendance of the non-executive directors to the meetings of the Board of Directors (who correspond to the majority of the members of this corporate body in functions), having been held a broad number of meetings of this corporate body (13 meetings during the year of 2011), as well as informal meetings and presentations with the non-executive directors, intended for the clarification and discussion concerning specific themes that are related to the financial information and the business of the Company;

- Intervention in the decision-making process regarding certain related party transactions, notably: (i) the conclusion of transactions in an amount exceeding 100,000 euros is subject to a prior opinion of the Audit Committee; and (ii) the transactions with shareholders in an amount exceeding 1,000,000 euros are subject to approval by the Board of Directors;

- Obtaining by the non-executive directors, jointly or separately, of the necessary or convenient information for the performance of their functions, upon request to the Chairman of the Board of Directors and/or to the Chief Executive Officer, thus allowing that the response is provided in a timely and proper manner.

- Without prejudice to cases of recognised urgency, the notice to convene for the Board of Directors meetings is announced at least 5 days in advance, and the agenda as well as the documentation supporting the resolutions are made available at least 3 days in advance.

In addition to these activities, it should by mentioned that, having the Company chosen the Anglo-Saxon model, its supervisory body is the Audit Committee, exclusively comprised by non-executive Directors, which, in the performance of its functions pursuant to the law, the by-laws and the regulations better described in chapter II, paragraph 3 B of the Company s Corporate Governance Report, presents the result of its activity in autonomous reports and opinions, among which the report on the supervisory activity and the opinions on the individual and consolidated reports and accounts submitted in each year.

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Portugal Telecom

2011 Consolidated Financial Statements

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PORTUGAL TELECOM, SGPS, S.A.

CONSOLIDATED INCOME STATEMENT

FOR THE YEARS ENDED 31 DECEMBER 2011 AND 2010

Euro

	Notes	2011	2010
CONTINUING OPERATIONS			
REVENUES			
Services rendered	6	5,859,286,893	3,516,023,963
Sales	6	141,455,409	165,615,850
Other revenues	6	146,102,419	60,614,025
	6	**6,146,844,721**	**3,742,253,838**
COSTS, LOSSES AND (INCOME)			
Wages and salaries	8	1,020,475,455	637,115,622
Direct costs	9	1,012,274,450	547,559,101
Costs of products sold	10	169,875,122	179,893,915
Marketing and publicity		131,118,820	81,096,858
Supplies, external services and other expenses	11	1,281,382,721	724,519,676
Indirect taxes	13	187,460,760	45,418,246
Provisions and adjustments	42	156,264,110	34,951,944
Depreciation and amortisation	36 and 37	1,325,584,609	758,567,813
Post retirement benefits costs	14	58,527,048	38,209,838
Curtailment costs	14	36,429,874	145,513,252
Gains on disposal of fixed assets, net		(9,190,969)	(5,542,839)
Other costs, net	15	32,632,583	141,194,008
		5,402,834,583	**3,328,497,434**
Income before financial results and taxes		**744,010,138**	**413,756,404**
FINANCIAL LOSSES AND (GAINS)			
Net interest expenses	16	297,114,673	185,044,935
Net foreign currency exchange losses	17	18,146,031	6,814,213
Net gains on financial assets and other investments	18	(577,737)	(1,860,287)
Equity in earnings of associated companies, net	34	(209,183,860)	(141,709,104)
Net other financial losses	19	107,402,475	33,300,530
		212,901,582	**81,590,287**
Income before taxes		**531,108,556**	**332,166,117**
Income taxes	20	108,196,813	77,525,848
Netincome from continuing operations		**422,911,743**	**254,640,269**
DISCONTINUED OPERATIONS			
Net income from discontinued operations	21		5,565,426,533
NET INCOME		**422,911,743**	**5,820,066,802**
Attributable to non-controlling interests	22	83,782,511	147,871,835

Attributable to equity holders of the parent	24	**339,129,232**	**5,672,194,967**
Earnings per share			
Basic	24	0.39	6.48
Diluted	24	0.39	6.06
Earnings per share from continuing operations			
Basic	24	0.39	0.19
Diluted	24	0.39	0.19

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

PORTUGAL TELECOM, SGPS, S. A.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEARS ENDED 31 DECEMBER 2011 AND 2010

Euro

	Notes	2011	2010
Income (expenses) recognised directly in shareholders equity (Note 44.5)			
Foreign currency translation adjustments			
Translation of foreign operations (i)		(289,362,828)	433,946,646
Transfers to profit and loss (ii)		(37,794,036)	(1,166,099,952)
Post retirement benefits			
Net actuarial losses	14	(80,537,620)	(450,674,906)
Tax effect (iii)	20	20,934,533	85,748,128
Hedge accounting of financial instruments			
Change in fair value	45	24,494,061	3,859,739
Transfers to profit and loss	45	(25,863,984)	(3,791,679)
Tax effect	20	958,275	(18,037)
Other expenses recognised directly in shareholders equity, net (iv)		(24,055,124)	(11,283,072)
		(411,226,723)	**(1,108,313,133)**
Reserves recognised directly in shareholders equity (Note 44.5)			
Revaluation reserve			
Revaluation of real estate and ducts infrastructure	37	(126,167,561)	
Tax effect	20	31,541,890	
Reassessement of the deferred tax liability related to the revaluation of assets (v)	20		14,181,908
		(94,625,671)	**14,181,908**
Total earnings and reserves recognised directly in shareholders equity		**(505,852,394)**	**(1,094,131,225)**
Income recognised in the income statement		**422,911,743**	**5,820,066,802**
Total income recognised		**(82,940,651)**	**4,725,935,577**
Attributable to non-controlling interests		30,339,901	257,155,531
Attributable to equity holders of the parent		**(113,280,552)**	**4,468,780,046**

(i) Losses recorded in the year ended 31 December 2011 relate mainly to the impact of the depreciation of the Brazilian Real against the Euro on Portugal Telecom s investments in Oi and Contax. Gains recognized in the year ended 31 December 2010 relate mainly to the impact of the appreciation of the Brazilian Real against the Euro on Portugal Telecom s former investment in Brasilcel, amounting to Euro 337 million.

(ii) In 2011, this caption corresponds to the cumulative amount of foreign currency translation adjustments relating to the investment in UOL that was reclassified to profit and loss upon the completion of the disposal of this investment in January 2011 (Note 33). In 2010, this caption includes an amount of Euro 1,134,159,099 (Note 21) corresponding to the cumulative amount of foreign currency translation adjustments relating to the investment in Brasilcel that was reclassified to profit and loss upon the disposal of this investment in September 2010, and an amount of Euro 31,940,853 (Note 21) corresponding to a portion of the cumulative amount of foreign currency translation adjustments that was reclassified to profit and loss following a repayment of part of the investment in Brasilcel through share capital reductions occurred at this company during the first half of 2010.

(iii) This caption includes the tax effect on net actuarial losses recorded in the years ended 31 December 2011 and 2010 and a loss of Euro 26,924,481 recognised in 2010 related to the impact on deferred tax assets resulting from a reduction on the applicable corporate tax rate from 26.5% to 25.0%.

(iv) This caption includes an amount of Euro 11 million in both years corresponding to the tax effect on dividends received in 2011 and 2010 under the equity swap contracts over own shares, which for accounting purposes were recorded as treasury shares. In addition, this caption includes an expense of Euro 7 million in 2011 related to the tax effect on dividends received by Telemar Norte Leste regarding its investment in Portugal Telecom, which for accounting purposes was recorded as treasury shares in the Consolidated Statement of Financial Position.

(v) In 2010, this caption corresponds to the impact on deferred tax liabilities resulting from a reduction on the applicable tax rate.

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

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PORTUGAL TELECOM, SGPS, S. A.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

31 DECEMBER 2011 AND 2010

Euro

	Notes	31 Dec 2011	31 Dec 2010
ASSETS			
Current Assets			
Cash and cash equivalents		4,930,012,396	4,764,732,734
Short-term investments	25	738,112,198	341,772,444
Accounts receivable - trade	26	1,580,334,752	1,054,028,600
Accounts receivable - other	27	332,635,396	2,330,095,617
Inventories	28	133,506,967	101,515,755
Taxes receivable	29	374,500,400	37,545,321
Prepaid expenses	30	73,584,328	39,617,800
Judicial deposits	31	229,321,275	
Other current assets	32	41,028,329	25,647,001
Non-current assets held for sale	33		160,448,046
Total current assets		**8,433,036,041**	**8,855,403,318**
Non-Current Assets			
Accounts receivable - trade		1,225,001	1,451,332
Accounts receivable - other	27	22,096,000	17,661,730
Taxes receivable	29	56,406,992	267,622
Investments in group companies	34	533,444,415	361,517,602
Other investments	35	22,884,590	17,680,614
Intangible assets	36	5,424,100,459	1,111,692,584
Tangible assets	37	6,228,622,568	3,874,613,414
Post retirement benefits	14	13,620,935	1,927,991
Deferred taxes	20	1,220,882,009	653,075,198
Judicial deposits	31	854,761,888	
Other non-current assets	32	132,710,054	274,640,756
Total non-current assets		**14,510,754,911**	**6,314,528,843**
Total assets		**22,943,790,952**	**15,169,932,161**
LIABILITIES			
Current Liabilities			
Short-term debt	38	3,291,558,305	951,921,279
Accounts payable	39	1,244,239,461	711,489,295
Accrued expenses	40	922,779,134	558,974,927
Deferred income	41	299,352,137	287,808,093
Taxes payable	29	411,776,877	57,410,840
Provisions	42	282,487,720	87,683,131
Other current liabilities	43	359,660,738	28,391,592
Total current liabilities		**6,811,854,372**	**2,683,679,157**

Non-Current Liabilities			
Medium and long-term debt	38	8,989,400,331	6,254,380,288
Accounts payable	39	201,956,296	11,110,580
Taxes payable	29	314,374,825	3,805,301
Provisions	42	579,396,803	40,947,202
Post retirement benefits	14	1,004,065,628	968,792,596
Deferred taxes	20	1,052,457,228	311,597,337
Other non-current liabilities	43	247,479,376	286,474,565
Total non-current liabilities		**12,389,130,487**	**7,877,107,869**
Total liabilities		**19,200,984,859**	**10,560,787,026**
SHAREHOLDERS EQUITY			
Share capital	44	26,895,375	26,895,375
Treasury shares	44	(326,382,864)	(178,071,827)
Legal reserve	44	6,773,139	6,773,139
Reserve for treasury shares	44	6,970,320	6,970,320
Revaluation reserve	44	556,543,594	693,283,402
Other reserves and accumulated earnings	44	2,557,270,220	3,836,598,153
Equity excluding non-controlling interests		**2,828,069,784**	**4,392,448,562**
Non-controlling interests	22	914,736,309	216,696,573
Total equity		**3,742,806,093**	**4,609,145,135**
Total liabilities and shareholders equity		**22,943,790,952**	**15,169,932,161**

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

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PORTUGAL TELECOM, SGPS, SA

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEARS ENDED 31 DECEMBER 2011 AND 2010

Euro

	Share capital	Treasury shares	Legal reserve	Reserve for treasury shares	Revaluation reserve	Other reserves and accumulated earnings	Equity excluding non-controlling interests	Non-controlling interests (Note 22)	Total equity
Balance as at 31 December 2009	**26,895,375**	**(178,071,827)**	**6,773,139**	**6,970,320**	**722,108,135**	**733,636,104**	**1,318,311,246**	**1,069,135,212**	**2,387,446,458**
Dividends (Note 23)						(503,626,688)	(503,626,688)	(61,483,720)	(565,110,408)
Antecipated dividends (Note 23)						(875,872,500)	(875,872,500)		(875,872,500)
Acquisitions, disposals and share capital increases								(1,048,110,450)	(1,048,110,450)
Tax effect on equity component of exchangeable bonds (Note 20)						(15,143,542)	(15,143,542)		(15,143,542)
Income recognized directly in equity					(28,824,733)	(1,174,590,188)	(1,203,414,921)	109,283,696	(1,094,131,225)
Income recognized in the income statement						5,672,194,967	5,672,194,967	147,871,835	5,820,066,802
Balance as at 31 December 2010	**26,895,375**	**(178,071,827)**	**6,773,139**	**6,970,320**	**693,283,402**	**3,836,598,153**	**4,392,448,562**	**216,696,573**	**4,609,145,135**
Dividends (Notes 23 and 44.5)						(1,117,987,321)	(1,117,987,321)	(54,718,768)	(1,172,706,089)
Antecipated dividends (Notes 23 and 44.5)						(184,799,868)	(184,799,868)		(184,799,868)
Changes in the consolidation perimeter								808,765,991	808,765,991
Portugal Telecom s shares acquired by Oi (Note 1)		(148,311,037)					(148,311,037)		(148,311,037)

Share distribution and redemption of Brasil Telecom shares (Note 1)								(86,347,388)	(86,347,388)
Revaluation of certain tangible assets					(94,625,671)		(94,625,671)		(94,625,671)
Income recognized directly in equity					(42,114,137)	(315,669,976)	(357,784,113)	(53,442,610)	(411,226,723)
Income recognized in the income statement						339,129,232	339,129,232	83,782,511	422,911,743
Balance as at 31 December 2011	**26,895,375**	**(326,382,864)**	**6,773,139**	**6,970,320**	**556,543,594**	**2,557,270,220**	**2,828,069,784**	**914,736,309**	**3,742,806,093**

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

PORTUGAL TELECOM, SGPS, S.A.

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEARS ENDED 31 DECEMBER 2011 AND 2010

Euro

	Notes	2011	2010
OPERATING ACTIVITIES (Note 47.a)			
Collections from clients		6,872,212,265	4,217,884,234
Payments to suppliers		(3,071,030,520)	(2,142,344,825)
Payments to employees		(1,052,530,685)	(657,641,753)
Payments relating to income taxes	47.b	(164,560,300)	(63,765,524)
Payments relating to post retirement benefits, net	14	(198,223,997)	(235,179,099)
Payments relating to indirect taxes and other	47.c	(610,714,238)	(215,112,767)
Cash flows from operating activities from continuing operations		**1,775,152,525**	**903,840,266**
Cash flows from operating activities from discontinued operations	21		**603,033,383**
Cash flows from operating activities (1)		**1,775,152,525**	**1,506,873,649**
INVESTING ACTIVITIES			
Cash receipts resulting from:			
Short-term financial applications	47.d	97,492,590	6,602,876
Financial investments	47.e	170,819,847	4,443,356
Tangible and intangible assets		10,761,447	34,181,595
Interest and related income	47.f	339,561,933	85,588,733
Dividends	47.g	147,209,113	54,102,740
Other investing activities	47.h	40,530,444	510,002
		806,375,374	**185,429,302**
Payments resulting from:			
Short-term financial applications	47.d	(301,661,547)	(326,770,774)
Financial investments	47.i	(2,265,668,045)	(3,654,405)
Tangible and intangible assets		(1,217,277,754)	(1,154,806,237)
Other investing activities	47.i	(30,996,476)	(1,413,736)
		(3,815,603,822)	**(1,486,645,152)**
Cash flows from investing activities related to continuing operations		**(3,009,228,448)**	**(1,301,215,850)**
Cash flows from investing activities related to discontinued operations	21	**2,000,000,000**	**5,373,608,488**
Cash flows from investing activities (2)		**(1,009,228,448)**	**4,072,392,638**
FINANCING ACTIVITIES			
Cash receipts resulting from:			
Loans obtained	47.j	7,333,257,840	21,541,252,607
Subsidies		1,062,132	1,774,045
Other financing activities		897,290	245,539
		7,335,217,262	**21,543,272,191**
Payments resulting from:			
Loans repaid	47.j	(5,878,028,282)	(21,341,949,798)
Interest and related expenses	47.f	(647,706,534)	(312,643,855)
Dividends	47.k	(1,206,055,463)	(1,451,951,875)

Acquisition of treasury shares	47.l	(86,819,821)	
Other financing activities	47.m	(56,906,153)	(7,904,034)
		(7,875,516,253)	**(23,114,449,562)**
Cash flows from financing activities related to continuing operations		**(540,298,991)**	**(1,571,177,371)**
Cash flows from financing activities related to discontinued operations	21		**(357,879,144)**
Cash flows from financing activities (3)		**(540,298,991)**	**(1,929,056,515)**
Cash and cash equivalents at the beginning of the period		4,764,732,734	1,449,516,549
Change in cash and cash equivalents (4)=(1)+(2)+(3)		225,625,086	3,650,209,772
Effect of exchange differences		(60,345,424)	47,474,641
Cash and cash equivalents of discontinued operations as at the date of disposal			(382,468,228)
Cash and cash equivalents at the end of the period		**4,930,012,396**	**4,764,732,734**

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

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Portugal Telecom, SGPS, S.A.

Notes to the Consolidated Financial Statements

As at 31 December 2011

(Amounts expressed in Euros, except where otherwise stated)

1. Introduction

a) Parent company

Portugal Telecom, SGPS, S.A. (Portugal Telecom) and its subsidiaries (Group , Portugal Telecom Group , or the Company) are engaged in rendering a comprehensive range of telecommunications and multimedia services in Portugal, Brazil and other countries in Africa and Asia.

Portugal Telecom was incorporated on 23 June 1994, under Decree-Law 122/94, as a result of the merger, effective 1 January 1994, of Telecom Portugal, S.A., Telefones de Lisboa e Porto, S.A. (TLP) and Teledifusora de Portugal, S.A. (TDP). As a result of the privatization process, between 1 June 1995 and 4 December 2000, Portugal Telecom s share capital is mainly owned by private shareholders. On 12 December 2000, Portugal Telecom, S.A. changed its name to Portugal Telecom, SGPS, S.A., and became the holding company of the Group.

On 26 July 2011, Portugal Telecom s General Meeting of Shareholders approved an amendment to the Company s Bylaws that eliminated the special rights granted to the 500 Class A shares, the so-called golden share (Note 44).

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

b) Corporate purpose

Portugal Telecom Group is engaged in rendering a comprehensive range of telecommunications and multimedia services in Portugal, Brazil and other countries in Africa and Asia.

Portugal

In Portugal, fixed line services are rendered by PT Comunicações, S.A. (PT Comunicações) under the provisions of the Concession Contract entered into with the Portuguese State on 20 March 1995, in accordance with Decree-Law 40/95, for an initial period of thirty years, subject to renewal for subsequent periods of fifteen years. On 11 December 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). PT Comunicações also renders Pay-TV services branded Meo, through IPTV, FTTH and DTH platforms, and Internet Service Provider (ISP) services to residential and small and medium size companies. In addition and following the merger of PT Prime - Soluções Empresariais de Telecomunicações e Sistemas, S.A. (PT Prime) in 2011, PT Comunicações renders data transmission services and is an ISP for large clients.

Mobile services in Portugal are rendered by TMN - Telecomunicações Móveis Nacionais, S.A. (TMN), under a GSM license granted by the Portuguese State in 1992 (initial period of 15 years), which was renewed in 2007 until 16 March 2022, and a UMTS license obtained on 19 December 2000 (initial period of 15 years, renewable for an addition period of another 15 years). In December 2011, TMN acquired a fourth generation mobile license (4G license), under which will provide services as from 2012 through the

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Long Term Evolution (LTE) technology, which represents an evolution from the GSM technology that allows for higher levels of bandwith and speed. This license has an initial period of 15 years, renewable for an addition period of another 15 years.

Brazil

In Brazil, since March 2011, the Group renders telecommunication services through Telemar Norte Leste, S.A. (Telemar) and its subsidiaries, which operate under the brand name Oi, and renders corporate and call center services through Contax, S.A. (Contax) and its subsidiaries.

Oi is the leading provider of telecommunication services in the Brazilian market and the largest fixed telecommunications operator in South America in terms of active clients. Portugal Telecom completed the acquisition of a direct and indirect stake of a 25.3% in Telemar, for a total cash consideration of R$ 8,256 million, equivalent to Euro 3,647 million (Note 2.b), through (1) the subscription of share capital increases undertaken, on 28 March 2011, by Telemar Participações, S.A. (Telemar Participações), Tele Norte Leste Participações, S.A. (TNL) and Telemar, and (2) the acquisition of a 35% stake in each of the two main shareholders of Telemar Participações, AG Telecom Participações, S.A. (AG) and LF Tel, S.A. (LF). This transaction was completed following the Memorandum of Understanding entered into, on 28 July 2010, by Portugal Telecom, AG and LF, which sets the principles for the development of a strategic partnership between Portugal Telecom and Oi Group.

The terms of the shareholders agreements entered into by Portugal Telecom, AG and LF contain mechanisms designed to produce unanimous voting by these parties in meetings of the board of directors of Telemar Participações on strategic financial and operating decisions relating to the activity of the Oi Group. Therefore, in accordance with the provisions of IAS 31 *Interests in Joint Ventures* (IAS 31), the Company concluded that it contractually shares the control of Telemar Participações and that therefore this company is a jointly controlled entity. Notwithstanding the option included in IAS 31 to apply the equity method of accounting, Portugal Telecom, in line with the accounting policy used in previous years, has chosen to use the proportional consolidation method to recognize in the consolidated financial statements its investment in the jointly controlled entity Telemar Participações, which in turn fully consolidates TNL and Telemar and its subsidiaries. In connection with the acquisition process of the investment in Oi, Portugal Telecom acquired a direct and indirect interest in Telemar Participações of 25.6%, percentage that is considered in the proportional consolidation desta empresa e de todas as suas empresas controladas.

The purpose of the strategic partnership between Portugal Telecom and Oi is to develop a global telecommunications platform that will allow for cooperation in diverse areas, with a view to, among other things, sharing best practices, achieving economies of scale, implementing research and development initiatives, developing new technologies, expanding internationally, particularly in Latin America and Africa, diversifying the services provided to customers, maximizing synergies and reducing costs, and seeking to offer constant high quality services to our corporate and individual customers, while creating and adding value for our shareholders.

Under the strategic partnership between Portugal Telecom and Oi, it was envisaged that, amongst other purposes, Oi would use part of the proceeds received from the share capital increase for the acquisition of up to 10% of Portugal Telecom s share capital. Up to 31 December 2011, Oi acquired 64,557,566 shares of Portugal Telecom (Note 23), representing 7.2% of Portugal Telecom s share capital. Portugal Telecom s share in this investment was classified as treasury shares in its Consolidated Statement of Financial Position and amounted to Euro 148 million as at 31 December 2011 (Note 44.2), including Euro 61 million (Note 2.b) related to shares acquired before the end of March 2011 and Euro 87 million (Note 47.l) that relates to shares acquired during the second quarter of 2011.

Contax is one of the leading corporate services company and the leader in contact centre services in Brazil. On 28 March 2011, Portugal Telecom concluded the acquisition of a 16.2% stake in CTX Participações S.A. (CTX) for a consideration of R$ 181 million, equivalent to Euro 80 million (Note 2.b). As a result of this acquisition, Portugal Telecom acquired a direct (16.2%) and indirect stake

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(25.8%, via AG and LF) of 42.0% in CTX and an indirect stake of 14.1% in Contax. CTX, which controls and fully consolidates Contax, is proportionally consolidated in Portugal Telecom s financial statements, considering the corporate governance rights attributed to Portugal Telecom under the shareholders agreements entered into by the Company.

The final step of the acquisition of Contax consisted of the acquisition of Dedic/GPTI (Portugal Telecom s Business Process Outsourcing provider) by Contax and was completed on 1 July 2011, as the Board of Directors and the Shareholders Meetings of Dedic, CTX and Contax approved the following operations: (1) the exchange of Portugal Telecom s investment in Dedic/GPTI for a 7.6% stake in Contax; (2) the exchange of a 1.3% stake in Contax held by Portugal Telecom for an additional 3.7% stake in CTX; and (3) the disposal by Portugal Telecom to CTX of a 2.0% stake in Contax for a total amount of R$49.7 million (Euro 22 million). As a result of these operations, Portugal Telecom s direct and indirect stakes in CTX and Contax were increased from 42.0% to 44.4% and from 14.1% to 19.5%, respectively, and Dedic/GPTI became a wholly owned subsidiary of Contax and, as such, its assets, liabilities and results were proportionally consolidated as from 1 July 2011, together with Contax. Additionally, a total goodwill of Euro 28 million (Note 36) was recorded, corresponding to the difference between the fair value and the carrying amount of the net assets acquired by both Portugal Telecom and Contax.

In April 2011, moving ahead with its internationalization strategy, Contax completed the acquisition of 100% of Allus Global BPO Center (Allus) for an amount of R$245 million (Note 2.b). Consequently, the results of Contax, which are proportionally consolidated in Portugal Telecom s Income Statement as from 1 April 2011, include the full consolidation of the results of Allus as from 1 May 2011. Allus is one of the largest contact center service providers in Latin America, with operations in Argentina, Colombia and Peru and has commercial activities in the United States and Spain. With this acquisition, Contax took an important step towards becoming one of the most complete global BPO (Business Process Outsourcing) providers, dedicated to support its clients throughout their entire customer relationship chain.

On 24 May 2011, in a pre-meeting of the shareholders of Telemar Participações, in accordance with the terms of the Shareholders Agreement of this company, it was approved to instruct the managements of Telemar Participações and of each of its controlled companies TNL, Telemar, Coari Participações (Coari) and Brasil Telecom (together Oi Companies) to conduct the relevant analysis and implement the required procedures for the execution of a corporate reorganization of the Oi companies (the Corporate Reorganization). Regarding this corporate reorganization, the following should be mentioned:

- The main steps necessary to conclude this corporate reorganization include:

(a) The share exchange of newly issued shares of Coari for currently outstanding shares issued by Telemar, resulting in Telemar becoming a wholly-owned subsidiary of Coari;

(b) The merger of Coari into Brasil Telecom, with Coari ceasing to exist;

(c) The merger of TNL into Brasil Telecom, with TNL ceasing to exist; and

(d) The distribution of redeemable shares of Brasil Telecom exclusively to holders of Brasil Telecom prior to the merger, with cash redemption of such shares to be made immediately after their issuance for an amount of R$1,502 million, which was reflected in the calculation of the exchange ratios. Considering the commitment underlying these operations, Brasil Telecom recognized this amount payable to its shareholders, including R$740 million payable to its controlling shareholder Coari Participações (49.3%), which is fully owned by Telemar, and R$762 million payable to non-controlling interests. Consequently, Portugal Telecom proportionally consolidated the liability related to non-controlling interests amounting to Euro 86 million (Notes 22 and 43) as at the date of the deliberation, which was included under the caption

Other current liabilities .

Following these operations, Brasil Telecom, which shall be renamed Oi, S.A., will consolidate all of the current equity interests of the Oi Companies, and will be the only of the Oi Companies to have its shares listed on the stock exchange.

• The main benefits associated with this reorganization include, among other things, simplifying the corporate structure of the Oi Companies, consolidating the Oi Companies shareholders bases, significantly increasing the liquidity of the shares of the

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Oi Companies, consolidating the Oi Companies balance sheets allowing for the definition of a long term dividend policy and reducing operational, administrative and financial costs.

- In order to conclude this corporate reorganization, TNL, Telemar and Brasil Telecom constituted Special Independent Committees, each of which negotiated the conditions of the transactions involving its company, including the definition of the exchange ratios, and submited its recommendations to the Board of Directors of each company.

- On 1 August 2011, as a result of the analysis made by each independent committees individually and the negotiations held among all, the independent committees informed the president of the Board of Directors of each of those companies about the exchange ratios recommended that the Oi Companies respective Board of Directors should adopt in relation to the mergers of Coari and TNL into Brasil Telecom.

- On 27 February 2012, the shareholders meetings of the Oi Companies approved the Corporate Reorganization (Note 50).

Africa

In Africa, the group renders fixed, mobile and other telecommunication related services essentially through Africatel Holding BV (Africatel). The Group provide services in Angola, mainly through its associated company Unitel, and in Namíbia, Mozambique, Cabo Verde and São Tomé, among other countries, primarily through its subsidiaries Mobile Telecommunications Limited (MTC), LTM Listas Telefónicas de Moçambique (LTM), Cabo Verde Telecom and CST Companhia Santomense de Telecomunicações, SARL (CST).

Asia

In Asia, the group renders fixed, mobile and other telecommunication related services essentially through Timor Telecom and Companhia de Telecomunicações de Macau, SARL (CTM).

Discontinued operations (Note 21)

On 27 September 2010, Portugal Telecom concluded the sale of its 50% stake in Brasilcel (the joint venture that controls Vivo) to Telefónica for a total consideration of Euro 7,500 million, having received Euro 4,500 million on that day, Euro 1,000 million on 30 December 2010, totaling Euro 5,500 million in 2010 (Note 21), and Euro 2,000 million on 31 October 2011 (Note 21), in accordance with the terms of the agreement reached with Telefónica. Portugal Telecom recognized a net gain of Euro 5,423 million (Note 21) on this sale.

As a result of the sale of the investment in Brasilcel, Portugal Telecom s former Brazilian mobile business was classified as a discontinued operation and accordingly: (1) the earnings of this business in 2010 until the completion of the disposal were presented in the Consolidated Income Statement under the caption Net income from discontinued operations ; and (2) cash flows from this business up to the date of disposal were presented in the Consolidated Statement of Cash Flows under captions of cash flows from discontinued operations, together with the proceeds obtained with the sale.

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2. Basis of presentation

The consolidated financial statements for the year ended 31 December 2011 were approved by the Board of Directors and authorized for issue on 22 March 2012.

Consolidated financial statements are presented in Euros, which is the functional currency of Portugal Telecom and of a significant part of the Group s operations. Financial statements of foreign subsidiaries are translated to Euros according to the accounting principles described in Note 3.q).

The consolidated financial statements of Portugal Telecom have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), and include all interpretations of the International Financial Reporting Interpretation Committee (IFRIC) as at 31 December 2011, approved by the EU. For Portugal Telecom, no differences have been identified between IFRS as adopted by the EU and applied by Portugal Telecom and IFRS as published by the International Accounting Standards Board.

Consolidated financial statements have been prepared assuming the continuity of operations.

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and of revenues and expenses during the reported periods (Note 3).

a) Consolidation principles

Controlled entities (exhibit I)

Portugal Telecom has fully consolidated the financial statements of all controlled entities. Control is achieved whenever the Group has the majority of the voting rights or has the power to govern the financial and operating policies of an entity and obtains the majority of the economic benefits and risks. In any case, where the Group does not have the majority of the voting rights but in substance controls the entity, the financial statements of the entity are fully consolidated.

The interest of any third party in the equity and net income of fully consolidated companies is presented separately in the Consolidated Statement of Financial Position and in the Consolidated Income Statement, under the caption Non-controlling interests (Note 22).

Assets, liabilities and contingent liabilities of an acquired subsidiary are measured at fair value at acquisition date. Any excess of the acquisition cost over the fair value of identifiable net assets is recognised as goodwill. If the acquisition cost is lower than the fair value of identifiable net assets acquired, the difference is recognised as a gain in the net income for the period. Non-controlling interests are presented proportionally to the fair value of identifiable net assets.

The results of subsidiaries acquired or sold during the period are included in the Consolidated Income Statement as from the effective date of the acquisition or up to the effective date of disposal.

All intra-group transactions and balances are eliminated in the consolidation process. Gains obtained in intra-group transactions are also eliminated in the consolidation process.

When necessary, adjustments are made to the financial statements of subsidiaries to adjust their accounting policies in line with those adopted by the Group.

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Interests in joint ventures (exhibit II)

Portugal Telecom has proportionally consolidated the financial statements of jointly controlled entities beginning on the date the joint control is effective. Financial investments are classified as jointly controlled entities if the joint control agreement clearly demonstrates the existence of joint control.

Under the proportional consolidation method, assets, liabilities, income and expenses of the entity are added, on a proportional basis, to the corresponding consolidated caption.

Assets, liabilities and contingent liabilities of a joint venture are measured at fair value at acquisition date. Any excess of the acquisition cost over the fair value of identifiable net assets is recognised as goodwill. If the acquisition cost is lower than the fair value of identifiable net assets acquired, the difference is recognised as a gain in the net income for the period.

Where necessary, adjustments are made to the financial statements of jointly controlled entities to adjust their accounting policies in line with those adopted by the Group.

Following the acquisition of the investments in Oi and Contax, which are classified as jointly controlled entities in accordance with IAS 31, Portugal Telecom proportionally consolidated its assets and liabilities as from 31 March 2011 and its earnings as from 1 April 2011.

As a result of the disposal of the 50% stake in Brasilcel, as mentioned above, Portugal Telecom s share in the earnings of this joint venture for all the periods presented was included under the caption Net income from discontinued operations (Note 21).

Investments in associates (exhibit III)

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policies of the entity but not to control or jointly control those policies.

Financial investments in associated companies are accounted for under the equity method adjusted, when applicable, to comply with Portugal Telecom s accounting policies. Under this method, investments in associated companies are carried at cost in the Consolidated Statement of Financial Position, adjusted periodically for the Group s share in the results of the associated company, recorded under the caption Equity in earnings of associated companies, net (Note 34). In addition, these financial investments are adjusted for any impairment losses that may occur.

Losses in associated companies in excess of the cost of acquisition are not recognised, except where the Group has assumed any commitment to cover those losses.

Dividends attributed by associated companies are recorded as a reduction to the carrying value of financial investments when they are declared.

Where necessary, adjustments are made to the financial statements of associated companies to adjust their accounting policies in line with those adopted by the Group.

Goodwill

Goodwill represents the excess of the acquisition cost over the Group s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary, jointly controlled or associated entity recognised at the date of acquisition, in accordance with IFRS 3 *Business Combinations* (IFRS 3). Considering the exception of IFRS 1 *First-Time Adoption of IFRS*, the Group used the provisions of IFRS 3 only for acquisitions occurred after 1 January 2004. Goodwill related to acquisitions made up to 1

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January 2004 was recorded at the carrying amount of those acquisitions as of that date, and is subject to annual impairment tests thereafter.

Goodwill related to foreign investments is carried at the reporting currency of the investment, being translated to Euros at the exchange rate prevailing at the statement of financial position date. Exchange gains or losses are recognised in the Consolidated Statement of Comprehensive Income under the caption Foreign currency translation adjustments .

Goodwill related to subsidiaries and jointly controlled entities is recognized under the caption Intangible assets (Note 36) and is not amortised, but tested, at least on an annual basis, for impairment losses, which are recognised in net income in the period they occur, and cannot be reversed in a subsequent period. Goodwill related to associated companies is recognised under the caption Investments in group companies (Note 34). These investments are also tested for impairment losses.

On disposal of a subsidiary, jointly controlled entity or associate, the goodwill allocated to that investment is included in the determination of the gain or loss on disposal.

b) Changes in the consolidated Group

Acquisitions

On 28 March 2011, Portugal Telecom completed the acquisition of direct and indirect stakes in Telemar and Contax, following which Portugal Telecom proportionally consolidated its assets and liabilities as from 31 March 2011 and its earnings as from 1 April 2011, as explained above. The investment in Telemar was made through the acquisition of a direct stake in this company and indirectly through the acquisition of stakes in the share capital of its controlling shareholders, while the investment in Contax was made indirectly through the acquisition of direct stakes in the share capital of CTX and of its controlling shareholders. The investments in Telemar and Contax were acquired through the subsidiaries Bratel Brasil, S.A. and Portugal Telecom Brasil, S.A., respectively, and were structured as follows as at 28 March 2011 (acquisition date):

				Stake as at 28 March 2011 (a)	
Company	**Notes**	**Head office**	**Activity**	**Direct**	**Effective**
PASA Participações, S.A.		Belo Horizonte	Management of investments.	Bratel Brasil, S.A. (35.0%)	35.0%
EDSP 75 Participações, S.A.		São Paulo	Management of investments.	Bratel Brasil, S.A. (35.0%)	35.0%
AG Telecom Participações, S.A.		Belo Horizonte	Management of investments.	PASA Participações, S.A. (100%)	35.0%
Luxemburgo Participações, S.A.		Belo Horizonte	Management of investments.	AG Telecom Participações, S.A.(100%)	35.0%
LF Tel, S.A.		São Paulo	Management of investments.	EDSP 75 Participações, S.A.(100%)	35.0%

Telemar Participações, S.A.	(b)	Rio de Janeiro	Management of investments.	Bratel Brasil, S.A. (12.1%); AG Telecom Participações, S.A. (12.9%); Luxemburgo Participações, S.A. (6.5%); LF Tel, S.A. (19.4%)	25.6%
Tele Norte Leste Participações, S.A.	(c)	Rio de Janeiro	Management of investments.	Bratel Brasil, S.A. (10.5%); Luxemburgo Participações, S.A. (2.4%); LF Tel, S.A. (2.4%); Telemar Participações (22.2%)	17.9%
Telemar Norte Leste, S.A.	(d)	Rio de Janeiro	Provider of telecommunications services in Brazil.	Bratel Brasil, S.A. (9.4%); Luxemburgo Participações, S.A. (3.3%); LF Tel, S.A. (3.3%); Telemar Participações (3.8%); TNL (70.5%)	25.3%
CTX Participações, S.A.	(b)	Rio de Janeiro	Management of investments.	Portugal Telecom Brasil, S.A.(16.2%); AG Telecom Participações, S.A. (25.4%); Luxemburgo Participações, S.A. (11.4%); LF Tel, S.A.(36.8%)	42.0%
Contax Participações, S.A.	(e) (f)	Rio de Janeiro	Management of investments.	CTX Participações (33.5%)	14.1%
Contax, S.A.	(f)	Rio de Janeiro	Call center services.	Contax Participações (100%)	14.1%

(a) The ownership structures of Telemar and Contax as at 31 December 2011, including its subsidiaries and controlling shareholders, is detailed in Exhibit II.

(b) Under the terms of the acquisition of the investments in Oi and Contax and the agreements entered into with its controlling shareholders, Portugal Telecom shares the power to govern the strategic financial and operating policies, resulting in the proportional consolidation of Portugal Telecom s direct and indirect

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stakes in Telemar Participações (25.6%), which fully consolidates TNL, Telemar and all its subsidiaries, and in CTX (42.0%), which fully consolidates Contax Participações, Contax and its subsidiaries. Following the operations completed on 1 July 2011 regarding the Contax transaction, as mentioned above, Portugal Telecom increased its effective stake in CTX to 44.4%.

(c) Telemar Participações had 56.4% of the voting rights in TNL as at 28 March 2011.

(d) TNL had 98.0% of the voting rights in Telemar as at 28 March 2011.

(e) CTX had 69.3% of the voting rights in Contax as at 28 March 2011.

(f) Following the operations completed on 1 July 2011 regarding the Contax transaction, as mentioned above, Portugal Telecom obtained a direct stake of 4.3% in Contax Participações and increased its effective stakes in Contax Participações and Contax, S.A. from 14.1% to 19.5%.

Oi Group is the leading provider of telecommunication services in the Brazilian market, providing these services through Telemar and its subsidiaries (Exhibit II), as follows:

- Telemar renders fixed telephone services in Region I of Brazil;
- TNL PCS, S.A. renders mobile telephone services in Regions I and III of Brazil (99.7% owned by Telemar);
- Brasil Telecom renders fixed telephone services in Region II of Brazil (49.3% indirectly owned by Telemar, with voting rights of 79.6%);
- 14 Brasil Telecom Celular, S.A. renders mobile telephone services in Region II of Brazil (100% owned by Brasil Telecom);
- Several other companies, including holding companies and others rendering network services, data traffic services, financial services, services related to payment and credit systems and call center and telemarketing services.

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Following these acquisitions, the Company performed a preliminary assessment of the fair value of the assets acquired and liabilities assumed under these businesses combinations and, consequently, the purchase price allocations may be subject to changes until the completion of the one year period from the acquisition date, as allowed by IFRS 3 *Business Combinations*. Nevertheless, the Company does not estimate material changes on its financial position resulting from possible changes in the allocation recorded in 2011. The detail of the fair value of net assets proportionally consolidated in Portugal Telecom s Statement of Financial Position related to Telemar (25.6%), Contax (42.0%) and its controlling shareholders and the goodwill recorded in connection with the transaction mentioned above is as follows:

Euro million

	Carrying value	Fair value adjustments (i)	Fair value
Assets	**9,275**	**1,527**	**10,802**
Cash and cash equivalents (Note 47.i)	1,504		1,504
Short-term investments (Note 25)	192		192
Current accounts receivable	767		767
Current taxes receivable	300		300
Current judicial deposits (Note 31)	208		208
Intangible assets (Note 36)	2,031	1,527	3,558
Tangible assets (Note 37)	2,632		2,632
Deferred taxes (Note 20)	658		658
Non-current judicial deposits (Note 31)	776		776
Post retirement benefits (Note 14)	11		11
Other (ii)	197		197
Liabilities	**6,756**	**519**	**7,275**
Short-term debt (Note 38)	656		656
Current accounts payable (Note 39)	303		303
Current accrued expenses (Note 40)	367		367
Current taxes payable	318		318
Current provisions (Note 42)	213		213
Medium and long-term debt (Note 38)	3,092		3,092
Non-current taxes payable (iii)	312		312
Non-current provisions (Note 42)	594		594
Post retirement benefits (Note 14)	63		63
Deferred taxes (Note 20)	353	519	873
Other (iv)	484		484
Net assets acquired	**2,519**	**1,008**	**3,526**
Non-controlling interests (Note 22)	710	106	816
Net assets acquired attributable to equity holders of the parent	**1,809**	**902**	**2,711**
Treasury shares acquired (Note 1) (v)	61		61
Sub-total based on the exchange rate prevailing as at 31 March 2011 (vi)	**1,870**	**902**	**2,772**
Sub-total based on the exchange rate considered in the purchase price (vi)	**1,905**	**919**	**2,824**
Goodwill (Note 36) (vii)			904
Purchase price (Note 47. i)			**3,728**

(i) The nature of the fair value adjustments is described in more detail below.

(ii) This caption includes primarily prepaid expenses and non-current taxes receivable.

(iii) Non-current taxes payable relate mainly to federal tax partial payment programmes in place in Brazil, under which companies enrolled a substantial portion of their tax debt to the National Treasury and the National Social Security Institute past due up to 30 November 2008.

(iv) This caption includes primarily (1) dividends payable, which are included under the caption Other current liabilities of the Consolidated Statement of Financial Position, (2) non-current accounts payable, namely related to licenses payable to Anatel, and (3) deferred income.

(v) As at 31 March 2011, Oi had a 3.1% stake in Portugal Telecom. This investment was recorded as treasury shares under Portugal Telecom s Consolidated Statement of Financial Position and was acquired under the strategic partnership entered into between Portugal Telecom and Oi (Note 1).

(vi) Following the completion of the acquisition process of Oi, Contax and its controlling shareholders on 28 March 2011, Portugal Telecom proportionally consolidated the fair value of the net assets acquired for the first time as at 31 March 2011, based on the Euro/Brazilian Real exchange rate prevailing as at that date, which differs from the Euro/Brazilian Real exchange rate implicit in the transfers of funds from Portugal to Brazil for the payment of the purchase price. The impact of the difference between these exchange rates was recognized directly in shareholders equity and included in the Consolidated Statement of Comprehensive Income under the caption Foreign currency translation adjustments .

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(vii) In most business acquisitions, there is a part of the acquisition cost that is not capable of being attributed in accounting terms to the fair value of identifiable assets and liabilities assumed and is therefore recognized as goodwill. In the case of the acquisition of Oi and Contax, this goodwill is underpinned by a number of elements, which individually cannot be quantified reliably and isolated, and includes synergies resulting from cost savings, skilled workforce, core technological capabilities and established market reputation.

The fair value of the net assets acquired of Oi, Contax and its controlling shareholders was determined through various measurement methods for each type of asset or liability, based on the best available information. The advice of experts has also been considered in addition to the various other considerations made in determining the fair value of the net assets acquired. The fair value adjustments relate primarily to: (1) the mobile licenses held by TNL PCS, S.A. (TNL PCS) for Regions I and III and by 14 Brasil Telecom Celular, S.A. (Brasil Telecom Celular) for Region II, which are amortized up to 2038, the end of the first renewal period of these licenses; (2) the fixed line concessions held by Telemar Norte Leste for Region I and by Brasil Telecom for Region II, which are amortized up to 2025, the end of the initial period of these concessions; and (3) the customer base of Oi s mobile operations and Contax, which are amortized, on a linear basis, based on the estimated average period of customer retention for each business. The detail of these fair value adjustments is as follows:

Euro million

	Oi	**Contax**	**Total**
Carrying value	**1,797**	**11**	**1,809**
Fair value adjustments:			
Intangibles			
Mobile licenses and fixed line concessions	1,191		**1,191**
Customer base	171	165	**336**
Tax effect	(463)	(56)	**(519)**
Non-controlling interests	(34)	(73)	**(106)**
	865	**36**	**902**
Treasury shares acquired	**61**		**61**
Fair value of net assets acquired based on the exchange rate prevailing as at 31 March 2011	**2,724**	**48**	**2,772**
Fair value of net assets acquired based on the exchange rate considered in the purchase price	**2,775**	**49**	**2,824**
Goodwill (Note 36)	872	31	**904**
Purchase price (Notes 1 and 47.i)	**3,647**	**80**	**3,728**

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The contribution of Oi, Contax and its controlling shareholders for Portugal Telecom s net income attributable to equity holders of the parent in the year ended 31 December 2011 was negative in Euro 32 million. Such contribution differs from the net income included in the financial statements of those companies, primarily due to the impact of the amortization of the fair value adjustments described above. The detail of such contribution is as follows:

	Euro million
REVENUES	**2,768**
COSTS, EXPENSES, LOSSES AND (INCOME)	
Wages and salaries (Note 8)	505
Direct costs (Note 9)	521
Costs of products sold (Note 10)	32
Marketing and publicity	48
Supplies, external services and other expenses (Note 11)	597
Indirect taxes (Note 13)	146
Provisions and adjustments	135
Depreciation and amortisation	545
Post retirement benefits, net (Note 14)	5
Other costs, net	2
Income before financial results and taxes	**231**
Net interest expenses (Note 16)	175
Net other financial expenses	70
Income (loss) before taxes	**(15)**
Income taxes (Note 20)	7
Net income (loss) (before non-controlling interests)	**(22)**
Income attributable to non-controlling interests	10
Net loss attributable to equity holders of Portugal Telecom	**(32)**

The pro-forma of Portugal Telecom s consolidated operating revenues and net income before non-controlling interests for the period ended 31 December 2011 as if Oi, Contax and its controlling holdings had been proportionally consolidated as from 1 January 2011, would be as follows:

Euro million

	Reported figures	Oi and Contax effect	Pro-forma information
Operating revenues	6,147	890	7,037
Net income (before non-controlling interests)	423	(75)	348

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The contribution of Oi, Contax and its controlling shareholders for Portugal Telecom s consolidated statement of financial position as at 31 December 2011, which does not include the goodwill generated by the Company as a result of the acquisition of the investments in these companies, is as follows:

	Euro million
Cash, cash equivalents and short-term investments	1,563
Current accounts receivable	798
Current taxes receivable	287
Current judicial deposits	229
Intangible assets	3,401
Tangible assets	2,573
Post retirement benefits	12
Deferred taxes	626
Non-current judicial deposits	855
Other	172
Assets	**10,515**
Short-term debt	601
Current accounts payable	362
Current accrued expenses	361
Current taxes payable	338
Current provisions	191
Medium and long-term debt	3,281
Non-current taxes payable	311
Non-current provisions	570
Post retirement benefits	74
Deferred taxes	776
Other	477
Liabilities	**7,341**
Non-controling interests	**694**
Net assets	**2,480**

In April 2011, as mentioned above, Contax acquired an investment in Allus for an amount of R$245 million (Note 1), equivalent to R$103 million based on the stake proportionally consolidated by Portugal Telecom. This investment was proportionally consolidated in Portugal Telecom s Statement of Financial Position for the first time as at 30 April 2011. The fair value of net assets proportionally consolidated as at 30 April 2011 and the goodwill recorded in connection with this transaction is as follows:

	Million	
	Brazilian Reais	**Euro**
Assets	**94**	**40**
Current assets (i)	41	18
Intangible assets (Note 36)	31	13
Tangible assets (Note 37)	16	7
Other	5	2

Liabilities	**59**	**25**
Current liabilities	46	19
Medium and long-term debt	13	5
Other	1	0
Net assets acquired	**35**	**15**
Goodwill (Note 36)	68	29
Acquisition price (Note 47.i)	**103**	**44**

(i) This caption includes cash and cash equivalents amounting to Euro 2 million, which were included in the Consolidation Statement of Cash Flows under the caption Cash receipts resulting from financial investments (Note 47.i).

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On 7 February 2010, Portugal Telecom, through Dedic, a company that operates in the call centre business in Brazil, agreed to acquire a 100% equity stake in GPTI, S.A. (GPTI), a company which renders services related to information systems and technologies which are a complement to the services provided by Dedic. The purchase price of this acquisition included (1) the issuance of shares of Dedic corresponding to a 12.5% stake, and (2) an option granted to the former shareholder of GPTI to increase or decrease that stake up to 7.5%, depending on the operational and financial performance of GPTI during 2010 and 2011. As a result of this acquisition, which was completed through the issuance of shares of Dedic on 1 March 2010 (the effective date of the acquisition of control), the former shareholder of GPTI obtained a 12.5% stake in Dedic. The detail of the net assets of GPTI that were consolidated as at 1 March 2010 and the goodwill recorded in connection with this transaction is as follows:

Euro million

	Book value	**Fair value adjustments (i)**	**Fair value**
NET ASSETS ACQUIRED			
Accounts receivable	13		13
Taxes receivable	2		2
Intangible assets		3	3
Tangible assets	1		1
Other assets	0		0
Short-term debt	(18)		(18)
Accounts payable	(2)		(2)
Taxes payable	(11)		(11)
Current provisions	(4)		(4)
Medium and long-term debt	(13)		(13)
Non-current provisions	(2)	(1)	(3)
Other liabilities	(3)		(3)
Total net assets acquired	**(37)**	**2**	**(35)**
Purchase price (ii)			14
Total goodwill (Note 36)			**49**

(i) The fair value adjustments related to intangible assets consist of the estimate fair value of recurring contracts entered into between GPTI and certain customers. The fair value adjustments related to non-current provisions correspond to the fair value of certain tax contingencies whose settlement was considered to be possible at the date of acquisition.

(ii) As mentioned above, the purchase price includes (a) 28 million Brazilian Reais (Euro 11 million) corresponding to the fair value of the share capital increase at Dedic at the acquisition date, and (b) 5 million Brazilian Reais (Euro 2 million) corresponding to the fair value as at 1 March 2010 of the option granted to the former shareholder of GPTI.

The contribution of GPTI for Portugal Telecom s results for the year ended 31 December 2010 was a net profit before non-controlling interests of approximately Euro 4 million, including operating revenues of Euro 56 million. The pro-forma of Portugal Telecom s consolidated operating revenues and net income before non-controlling interests for the year ended 31 December 2010 as if GPTI had been consolidated as from 1 January 2010 are as follows:

Euro million

	Reported figures	GPTI s results for January and February of 2010	Pro-forma information
Operating revenues	3,742	8	3,751
Net income (before non-controlling interests)	5,820	(5)	5,815

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Disposals

In 2010, Vivo was classified as a discontinued operation following the agreement reached by Portugal Telecom with Telefónica on 28 July 2010 for the disposal of its 50% stake in Brasilcel, which was completed in September 2010. Consequently, financial information relating to this business was presented as a discontinued operation (Note 21).

Other corporate transactions

As explained in Note 1, on 1 July 2011, the Board of Directors and the Shareholders Meetings of Dedic, Contax and CTX approved the following operations: (1) the exchange of Portugal Telecom s investment in Dedic/GPTI for a 7.6% stake in Contax; (2) the exchange of a 1.3% Portugal Telecom s stake in Contax for an additional 3.7% stake in CTX; and (3) the disposal by Portugal Telecom to CTX of a 2.0% stake in Contax for a total amount of R$49.7 million. All these operations were recorded at fair value, including the exchange of the investment in Dedic and GPTI for an investment in Contax, which was recorded based on the related fair value attributed to the terms of the exchange. As a result of these operations, it was recorded a total goodwill of Euro 28 million (Note 36), corresponding to the difference between the fair value and the carrying amount of the net assets acquired by both Portugal Telecom and Contax. Basically, this goodwill represents the synergies resulting from the integration of these entities, since both operate in the call center business.

As a result of the operations mentioned above, Portugal Telecom s direct and indirect stakes in CTX and Contax were increased from 42.0% to 44.4% and from 14.1% to 19.5%, respectively, and Dedic/GPTI is no longer fully consolidated by Portugal Telecom as it became a wholly owned subsidiary of Contax. Consequently, Dedic/GPTI s assets, liabilities and results were proportionally consolidated as from 1 July 2011, together with Contax, while up to that date were fully consolidated in Portugal Telecom s financial statements. The detail of Dedic/GPTI s assets and liabilities that were fully consolidated as at 30 June 2011 and were then integrated in Contax and proportionally consolidated as from 1 July 2011, based on the Company s 44.4% effective stake in CTX, is as follows:

Euro million

	30 Jun 2011
Assets	
Cash and cash equivalents	3
Accounts receivable	74
Intangible assets (including goodwill over GPTI) (Note 36)	70
Tangible assets (Note 37)	46
Deferred taxes (Note 20)	22
Other	8
	223
Liabilities	
Gross debt	21
Accounts payable	19
Accrued expenses	19
Taxes payable	12
Provisions (Note 42)	9
	79

Except for the transactions mentioned above, there are no other relevant changes in the consolidation Group that occurred during the years ended 31 December 2011 and 2010.

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3. Significant accounting policies, judgments and estimates

Significant accounting policies

a) Current classification

Assets to be realized within one year from the date of the Consolidated Statement of Financial Position are classified as current. Liabilities are also classified as current when they are due to be settled, or there is no unconditional right to defer its settlement, for a period of at least twelve months after the date of the Consolidated Statement of Financial Position.

b) Inventories

Inventories are stated at average acquisition cost. Adjustments to the carrying value of inventories are recognised based on technological obsolescence or slow moving.

c) Tangible assets

In 2008, Portugal Telecom changed the accounting policy regarding the measurement of real estate properties and ducts infra-structure from the cost model to the revaluation model, since it believes the latter better reflects the economic value of those asset classes, given the nature of the assets revalued, which are not subject to technological obsolescence. The increase in tangible assets resulting from the revaluation reserves, which are non-distributable reserves, is being amortised in accordance with the criteria used to amortize the revalued assets. Portugal Telecom has adopted the policy to revise the revalued amount every 3 years.

The remaining tangible assets are stated at acquisition cost, net of accumulated depreciation, investment subsidies and accumulated impairment losses, if any. Acquisition cost includes: (1) the amount paid to acquire the asset; (2) direct expenses related to the acquisition process; and (3) the estimated cost of dismantling or removal of the assets (Notes 3.g and 43). Under the exception of IFRS 1, revaluation of tangible assets made, prior to 1 January 2004, in accordance with Portuguese legislation applying monetary indices, was not adjusted and was included as the deemed cost of the asset for IFRS purposes.

Tangible assets are depreciated on a straight-line basis from the month they are available for use, during its expected useful life. The amount of the asset to be depreciated is reduced by any residual estimated value. The depreciation rates used correspond to the following estimated average economic useful lives:

	Years
Buildings and other constructions	3 - 50
Basic equipment:	
Network installations and equipment	7 - 40
Ducts infra-structure	40
Telephones, switchboards and other	3 - 10
Submarine cables	15 - 20
Satellite stations	5 - 7
Other telecommunications equipment	4 - 10
Other basic equipment	4 - 20
Transportation equipment	4 - 8
Tools and dies	4 - 8
Administrative equipment	3 - 10
Other tangible fixed assets	4 - 8

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Estimated losses resulting from the replacement of equipments before the end of their economic useful lives are recognised as a deduction to the corresponding asset s carrying value, against results of the period, as well as any impairment of these assets. The cost of recurring maintenance and repairs is charged to net income as incurred. Costs associated with significant renewals and betterments are capitalized if any future economic benefits are expected and those benefits can be reliably measured.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the assets, and is recognised in the Consolidated Income Statement under the caption Gains on disposals of fixed assets, net when occurred.

d) Intangible assets

Intangible assets are stated at acquisition cost, net of accumulated amortisation and accumulated impairment losses, if any. Intangible assets are recognised only if any future economic benefits are expected and those benefits as well as the cost of the asset can be reliably measured.

Intangible assets include mainly goodwill (Note 2.a), the acquisition of the Basic Network held by PT Comunicações, telecommunications licenses and concessions related rights, mainly related to Oi and TMN, and software licenses.

Intangible assets, except goodwill, are amortised on a straight-line basis from the month they are available for use, during the estimated economic useful lifes or contractual periods if lower (including additional renewal periods if applicable), as follows:

[redacted]

The renewal period of the licenses depends basically on the companies meeting certain pre-defined goals or obligations set out in the agreements under which those licenses were initially obtained.

e) Real estate investments

Real estate investments, which are included under the caption Other investments (Note 35), consist primarily of buildings and land held to earn rentals and/or capital appreciation, and not for use in the normal course of business (exploration, service render or sale).

These investments are stated at its acquisition cost plus transaction costs and reduced by accumulated depreciation (straight-line basis) and accumulated impairment losses, if any. Expenditures incurred (maintenance, repairs, insurance and real estate taxes) and any income obtained are recognised in the Consolidated Income Statement of the period.

Real estate investments are depreciated on a straight-line basis, during their expected useful lifes (Note 3.c).

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f) Impairment of tangible and intangible assets, excluding goodwill

The Group performs impairment tests for its tangible and intangible assets if any event or change results in an indication of impairment. In case of any such indication, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss.

Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. The recoverable amount is the higher of fair value less cost to sell and the value in use. In assessing fair value less cost to sell, the amount that could be received from an independent entity is considered, reduced by direct costs related to the sale. In assessing the value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the specific risk to the asset.

If the recoverable amount of an asset is estimated to be less than its carrying amount, an impairment loss is recognised immediately in the Consolidated Income Statement.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior periods. A reversal of an impairment loss is recognised immediately in net income.

Tangible assets recognized according to the revaluation model are subject to periodic remeasurement. Any impairment loss of these assets is recorded as a reduction to the revaluation reserve initially recognized under shareholders equity. Impairment losses in excess of the initial revaluation reserve are recognized in the Consolidated Income Statement.

g) Provisions, liabilities and contingent liabilities

Provisions are recognised when the Group has a present obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where any of the above mentioned criteria does not exist, or is not accomplished, the Group discloses the event as a contingent liability, unless the cash outflow is remote.

Provisions for restructuring are only recognised if a detailed and formal plan exists and if the plan is communicated to the related parties.

Provisions are updated on the date of the Consolidated Statement of Financial Position, considering the best estimate of the Group s management.

Obligations for dismantling and removal costs are recognised from the month the assets are in use and if a reliable estimate of the obligation is possible (Notes 3.c) and 43). The amount of the obligation is discounted, being the corresponding effect of time value recognised in net income, under the caption Net interest expense .

h) Pension and pension supplement benefits

Under several defined benefit plans, PT Comunicações and PT Sistemas de Informação, S.A. (PT SI) were responsible to pay to a group of employees a pension or a pension supplement. Following the transfer in 2010 to the Portuguese State of the unfunded regulatory pension obligations, as explained in Note 14.1, PT Comunicações and PT SI are responsible since December 2011 to pay only pension supplements. In order to finance these obligations, various funds were incorporated by PT Comunicações (Note 14.1.1).

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Telemar and its subsidiaries sponsor private pension plans and other post retirement benefits for their employees, which are managed by two foundations. Telemar and its subsidiaries have defined contribution and defined benefit plans (Note 14.2).

The amount of the Group s liabilities with the defined benefit plans described above is estimated based on actuarial valuations, using the Projected Unit Credit Method . The Group has elected to apply the option in IAS 19 to recognise actuarial gains and losses directly in the Consolidated Statement of Comprehensive Income, namely those resulting from changes in actuarial assumptions and from differences between actual data and actuarial assumptions.

Plan amendments related to reduction of the benefits granted to employees are recorded as prior years service gains or losses. Prior years service gains or losses related to vested rights are recognised under the caption Post retirement benefits when they occur and those related to unvested rights are recognised on a straight-line basis until they become vested, which usually corresponds to the retirement date. Gains obtained with the settlement of any plan are recognized when incurred under the caption Curtailment costs .

Liabilities stated in the Consolidated Statement of Financial Position correspond to the difference between the Projected Benefit Obligation (PBO) related to pensions deducted from the fair value of pension fund assets and any prior years service gains or losses not yet recognised.

For the plans that report an actuarial surplus, assets are recorded when there is an express authorization for offsetting them against future employer contributions, or if a reimbursement of the excess finance is expressly authorized or permitted.

Contributions made under defined contribution pension plans are determined based on actuarial calculations, when applicable, and recognised in net income when incurred. Under these plans, the sponsor does not have the legal or constructive obligation of making additional contributions, in the event the fund lacks sufficient assets to pay all employees the benefits related to the services provided in the current year and prior years.

i) Post retirement health care benefits

Under a defined benefit plan, PT Comunicações and PT SI are responsible to pay, after the retirement date, health care expenses to a group of employees and its relatives. This health care plan is managed by Portugal Telecom Associação de Cuidados de Saúde (PT-ACS). In 2004, the Group established PT Prestações Mandatária de Aquisições e Gestão de Bens, S.A. (PT Prestações) to manage an autonomous fund to finance these obligations (Note 14.1.2).

Telemar and its subsidiaries manage a defined benefit plan intended to provide medical care to retirees and survivor pensioners.

The amount of the Group s liabilities with respect to these benefits after retirement date is estimated based on actuarial valuations, using the Projected Unit Credit Method . The Group has elected to apply the option in IAS 19 to recognise actuarial gains and losses in the Consolidated

Statement of Comprehensive Income, namely those resulting from changes in actuarial assumptions and from differences between actual data and actuarial assumptions.

Plan amendments related to reduction of the benefits granted to employees are recorded as prior years service gains or losses. Prior years service gains or losses related to vested rights are recognised under the caption Post retirement benefits when they occur and those related to unvested rights are recognised on a straight-line basis until they become vested, which usually corresponds to the retirement date. Gains obtained with the settlement of any plan are recognized when incurred under the caption Curtailment costs .

Accrued post retirement health care liabilities stated in the Consolidated Statement of Financial Position correspond to the present value of obligations from defined benefit plans, reduced by the fair value of fund assets and any prior years service gains or losses not yet recognised.

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For the plans that report an actuarial surplus, assets are recorded when there is an express authorization for offsetting them against future employer contributions, or if a reimbursement of the excess finance is expressly authorized or permitted.

j) Pre-retired and suspended employees

In connection with the programs related to employees that are under a suspended contract agreement or that have been pre-retired, the Group recognizes a liability in the Consolidated Statement of Financial Position equivalent to the present value of salaries payable up to the retirement age. The correspondent cost is recorded in the Consolidated Income Statement under the caption Curtailment costs (Note 14.1.3).

k) Grants and subsidies

Grants and subsidies from the Portuguese Government and from the European Union are recognised at fair value when the receivable is probable and the Company can comply with all requirements of the subsidy s program.

Grants and subsidies for training and other operating activities are recognised in net income when the related expenses are recognised. Grants and subsidies to acquire assets are deducted from the carrying amount of the related assets (Note 3.c).

l) Financial assets and liabilities

Financial assets and liabilities are recognised in the Group s Consolidated Statement of Financial Position when the Group becomes a party to the contractual provisions of the instrument.

(i) Receivables (Notes 26 and 27)

Trade receivables, loans granted and other receivables that have fixed or determinable payments and that are not quoted in an active market are classified as receivables or loans granted.

Trade receivables do not have any implicit interest and are presented at nominal value, net of allowances for estimated non-recoverable amounts, which are mainly computed based on (a) the aging of the receivables and (b) the credit profile of specific customers.

(ii) Financial liabilities and equity instruments

Financial liabilities and equity instruments issued by the Group are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

Equity instruments issued by the Group are recognised based on their proceeds, net of any issuance costs.

Exchangeable bonds issued by Portugal Telecom are recognised as compound instruments, comprising the following elements: (i) the present value of the debt, estimated using the prevailing market interest rate for similar non-convertible debt and recorded under debt liabilities; and (ii) the fair value of the embedded option for the holder to convert the bond into equity, recorded directly in shareholders equity. As of the Consolidated Statement of Financial Position date, the debt component is recognised at amortised cost.

(iii) Bank loans (Note 38)

Bank loans are recognised as a liability based on the related proceeds, net of any transaction cost. Interest and other financial costs, which are computed based on the effective interest rate and include the recognition of up front fees, are recognised when incurred.

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(iv) Accounts payable (Note 39)

Trade payables are recognised at nominal value, which is substantially similar to their fair value.

(v) Derivative financial instruments and hedge accounting (Note 45)

The activities of the Group are primarily exposed to financial risks related with changes in foreign currency exchange rates and changes in interest rates. The Group s policy is to contract derivative financial instruments to hedge those risks, subject to detailed analysis of related economics and Executive Committee approval.

Derivative financial instruments are initially measured at fair value on the contract date, and are remeasured to fair value at subsequent reporting dates.

Hedge accounting

The provisions and requirements of IAS 39 must be met in order to qualify for hedge accounting. Currently, for accounting purposes, Portugal Telecom classifies certain derivative financial instruments as fair value and cash flow hedges.

Changes in the fair value of derivative financial instruments classified as fair value hedges are recognised in net income of the period, together with the changes in the value of the covered assets or liabilities related with the hedged risk.

The effective portion of the changes in fair value of derivative financial instruments classified as cash flow hedges is recognised directly in shareholders equity, and the ineffective portion is recognised as financial results. When changes in the value of the covered asset or liability are recognised in net income, the corresponding amount of the derivative financial instrument previously recognised under Hedge accounting directly in shareholders equity is transferred to net income.

Changes in fair value of derivative financial instruments that, in accordance with internal policies, were contracted to economically hedge an asset or liability but do not comply with the provisions and requirements of IAS 39 to be accounted for as hedges, are classified as derivatives held for trading and recognised in net income.

(vi) Treasury shares (Note 44)

Treasury shares are recognised as a deduction to shareholders equity, under the caption Treasury shares , at acquisition cost, and gains or losses obtained in the disposal of those shares are recorded under Accumulated earnings .

Equity swaps on own shares that include an option exercisable by Portugal Telecom for physical settlement are recognised as a financial liability and a corresponding reduction of equity, and are accounted for as an acquisition of treasury shares on the inception date of the contract.

Portugal Telecom s shares acquired by any of its affiliated companies are recognized at acquisition cost as treasury shares based on the Company s interest in the entity that acquired those shares.

(vii) Cash and cash equivalents and short term investments (Note 25)

Cash and cash equivalents comprise cash on hand and demand bank deposits, due within three months or less from the date of acquisition, that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value. Cash and cash equivalents also includes deposits from customers and other entities that have not yet been cleared.

In the Consolidated Statement of Cash Flows, cash and cash deposits also includes overdrafts recognised under the caption Short-term debt .

Short-term investments comprise investments for the purpose of generating investment returns, and they are therefore not classified as cash equivalents.

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(viii) Qualified Technological Equipment transactions

In previous years, the Company entered into certain Qualified Technological Equipment transactions (QTE), whereby certain telecommunications equipment were sold to certain entities. Simultaneously, those foreign entities entered into leasing contracts with respect to the equipment with special purpose entities, which entered into conditional sale agreements to resell the related equipment to the Company. The Company maintains the legal possession of this equipment.

These transactions correspond to a sale and lease-back transaction, and the equipment continued to be recorded on the Company s Consolidated Statement of Financial Position. The Company obtained the majority of the economic benefits of these entities and therefore is exposed to the risks resulting from the activities of these special purpose entities. Accordingly, those entities were fully consolidated in the Company s financial statements. Consolidated current and non-current assets include an amount equivalent to the proceeds of the sale of the equipment (Note 32), and current and non-current liabilities include the future payments under the lease contract (Note 43).

m) Own work capitalized

Certain internal costs (materials, work force and transportation) incurred to build or produce tangible assets are capitalized only if:

- the tangible assets are identifiable;
- the tangible assets will generate future economic benefits which can be reliably estimated; and
- development expenses can be reliably measured.

The amounts capitalized are deducted from the corresponding operating costs incurred and no internally generated margin is recognised. When any of the above mentioned criteria is not met, the expense is recognised in net income.

Expenses incurred during investigation are recognised in net income when incurred.

n) Leasings (the company as a lessee)

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases (Note 12). The classification of leases depends on the substance of the transaction and not on the form of the contract.

Assets acquired under finance leases and the corresponding liability to the lessor are accounted for using the finance method, in accordance with the lease payment plan (Note 38). Interest included in the rents and the depreciation of the assets are recognised in net income in the period they occur.

Under operating leases, rents are recognised on a straight-line basis during the period of the lease (Note 12).

o) Taxation

Income tax expense is recognised in accordance with IAS 12 *Income Taxes* (IAS 12) and represents the sum of the tax currently payable and deferred tax.

Portugal Telecom has adopted the tax consolidation regime in Portugal (currently known as the special regime for the taxation of groups of companies). The provision for income taxes is determined on the basis of the estimated taxable income for all the companies in which Portugal Telecom holds at least 90% of the share capital and that are domiciled in Portugal and subject to Corporate Income Tax (IRC). The remaining Group companies not covered by the tax consolidation regime of Portugal Telecom are taxed individually based on their respective taxable income, at the applicable tax rates.

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The current tax payable is based on taxable income for the period, and deferred taxes are based on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and are accounted for using the liability method.

Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is reasonably likely that taxable income will be available against which deductible temporary differences can be used, or when there are deferred tax liabilities the reversal of which is expected in the same period in which the deferred tax assets reverse. The carrying amount of deferred tax assets is reviewed at the date of the Consolidated Statement of Financial Position and is reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow for all or part of the asset to be recovered.

Deferred tax is charged to net income, except when it relates to items charged or credited directly to shareholders equity, in which case the deferred tax is also recognised directly in shareholders equity. Accordingly, the impact of changes in tax rate is also charged to net income, except when it relates to items charged or credited directly to shareholders equity, in which case that impact is also recognised directly in shareholders equity.

p) Revenue recognition

Revenues from fixed line telecommunications are recognised at their gross amounts when services are rendered. Billings for these services are made on a monthly basis throughout the month. Unbilled revenues or revenues not billed by other operators but accrued or incurred as of the date of the financial statements are recorded based on estimates. Differences between accrued amounts and the actual unbilled revenues, which ordinarily are not significant, are recognised in the following period.

Revenues from international telecommunications services are divided with the operators of the transit countries and the operators of the country in which calls are terminated based on traffic records of the country of origin and rates established in agreements with the various 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.

Revenues from rentals of terminal equipment are recognised as an operating lease in the period to which they apply, under operating revenues.

Revenues from Internet Service Providers (ISP) services result essentially from monthly subscription fees and telephone traffic when the service is used by customers. These revenues are recognised when the service is rendered.

Revenues from Pay-TV services result essentially from and are recognised as follows:

Nature of the revenue	Caption	Moment of recognition
Monthly subscription fees for the use of the service	Services rendered	When the service is rendered
Rental of equipment	Services rendered	The period of rental
Sale of equipment	Sales	When the sale occurs
Penalties imposed to customers	Other revenues	When received

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Revenues from mobile telephony services result essentially from the use of the wireless network, by customers or other operators.

The moment in which revenues are recognised and the corresponding caption are as follows:

Nature of the revenue	Caption	Moment of recognition
Use of the network	Services rendered	In the month the service is rendered
Interconnection fees	Services rendered	In the month the service is rendered
Roaming	Services rendered	In the month the service is rendered
Pre-paid cards	Services rendered	When the service is rendered
Wireless broadband	Services rendered	When the service is rendered
Terminal equipment and accessories	Sales	When the sale occurs
Penalties imposed to customers	Other revenues	When received

Revenues from bundling services or products are allocated to each of its components based on its fair value and are recognised separately in accordance with the methodology adopted to each component.

The Group operates loyalty programmes for some of its customers, under which, based on certain levels of mobile traffic, these customers receive loyalty points that can be exchanged for equipments, accessories and discounts on subsequent purchases of telecommunications services. Portugal Telecom splits the consideration received in the initial transaction between the revenue related to traffic and the loyalty points earned by the customer, recognizing a deferred income measured at fair value for the award credits, taking into consideration the expected points to be redeemed. Deferred income is then recognized as revenue when award credits are redeemed or expire.

q) Foreign currency transactions and balances

Transactions denominated in foreign currencies are translated to Euros at the exchange rates prevailing at the time the transactions are made. At the date of the Consolidated Statement of Financial Position, assets and liabilities denominated in foreign currencies are adjusted to reflect the exchange rates prevailing at such date. The resulting gains or losses on foreign exchange transactions are recognised in net income. Exchange differences on non-monetary items, including goodwill, and on monetary items representing an extension of the related investment and where settlement is not expected in the foreseeable future, are recognized directly in shareholders equity under the caption Cumulative foreign currency translation adjustments , and included in the Consolidated Statement of Comprehensive Income.

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

- Assets and liabilities at exchange rates prevailing at the date of the Consolidated Statement of Financial Position;
- Profit and loss items at average exchange rates for the reported period;

- Cash flow items at average exchange rates for the reported period, where these rates approximate the effective exchange rates (and in the remaining cases, at the rate effective on the day the transaction occurred); and

- Share capital, reserves and retained earnings at historical exchange rates.

The effect of translation differences is recognised in shareholders equity under the caption Cumulative foreign currency translation adjustments and is included in the Consolidated Statement of Comprehensive Income. In accordance with IAS 21, when a reduction of Portugal Telecom s investment in a foreign entity occurs, through the sale or reimbursement of share capital, the accumulated effect of translated differences is transferred to the Consolidated Income Statement, considering the proportion of the reduction occurred.

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The Group adopted the exception under IFRS 1 relating to cumulative translation adjustments as of 1 January 2004 and transferred this amount from Foreign currency translation adjustments to Accumulated earnings . As from 1 January 2004, the Group has been recognizing all translation adjustments directly in shareholders equity and therefore these amounts are transferred to net income only if and when the related investments are disposed off or there is a repayment of the investment made.

r) Borrowing costs

Borrowing costs related to loans are recognised in net income when incurred. The Group does not capitalise any borrowing costs related to loans to finance the acquisition, construction or production of any asset, where the construction period of its tangible and intangible assets is relatively short.

s) Consolidated Statement of Cash Flows

The Consolidated Statement of Cash Flows is prepared under IAS 7, using the direct method. The Group classifies all highly liquid investments, with original maturity of up to three months and an insignificant risk of change in fair value, as Cash and cash equivalents . The Cash and cash equivalents item presented in the Consolidated Statement of Cash Flows also includes overdrafts, classified in the Consolidated Statement of Financial Position under Short-term debt .

Cash flows are classified in the Consolidated Statement of Cash Flows according to three main categories, depending on their nature: (1) operating activities; (2) investing activities; and (3) financing activities. Cash flows from operating activities include primarily collections from clients, payments to suppliers, payments to employees, payments relating to post retirement benefits and net payments relating to income taxes and indirect taxes. Cash flows from investing activities include primarily acquisitions and disposals of investments, dividends received from associated companies and purchase and sale of property, plant and equipment. Cash flows from financing activities include primarily borrowings and repayments of debt, payments relating to interest and related expenses, acquisition and sale of treasury shares and payments of dividends to shareholders.

t) Subsequent events (Note 50)

Events that occur after the date of the Consolidated Statement of Financial Position that could influence the value of any asset or liability as of that date are considered when preparing the financial statements for the period. Those events are disclosed in the notes to the financial statements, if material.

Critical judgments and estimates

The preparation of the consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the application of policies and reported amounts. Estimates and judgements are continually evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances on which the estimate was based, or as a result of new information or more experience. The main accounting judgments and estimates reflected in the consolidated financial statements are as follows:

(a) Post retirement benefits The present value of post retirement obligations is computed based on actuarial methodologies, which use certain actuarial assumptions. Any changes in those assumptions will impact the carrying amount of post retirement obligations. The key assumptions for post retirement obligations are disclosed in Note 14. The Company has the policy to review key assumptions on a periodic basis, if the corresponding changes have a material impact on the financial statements.

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(b) Goodwill impairment analysis Portugal Telecom tests annually whether goodwill has suffered any impairment. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. The use of this method requires the estimate of future cash flows expected to arise from the continuing operation of the cash generating unit, the choice of a growth rate to extrapolate cash flow projections and the estimate of a suitable discount rate for each cash generating unit.

(c) Valuation and useful life of intangible and tangible assets Portugal Telecom has made assumptions in relation to the potential future cash flows resulting from separable intangible assets acquired as part of business combinations, which include expected future revenues, discount rates and useful life of such assets. Portugal Telecom has also made assumptions regarding the useful life of tangible assets.

(d) Recognition of provisions and adjustments Portugal Telecom is party to various legal claims for which, based on the opinion of its legal advisors, a judgment was made to determine whether a provision should be recorded for these contingencies (Note 49). Adjustments for accounts receivable are computed based primarily on the aging of the receivables, the risk profile of the customer and its financial condition. These estimates related to adjustments for accounts receivable differ from business to business.

(e) Assessment of the fair value of financial instruments Portugal Telecom chooses an appropriate valuation technique for financial instruments not quoted in an active market based on its best knowledge of the market and the assets. In this process, Portugal Telecom applies the valuation techniques commonly used by market practitioners and uses assumptions based on market rates.

(f) Assessment of the fair value of revalued assets Portugal Telecom uses the revaluation model to measure the carrying value of certain tangible asset classes. In order to determine the revalued amount of those assets, Portugal Telecom uses the replacement cost method for the ducts infra-structure and the market value for real estate assets, which require the use of certain assumptions related to the construction cost and the use of specific indicators for the real estate market, respectively, as explained in more detail in Note 37.

(g) Deferred taxes - The Group recognizes and settles income taxes based on the results of operations determined in accordance with the local corporate legislation, taking into consideration the provisions of the tax law, which are materially different from the amounts calculated for IFRS purposes. In accordance with IAS 12, the Company recognizes deferred tax assets and liabilities based on the differences between the carrying amounts and the taxable bases of the assets and liabilities. The Company regularly assesses the recoverability of deferred tax assets and recognizes an allowance for impairment losses when it is probable that these assets may not be realized, based on the history of taxable income, the projection of future taxable income, and the time estimated for the reversal of existing temporary differences. These calculations require the use of estimates and assumptions. The use of different estimates and assumptions could result in the recognition of an allowance for impairment losses for the entire or a significant portion of the deferred tax assets.

Estimates used are based on the best information available during the preparation of the consolidated financial statements, although future events, neither controlled nor foreseeable by the Company, could occur and have an impact on those estimates. In accordance with IAS 8, changes to the estimates used by management that occur after the date of the consolidated financial statements are recognised in net income, using a prospective methodology.

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4. Changes in accounting policies and estimates

During the year ended 31 December 2011, the following standards, revised standards or interpretations became effective, although their adoption had no material effect on Portugal Telecom s financial statements:

- Amendments to IAS 24 *Related Party Disclosures;*
- Amendments to IFRIC 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction;*
- IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments;*
- Amendments to IFRS 1 *First Time Adoption of IFRS;*
- Amendments to IAS 32 *Financial Instruments;*
- Amendments to IFRS 7 *Financial Instruments: Disclosures;* and
- Amendments to IAS I *Presentation of Financial Statements* and IFRS 3 *Business Combinations* as part of a document issued in 2010 related to minor improvements across several standards.

In 2011, the Inter*national Accounting Standards Board* (IASB) issued the following new standards, which were not yet adopted by Portugal Telecom as they were not yet endorsed by the European Union and their application is only required in subsequent periods:

- On 16 June 2011, the IASB issued amendments to IAS 19 *Employee Benefits*, which include primarily: (i) the elimination of an option to defer the recognition of actuarial gains and losses, known as the corridor method ; (ii) streamlining the presentation of changes in assets and liabilities arising from defined benefit plans, including requiring remeasurements to be presented in other comprehensive income, thereby separating those changes from changes that many perceive to be the result of an entity s day-to-day operations; and (iii) enhancing the disclosure requirements for defined benefit plans, providing better information about the characteristics of defined benefit plans and the risks that entities are exposed to when participating in those plans. This standard is effective for annual periods beginning on or after 1 January 2013. The Company is accessing the impacts resulting from the adoption of this revised standard, although it should be mentioned that Portugal Telecom already recognizes actuarial gains and losses directly in shareholders equity;

- On 16 June 2011, the IASB issued amendments to IAS 1 *Presentation of Financial Statements* that require additional disclosures to be made in the statement of comprehensive income such that items of other comprehensive income are grouped into two categories: (a) items that will not be reclassified subsequently to profit or loss; and (b) items that will be reclassified subsequently to profit or loss when specific conditions are met. These amendments to IAS 1 are effective for annual periods beginning on or after 1 July 2012;

- On 12 May 2011, the IASB issued IFRS 10 *Consolidated Financial Statements*, which establishes the principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. IFRS 10 builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. IFRS 10 replaces the consolidation requirements in SIC 12 *Consolidation Special Purpose Entities* and IAS 27 *Consolidated and Separate*

Financial Statements. The Company is accessing the impacts of the adoption of this standard, which is effective for annual periods beginning on or after 1 January 2013;

- On 12 May 2011, the IASB issued IFRS 11 *Joint Arrangements*, which classifies joint arrangements as either joint operations (combining the existing concepts of jointly controlled assets and jointly controlled operations) or joint ventures (equivalent to the existing concept of a jointly controlled entity) and requires the use of the equity method of accounting for interests in joint ventures thereby eliminating the proportionate consolidation method. This standard, which supersedes IAS 31 *Interest in Joint Ventures* and SIC 13 *Jointly Controlled Entities Non-Monetary Contributions by Ventures*, is effective for annual periods

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beginning on or after 1 January 2013. Upon the adoption of this new standard, Portugal Telecom will not be able to proportionally consolidate its investments in Oi, Contax and its controlling shareholders;

• On 12 May 2011, the IASB issued IFRS 12 *Disclosure of Interests in Other Entities*, which is applicable to entities that have an interest in subsidiaries, joint arrangements, associates or unconsolidated structured entities, establishes disclosure objectives and specifies minimum disclosures that an entity must provide to meet those objectives. In accordance with this standard, an entity should disclose information that helps users of its financial statements to evaluate the nature of and risks associated with its interests in other entities and the effects of those interests on its financial statements. The Company is accessing the impacts of the adoption of this standard, which is effective for annual periods beginning on or after 1 January 2013;

• On 12 May 2011, the IASB issued IFRS 13 *Fair Value Measurement*, which establishes a single source of guidance for fair value measurement under IFRS. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date . The Company is accessing the impacts of the adoption of this standard, which is effective for annual periods beginning on or after 1 January 2013;

• Following the above mentioned standards issued on 12 May 2011, the standards IAS 27 *Consolidated and Separate Financial Statements* and IAS 28 *Investments in Associates* were revised accordingly;

• On 20 December 2010, the IASB issued amendments to IAS 12 *Income Taxes* which provide an exception to the general principles in IAS 12 that the measurement of deferred tax assets and deferred tax liabilities should reflect the tax consequences that would follow from the manner in which the entity expects to recover the carrying amount of an asset. Specifically, under the amendments, investment properties that are measured using the fair value model in accordance with IAS 40 Investment Property are presumed to be recovered through sale for the purposes of measuring deferred taxes, unless the presumption is rebutted in certain circumstances. The Company is accessing the impacts of the adoption of these amendments to IAS 12, which are effective for annual periods beginning on or after 1 January 2012;

• On 7 October 2010, the IASB issued amendments to IFRS 7 *Financial Instruments: Disclosures* that increase the disclosure requirements for transactions involving transfers of financial assets. These amendments are intended to provide greater transparency around risk exposures when a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. These amendments are effective for annual periods beginning on or after 1 July 2011;

• In November 2009, the IASB issued IFRS 9 *Financial Instruments*, which introduces new requirements for the classification and measurement of financial assets. Subsequently, in October 2010, IFRS 9 was amended to include the requirements for the classification and measurement of financial liabilities and for derecognition. The Company is accessing the impacts of the adoption of this standard, which is effective for annual periods beginning on or after 1 January 2013.

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5. Exchange rates used to translate foreign currency financial statements

As at 31 December 2011 and 2010, assets and liabilities denominated in foreign currencies were translated to Euros using the following exchange rates to the Euro:

Currency	2011	2010
Argentine peso	5.5683	5.3125
Australian dollar	1.2723	1.3136
Botswana pula	9.6704	8.8932
Brazilian real	2.4159	2.2177
British pound	0.8353	0.8608
Canadian dollar	1.3215	1.3322
Cape Verde escudo	110.2650	110.2650
CFA franc	655.9570	655.9570
Chinese Yuan Renmimbi	8.159	8.822
Danish krone	7.4342	7.4535
Hong Kong dollar	10.0510	10.3856
Hungarian forint	314.5800	277.9500
Japanese yen	100.2000	108.6500
Kenyan shilling	109.9168	108.0318
Macao pataca	10.353	10.697
Moroccan dirham	11.095	11.221
Mozambique metical	34.9600	43.6500
Namibian dollar	10.4830	8.8625
Norwegian krone	7.7540	7.8000
São Tomé dobra	24,500.0	24,500.0
South African rand	10.483	8.863
Swedisk krone	8.912	8.966
Swiss franc	1.2156	1.2504
Ugandan shilling	3,208.9	3,086.6
US dollar	1.2939	1.3362

During the years ended 31 December 2011 and 2010, income statements of subsidiaries expressed in foreign currencies were translated to Euros using the following average exchange rates to the Euro:

Currency	2011	2010
Argentine peso	5.7591	5.2000
Botswana pula	9.5133	9.0274
Brazilian real	2.3265	2.3315
Cape Verde escudo	110.2650	110.2650
CFA franc	655.9570	655.9570
Chinese Yuan Renmimbi	8.996	8.972
Hungarian forint	279.37	275.48
Kenyan shilling	122.8537	105.2131
Macao pataca	11.1619	10.6125
Moroccan dirham	11.2677	11.1623
Mozambique metical	40.5400	45.3431
Namibian dollar	10.0970	9.6981

São Tomé dobra	24,500.0	24,500.0
Swiss franc	1.2326	1.3802
Ugandan shilling	3,501.2	2,883.0
US dollar	1.392	1.326

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6. Revenues

The contribution of reportable segments to consolidated revenues in the years ended 31 December 2011 and 2010 is as follows:

Euro

	2011	2010
Telecommunications in Portugal (Note 7.a) (i)	**2,868,688,041**	**3,102,159,717**
Services rendered (Note 3.p)	2,726,419,561	2,918,735,659
Sales	115,138,271	146,489,093
Other revenues	27,130,209	36,934,965
Telecommunications in Brazil - Oi (Note 7.b) (ii)	**2,409,199,493**	
Services rendered (Note 3.p)	2,297,480,556	
Sales	12,028,870	
Other revenues	99,690,067	
Other businesses (iii)	**868,957,187**	**640,094,121**
Services rendered	835,386,776	597,288,304
Sales	14,288,268	19,126,757
Other revenues	19,282,143	23,679,060
	6,146,844,721	**3,742,253,838**

(i) For information on this operating segment performance, including explanations for changes in operating revenues, see Note 7.a).

(ii) As mentioned in Note 2, the results of Oi were proportionally consolidated as from 1 April 2011. For information on this operating segment performance, see Note 7.b).

(iii) The increase in the contribution of other businesses to consolidated revenues relates mainly to (1) the impact of the proportional consolidation of Contax as from 1 April 2011 (Euro 359 million) and (2) improved revenue performance of MTC (mobile operator in Namibia) and Timor Telecom. These effects were partially offset by a lower contribution from Dedic/GPTI, as this business was fully consolidated until 30 June 2011 and then integrated in Contax.

Revenue is recognized in accordance with principles referred to in Note 3.p). Services rendered caption includes mainly revenue derived from (1) fixed line and international telecommunications services, including billed and interconnection revenues, (2) Pay-TV services, including monthly subscription fees and rental of equipment, (3) mobile telecommunications services, including usage of network, interconnection fees, roaming, pre-paid cards and wireless broadband, and (4) advertising in directories. Sales correspond mainly to the disposals of terminal equipment, including fixed telephones, modems, TV boxes and terminal mobile equipment. Other revenues include mainly Portal s advertising revenues, benefits from contractual penalties imposed to customers, rental of equipments and other own infra-structures and revenues resulting from consultancy projects.

Revenues in 2011 and 2010 by geographic area are as follows:

Euro

	2011	2010
Portugal	2,925,290,790	3,176,056,481
Brazil (i)	2,901,881,154	261,672,665
Other	319,672,777	304,524,692
	6,146,844,721	**3,742,253,838**

(i) In 2011, this caption includes revenues from Oi and Contax totalling Euro 2,768 million, which were proportionally consolidated as from 1 April 2011, as explained above.

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7. Segment reporting

Following the acquisition of a 25.3% stake in Oi and the proportionally consolidation of its results as from 1 April 2011, Portugal Telecom discloses Oi as an operating segment since the Company s management currently reviews and assesses its performance periodically. This operating segment, named Telecommunications in Brazil - Oi , includes the holding company TNL and Telemar Norte Leste and its subsidiaries.

Up to 30 June 2011, Portugal Telecom s operating segments in Portugal, which were organized based on the type of technology used to provide its services and products to customers, included the Wireline (fixed telecommunication services rendered through PT Comunicações and PT Prime) and Mobile (mobile telecommunication services rendered through TMN) operating segments. Following the progressive integration of the fixed line and mobile services and the launch of new bundle products offered to its customers, the Board of Directors of Portugal Telecom changed, as from that date, the way it reviews and assesses the performance of its businesses in Portugal, and therefore changed the disclosure of its operating segments in Portugal, replacing the former operating segments Wireline in Portugal and Mobile in Portugal for one operating segment named Telecommunications in Portugal , which includes all telecommunications services in Portugal. Following this change, the corresponding financial information for previous years was restated.

As a result of the changes mentioned above, the operating segments as at 31 December 2011 are as follows: (i) Telecommunications in Portugal; and (ii) Telecommunications in Brazil - Oi. There is no difference between operating and reportable segments.

In addition to the above mentioned reportable segments, the Group has other businesses that do not comply individually or together with any of the quantitive thresholds that would require a disclosure as a reportable segment. These businesses relate primarily to the following Goup companies: (1) Contax, which renders BPO and contact centre services; (2) MTC, Cabo Verde Telecom and Timor Telecom, which render wireline and mobile telecommunications services; and (3) certain Portuguese support companies, namely PT - Sistemas de Informação, Portugal Telecom Inovação, PT Pro Serviços Administrativos e de Gestão Partillhados and PT Contact Telemarketing e Serviços de Informação.

Segment information for the years ended 31 December 2011 and 2010 is presented below.

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a) Telecommunications in Portugal

Financial information of this reportable segment for the years ended 31 December 2011 and 2010 is as follows:

Euro

	2011	**2010**
REVENUES (i)		
Services rendered - external customers (Note 6)	2,726,419,561	2,918,735,659
Services rendered - inter-segment	13,549,575	14,859,164
Sales - external customers (Note 6)	115,138,271	146,489,093
Sales - inter-segment	1,137,761	2,950,652
Other revenues - external customers (Note 6)	27,130,209	36,934,965
Other revenues - inter-segment	8,623,453	4,485,632
	2,891,998,830	**3,124,455,165**
COSTS, EXPENSES, LOSSES AND (INCOME)		
Wages and salaries (Note 8)	252,457,557	274,983,361
Direct costs (ii)	480,297,290	535,052,022
Commercial costs (iii)	318,304,226	345,003,890
Supplies, external services and other expenses (iv)	535,438,223	591,830,390
Depreciation and amortisation (v)	703,169,318	681,638,261
Post retirement benefits, net (vi)	53,917,498	38,145,723
Work force reduction and settlement costs (vii)	34,003,038	142,543,090
Net gains on disposals of fixed assets	(556,261)	(2,490,280)
Other costs, net (viii)	16,613,077	102,657,831
	2,393,643,966	**2,709,364,288**
Income before financial results and taxes	**498,354,864**	**415,090,877**

(i) The composition of total revenues by customer segment for the years ended 31 December 2011 and 2010 is as follows:

Euro million

Residential	682	647
Personal	768	865
Enterprise	982	1,080
Wholesale, other and eliminations	459	533
	2,892	**3,124**

The reduction in total revenues is primarily explained by: (1) a revenue decline in the Personal customer segment (Euro 97 million), including lower mobile interconnection revenues (Euro 29 million), mainly as a result of the negative impact of lower Mobile Termination Rates (MTRs), lower customer service revenues (Euro 55 million) that reflect challenging economic conditions in Portugal, including a VAT increase (+3pp in the first half of 2011 and +2pp in the second half of 2011), coupled with increasing popularity of tribal plans, and lower sales; (2) lower revenues driven by the Enterprise customer segment (Euro 97 million), penalized by the economic environment and consequent cost cutting efforts from companies and also by a one-off public schools project that took place in 2010; and (3) lower revenues from wholesale and other businesses (Euro 74 million), including the impact from the decline in the directories business (Euro 20 million). These effects were partially offset by an increase in revenues from the Residential customer segment (Euro 35 million), mainly related to Pay-TV and broadband revenues, which are underpinned by the success of Meo s double and triple play offers.

(ii) The decrease in direct costs is primarily explained by a reduction in interconnection costs, mainly due to the decrease in regulated MTRs, and the decline in the directories business, which more than offset higher programming costs due to the continued growth of pay-TV customers, notwithstanding a decline in programming costs per customer as pay-TV is reaching critical mass.

(iii) This caption includes costs of products sold, commissions and marketing and publicity expenses. The reduction in 2011 is primarily explained by a decrease in costs of products sold, due to the racionalization of TMN s handset portfolin and lower equipment sales.

(iv) The reduction in this caption resulted primarily from lower maintenance and repair expenses, as a result of the rollout of Portugal Telecom s FTTH network, which is more efficient, and also from several cost cutting initiatives undertaken at Portuguese operations.

(v) The increase in depreciation and amortization costs relates mainly to the investments made in the roll-out of the pay-tv service, which more than offset the reduction related to the swap of TMN s 2G equipment for LTE (4G) enabled equipment.

(vi) As explained in more detail in Note 14, the increase in this caption reflects primarily a prior year service gain recorded in 2010, amounting to Euro 31 million, related to changes introduced in the pension formula by Law 3-B/2010, which more than offset the positive impact of the transfer to the Portuguese State of unfunded pension liabilities.

(vii) In 2010, this caption includes primarily redundancy programme costs amounting to Euro 136 million, related to a redundancy programme approved by the year end (Note 14.5), and a cost of Euro 7.5 million related to the settlement of the defined benefit plans transferred to the Portuguese State in December 2010.

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(viii) Other costs in 2010, as mentioned in Note 15, include non-recurring provisions and adjustments that were recognized in order to adjust certain receivables and inventories to their recoverable amounts and reflect estimated losses with certain legal actions.

Capital expenditures in tangible and intangible assets for this reportable segment decreased from Euro 657 million in 2010 to Euro 647 million in 2011. This performance reflected a decline in capital expenditures from residential customer segment due to a decrease in customer related capital expenditures as a result of: (1) a lower number of set-top boxes per fibre TV customer as compared to ADSL; (2) lower unitary cost of set-top boxes, optical network terminators and home gateways, and (3) improved refurbishment rates of set-top boxes. These effects were partially offset by an increase in capital expenditures related to the mobile network, explained by investments in the swap of TMN s 2G equipments for LTE (4G) enabled equipments and investments in capacity of existing 3G and 3.5G networks, namely in urban areas. Additionally, Portugal Telecom has been strengthening its mobile data capabilities and its network quality by leveraging the existing FTTH deployment to boost its mobile network quality and lead the 4G roll-out in the Portuguese market. In addition to the above mentioned capital expenditures, this business segment incurred in one-off capital expenditures totalling to Euro 136 million in 2011 and Euro 227 million in 2010, as mentioned in Notes 36 and 37.

As at 31 December 2011 and 2010, the total staff in this segment was 7,535 and 7,206 employees, respectively.

b) Telecommunications in Brazil - Oi

Financial information of this reportable segment for the nine months period between 1 April and 31 December 2011, which was proportionally consolidated in Portugal Telecom s Income Statement, is as follows:

Euro

	2011
REVENUES	
Services rendered - external customers (Note 6)	2,297,480,556
Sales - external customers (Note 6)	12,028,870
Other revenues - external customers (Note 6)	99,690,067
Other revenues - inter-segment	2,917,385
	2,412,116,878
COSTS, EXPENSES, LOSSES AND (INCOME)	
Wages and salaries	163,243,344
Direct costs	517,527,789
Commercial costs	174,426,926
Supplies, external services and other expenses	809,288,452
Depreciation and amortisation	512,203,623
Post retirement benefits, net	4,516,002
Net gains on disposals of fixed assets	(8,711,820)
Other costs, net	10,136,238
	2,182,630,554
Income before financial results and taxes	**229,486,324**

Oi s capital expenditures in tangible and intangible assets for the nine months period between 1 April and 31 December 2011 amounted to Euro 444 million. The investments were directed primarily to projects to improve fixed network quality, expand coverage of fixed and mobile networks, increase the speed of fixed broadband services, increase the capacity of 3G data traffic in strategic locations and to provide data packages to corporate clients.

As at 31 December 2011, the total staff in this segment (considering the 25.6% stake used in the proportional consolidation) was 7,892 employees, as compared to 7,343 employees as at 31 March 2011.

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c) Reconciliation of revenues and net income and information by geographic area

In 2011 and 2010, the reconciliation between revenues of reportable segments and consolidated revenues is as follows:

Euro

	2011	2010
Revenues relating to reportable segments	5,304,115,708	3,124,455,165
Revenues relating to other businesses (i)	1,441,145,339	1,088,297,486
Elimination of intragroup revenues (i)	(598,416,326)	(470,498,813)
Total consolidated revenues	**6,146,844,721**	**3,742,253,838**

(i) As mentioned above, other businesses include primarily Contax, MTC, Cabo Verde Telecom, Timor Telecom and certain Portuguese support companies, the performance of which is monitored by the management on a standalone basis. The increase in this caption in the year ended 31 December 2011 relates mainly to (1) the impact of the proportional consolidation of Contax as from 1 April 2011 (Euro 469 million) and (2) improved revenue performance of MTC (mobile operator in Namibia) and Timor Telecom. These effects were partially offset by a lower contribution from Dedic/GPTI (Euro 128 million), as this business was fully consolidated only until 30 June 2011 and then integrated in Contax. The higher level of eliminations in 2011, as compared to 2010, is primarily explained by the elimination of call centre and other corporate services rendered by Contax to Oi, as these companies were proportionally consolidated as from 1 April 2011.

In the years ended 31 December 2011 and 2010, the reconciliation between net income before financial results and taxes of reportable segments and Group s consolidated net income is as follows:

Euro

	2011	2010
Income before financial results and taxes relating to operating segments:		
Telecommunications in Portugal	498,354,864	415,090,877
Telecommunications in Brazil - Oi	229,486,324	
Income before financial results and taxes relating to other businesses (i)	16,168,950	(1,334,473)
Consolidated income before financial results and taxes	**744,010,138**	**413,756,404**
Financial gains (losses):		
Net interest expenses (Note 16)	(297,114,673)	(185,044,935)
Net foreign currency exchange losses (Note 17)	(18,146,031)	(6,814,213)
Net gains on financial assets and other investments (Note 18)	577,737	1,860,287
Equity in earnings of associated companies, net (Note 34)	209,183,860	141,709,104
Net other financial losses (Note 19)	(107,402,475)	(33,300,530)
Income taxes (Note 20)	(108,196,813)	(77,525,848)
Net income from continuing operations	**422,911,743**	**254,640,269**
Net income from discontinued operations (Note 21)		5,565,426,533

Net income (before non-controlling interests)	**422,911,743**	**5,820,066,802**

(i) The improvement in this caption is primarily explained by (1) expenses incurred in the third quarter of 2010, amounting to Euro 25 million, related to the acquisition of the investments in Oi and Contax, as mentioned in Note 15, (2) the improvement in the earnings of certain international operations, namely MTC and Timor Telecom, and (3) the impact of the proportional consolidation of Contax as from 1 April 2011. These effects were partially offset by a lower contribution from Dedic/GPTI business, which was fully consolidated only until 30 June 2011 and then integrated in Contax.

Total assets, liabilities and tangible and intangible assets by geographic area as at 31 December 2011 and 2010 and capital expenditures for tangible and intangible assets in the years ended 31 December 2011 and 2010 are as follows:

Euro

			2011		
	Total assets	**Total liabilities**	**Tangible assets (Note 37)**	**Intangible assets (Note 36)**	**Capital expenditures for tangible and intangible assets (iii)**
Portugal (i)	10,332,630,891	11,613,173,915	3,498,585,410	966,750,723	660,819,438
Brazil (ii)	11,503,977,140	7,337,963,518	2,572,891,593	4,270,430,011	482,918,619
Other	1,107,182,921	249,847,426	157,145,565	186,919,725	80,083,124
	22,943,790,952	**19,200,984,859**	**6,228,622,568**	**5,424,100,459**	**1,223,821,181**

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Euro

	2010				
	Total assets	**Total liabilities**	**Tangible assets (Note 37)**	**Intangible assets (Note 36)**	**Capital expenditures for tangible and intangible assets (iii)**
Portugal (i)	13,861,345,667	10,187,945,012	3,649,050,519	879,705,779	680,332,172
Brazil (ii)	276,929,107	124,576,877	46,801,227	67,841,069	27,320,165
Other	1,031,657,387	248,265,137	178,761,668	164,145,736	90,794,997
	15,169,932,161	**10,560,787,026**	**3,874,613,414**	**1,111,692,584**	**798,447,334**

(i) The decrease in total assets from operations in Portugal is primarily explained by the amount paid for the acquisition of the investments in Oi and Contax (Euro 3,728 million), partially offset by several financing loans entered into in 2011 which led to an increase in both total assets and liabilities.

(ii) The higher contribution from Brazilian businesses across all captions is basically explained by the contribution of Oi, Contax and its controlling shareholders, which are proportionally consolidated in Portugal Telecom s financial statements since 31 March 2011.

(iii) Total capital expenditures in 2011 and 2010 include capital expenditures for tangible assets, amounting to Euro 1,049 million and Euro 692 million (Note 37), respectively, and capital expenditures for intangible assets amounting to Euro 175 million and Euro 106 million (Note 36), respectively. In addition to these amounts, the Group recognized certain one-off capital expenditures in tangible and intangible assets, as mentioned in Notes 37 and 36.

8. Wages and salaries

The composition of this caption in the years ended 31 December 2011 and 2010 is as follows:

Euro

	2011	**2010**
Salaries	771,408,966	507,131,463
Social security	174,072,680	101,981,635
Health care benefits related to active employees	24,768,398	8,138,338
Trainning	6,098,169	7,163,740
Other (i)	44,127,242	12,700,446
	1,020,475,455	**637,115,622**

(i) In 2011, this caption includes mainly costs from Oi and Contax related to transportation expenses and personnel selection and recruitment expenses.

The increase in total consolidated wages and salaries is primarily explained by the impact of the proportional consolidation of Oi and Contax as from 1 April 2011, amounting to Euro 505 million (Note 2.b), partially offset by lower contributions from: (1) the operating segment Telecommunications in Portugal (Euro 23 million Note 7.a), reflecting primarily lower variable and overtime remunerations, higher efficiency levels in certain internal processes and lower personnel costs as a result of the restructuring plan implemented in the end of 2010; and

(2) Dedic/GPTI (Euro 78 million), as this business was fully consolidated only until 30 June 2011 and then integrated in Contax.

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9. Direct costs

The composition of this caption in the years ended 31 December 2011 and 2010 is as follows:

Euro

	2011	**2010**
Telecommunications costs (i)	729,640,282	312,919,690
Leasings of sites (i)	45,352,281	22,608,474
Programming costs (ii)	120,025,530	115,781,049
Directories (Note 3.p) (iii)	38,194,685	50,248,451
Other (iv)	79,061,672	46,001,437
	1,012,274,450	**547,559,101**

(i) In 2011 and 2010, these captions include costs related to operating leases totalling Euro 92,317,816 and Euro 44,538,490, respectively (Note 12).
(ii) This caption relates basically to the programming costs incurred by the Pay-TV operation.
(iii) The reduction in this caption is directly related to the decline of the directories business.
(iv) This caption includes primarily mobile contents and the increase occurred in 2011 relates primarily to the proportional consolidation of Oi as from 1 April 2011.

The increase in total consolidated direct costs is primarily explained by the impact of the proportional consolidation of Oi as from 1 April 2011, amounting to Euro 521 million (Note 2.b), partially offset by a lower contribution from the operating segment Telecommunications in Portugal (Euro 55 million), as a result of a decrease in interconnection costs, due to lower Mobile Termination Rates (MTRs), and the decline in the directories business.

10. Costs of products sold

The composition of this caption in the years ended 31 December 2011 and 2010 is as follows:

Euro

	2011	**2010**
Costs of products sold	175,720,765	180,819,046
Increases in adjustments for inventories (Note 42)	3,532,983	2,667,642
Reductions in adjustments for inventories (Note 42)	(9,378,626)	(3,592,773)
	169,875,122	**179,893,915**

The decrease in total consolidated costs of products sold relates mainly to a lower contribution from the operating segment Telecommunications in Portugal (Euro 38 million) in line with the decline in sales occurred in the period, which more than offset the impact of the proportional consolidation of Oi as from 1 April 2011, amounting to Euro 32 million (Note 2.b).

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11. Supplies, external services and other expenses

The composition of this caption in the years ended 31 December 2011 and 2010 is as follows:

Euro

	2011	**2010**
Maintenance and repairs	347,252,300	145,966,906
Support services	237,489,708	123,073,847
Commissions	216,666,335	131,953,259
Specialized work	198,757,611	93,771,359
Electricity	110,842,723	48,243,912
Operating leases (Note 12)	75,518,065	48,134,257
Communications	24,203,560	23,300,704
Other	70,652,419	110,075,432
	1,281,382,721	**724,519,676**

The increase in total consolidated supplies, external services and other expenses is primarily explained by the impact of the proportional consolidation of Oi and Contax as from 1 April 2011, amounting to Euro 597 million (Note 2.b), partially offset by a reduction in the operating segment Telecommunications in Portugal (Euro 48 million), reflecting the strict operational and cost discipline on external supplies, and a lower contribution from Dedic/GPTI (Euro 21 million, which was fully consolidated only until 30 June 2011 and then integrated in Contax.

12. Operating leases

In the years ended 31 December 2011 and 2010, operating lease costs were recognised under the following captions:

Euro

	2011	**2010**
Direct costs (Note 9)	92,317,816	44,538,490
Supplies, external services and other expenses (Note 11) (i)	75,518,065	48,134,257
	167,835,881	**92,672,747**

(i) This caption relates mainly to rentals of property and leases of transportation equipment.

As at 31 December 2011, the Company s obligations under non-cancellable operating lease contracts mature as follows:

	Euro
2012	45,789,930
2013	23,737,172
2014	19,858,401
2015	17,226,545
2016	15,181,652
2017 and following years	46,654,344
	168,448,044

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13. Indirect taxes

The composition of this caption in the years ended 31 December 2011 and 2010 is as follows:

Euro

	2011	2010
Spectrum fees (i)	81,019,498	30,493,286
Other (ii)	106,441,262	14,924,960
	187,460,760	**45,418,246**

(i) This caption includes primarily spectrum fees from Oi s mobile operations (Euro 53 million in 2011) and TMN (Euro 17 million in 2011 and Euro 21 million in 2010).

(ii) The increase in this caption relates primarily to the proportional consolidation of Oi as from 1 April 2011, amounting to Euro 91 million, including mainly (1) indirect taxes related to the funds Fust (fund to improve the general access to telecommunications services) and Funtel (National Telecommunications Fund), totalling Euro 29 million, (2) Value Added Tax expenses (Euro 13 million), (3) concessions fees (Euro 9 million), and (4) other municipal, federal and state taxes in Brasil.

The increase in total consolidated indirect taxes is primarily explained by the impact of the proportional consolidation of Oi, Contax and its controlling shareholders as from 1 April 2011, totalling Euro 146 million (Note 2.b).

14. Post retirement benefits

14.1. Portuguese Operations

As referred to in Note 3, PT Comunicações and PT SI sponsor defined benefit plans under which grant pension supplements to retired and active employees, healthcare services after retirement age and salaries to suspend and pre-retired employees until retirement age. Prior to the transfer of unfunded pension obligations to the Portuguese State in 2010, PT Comunicações was also responsible for the payment of pensions under the referred plans.

On 2 December 2010, Portugal Telecom reached an agreement with the Portuguese State for the transfer to Caixa Geral de Aposentações of the Pension Plans that were sponsored by PT Comunicações and the associated funds that covered such liabilities. The transfer included the Plano de Pensões do Pessoal da Portugal Telecom/CGA , the Plano de Pensões Regulamentares da Companhia Portuguesa Rádio Marconi and the liabilities associated with the survival benefit included in the Plano de Pensões Marconi (together the Regulated Pension Plans). The transfer date of the Plano de Pensões do Pessoal da Portugal Telecom/CGA was 1 December 2010 and for the Plano de Pensões Regulamentares da Companhia Portuguesa Rádio Marconi and Plano de Pensões Marconi was 31 December 2010.

The present value of past liabilities of the Regulated Pension Plans, as of the date of transfer, amounted to Euro 2,804 million (Note 14.1.1) and was determined by an independent actuary using actuarial assumptions that comply with best practices of similar transactions. The market value of the pension funds as of the delivery dates amounted to Euro 1,782 million (Note 14.1.1). Accordingly, the unfunded transferred liabilities amounted to Euro 1,022 million, of which an amount of Euro 100 million was paid in December 2010 (Note 14.4). As mentioned in Note 38.8, from the outstanding amount of Euro 922 million as at 31 December 2010, Portugal Telecom settled Euro 17.4 million in January 2011 and Euro 450.0 million in December 2011, and the remainder consideration of Euro 454.3 million shall be paid no later than 20 December 2012.

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The book value of the transferred pension liabilities computed in accordance with Portugal Telecom s actuarial assumptions amounted to Euro 2,796 million, as compared to the amount of Euro 2,804 million computed by an independent actuary used in this transaction. The difference amounting to Euro 7.5 million was recorded as a settlement cost (Note 14.1.1).

Following the transfer of the Regulated Pension Plans to the Portuguese State, PT Comunicações is now responsible for a fixed monthly contribution to Social Security and CGA in order to fund future service of the active beneficiaries included in these plans.

The actuarial valuations of Portugal Telecom s defined benefit plans related to Portuguese operations as at 31 December 2011, 2010 and 2009 were computed based on the projected unit credit method and considered the following main financial and demographic actuarial assumptions:

	2011	2010	2009
Financial assumptions			
Discount rate for responsabilities with:			
Pension supplements	4.75%	4.75%	5.50%
Salaries to suspended and pre-retired	3.75%	3.75%	5.50%
Healthcare	4.75%	4.75%	5.50%
Salary growth rate for responsabilities with:			
Pension supplements and healthcare	1.75%	1.75%	1.75%
Salaries to suspended and pre-retired	0% - 1.75% (i)	1.75%	1.75%
Pension growth rate	GDP linked	GDP linked	GDP linked
Social Security sustainability factor	Applicable	Applicable	Not applicable
Inflation rate	2.00%	2.00%	1.75%
Healthcare cost trend growth rate	3.00%	3.00%	3.00%
Expected return on assets	6.00%	6.00%	6.00%
Demographic assumptions			
Mortality tables for active beneficiaries:			
Males	AM (92)	AM (92)	AM (92)
Females	AF (92)	AF (92)	AF (92)
Mortality tables for non-active beneficiaries:			
Males	PA (90)m adjusted	PA (90)m adjusted	PA (90)m adjusted
Females	PA (90)f adjusted	PA (90)f adjusted	PA (90)f adjusted
Disability table (Swiss Reinsurance Company)	25%	25%	100%
Active employees with spouses under the plan	35%	35%	50%
Turnover of employees	Nil	Nil	Nil

(i) For salaries payable between 2012 and 2016, the salary growth rate ranges from 0% to 1% depending on the amount of the salary. As from 2017, the salary growth rate is 1.75% for all situations.

The changes in actuarial assumptions were primarily due to changes occurred in market conditions.

The discount rate was computed based on long-term yield rates of high-rating bonds as of the date of the Consolidated Statement of Financial Position for durations comparable to the liabilities for pensions and pension supplements, salaries and health care benefits (between 4 and 13 years).

The rate of return on long-term fund assets was estimated based on historical information on the return of portfolio assets, the expected portfolio in future years (defined in accordance with the expected maturity of the liabilities) and certain financial market performance indicators usually considered in market analysis.

Salary growth rate was established in accordance with Group policy for wages and salaries and pension growth rate and the sustainability factor was established in line with Portuguese Government information.

Demographic assumptions considered by Portugal Telecom are based on mortality tables generally accepted for actuarial valuation purposes, with these tables being periodically adjusted to reflect the mortality experience occurred in the closed universe of the plan participants.

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In the years ended 31 December 2011 and 2010, the total impact of changes in actuarial assumptions was a net gain of Euro 19,426,453 and a net loss of Euro 441,787,345 (Note 14.6), respectively, and was recognized directly in the Consolidated Statement of Comprehensive Income.

The impact of an increase by 25 bp on the average discount rate actuarial assumption would be a decrease of the responsibilities for post retirement benefits by approximately Euro 21 million as at 31 December 2011, while the impact of an increase (decrease) in the health care cost trend rate by 1% would be an increase (decrease) of the responsibilities for post retirement benefits by approximately Euro 61 million (Euro 50 million) as at 31 December 2011.

The impact of an increase (decrease) by 1% in the rate of return on long-term fund assets would be a decrease (increase) of post retirement benefit costs in the year 2011 by approximately Euro 4 million, corresponding to the increase (decrease) in expected return on assets, and the impact of an increase (decrease) by 1% in the health care cost trend rate would be an increase (decrease) of post retirement benefit costs in the year 2011 by approximately Euro 4 million (Euro 3 million).

14.1.1. Pension and supplement benefits

As referred to in Note 3.h, PT Comunicações is responsible for the payment of pension supplements to retired and active employees. Prior to the transfer of unfunded pension obligations to the Portuguese State, PT Comunicações was also responsible for the payment of pensions. These liabilities, which were estimated based on actuarial valuations, are as follows:

a) Retirees and employees of Telecom Portugal (Plan CGA) hired prior to 14 May 1992, or who were retired on that date, were entitled to receive a pension benefit from PT Comunicações. Employees hired after that date are covered by the general Portuguese Government social security system. Following the transfer of pension obligations to the Portuguese State, PT Comunicações is no longer responsible for these pension benefits since 31 December 2010.

b) Retirees and employees of Companhia Portuguesa Rádio Marconi, S.A. (Marconi , a company merged into PT Comunicações in 2002) hired prior to 1 February 1998 are entitled to a pension benefit from Caixa Marconi and to a supplemental pension benefit (Marconi Complementary Fund). In addition, PT Comunicações contributes to the fund Fundo de Melhoria Marconi with 1.55% of salaries paid to these employees, which is responsible to pay the additional pension supplement. Following the transfer of pension obligations to the Portuguese State, PT Comunicações in no longer responsible for the pension benefits since 31 December 2010, but remains responsible for supplemental pension benefits and for the contribution to the Fundo de Melhoria Marconi.

c) Retirees and employees of TLP and TDP hired prior to 23 June 1994 are entitled to receive a pension supplement from PT Comunicações, which complements the pension paid by the Portuguese 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.

Employees hired by PT Comunicações or any of its predecessor companies after the dates indicated above are not entitled to these benefits, as they are covered by the general Portuguese Government social security system.

PT SI employees who were transferred from PT Comunicações and Marconi and were covered by any of the pension plans described above maintain the right to such benefits.

As at 31 December 2011 and 2010, plans from PT Comunicações and PT SI covered 19,624 and 19,897 beneficiaries, respectively, of which approximately 64% and 65% were non-active, respectively.

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Based on the actuarial reports, the benefit obligation and the fair value of the pension funds as at 31 December 2011 and 2010 were as follows:

Euro

	2011	2010
Projected benefit obligations	121,564,812	129,890,253
Pension funds assets at fair value	(98,480,548)	(109,335,604)
Unfunded pension obligations	**23,084,264**	**20,554,649**
Prior years service gains (i)	4,541,608	5,217,983
Net liabilities recognized (Note 14.3)	**27,625,872**	**25,772,632**

(i) This caption refers to the component of the prior years service gains or losses resulting from the changes in the benefits granted under pension supplement plans related to unvested rights. This amount will be recognized in earnings during the estimated period in which those benefits will be earned by employees (9 years).

During the years ended 31 December 2011 and 2010, the movement in the projected benefit obligations was as follows:

Euro

	2011	2010
Opening balance of the projected benefit obligation	**129,890,253**	**2,710,211,583**
Payments of benefits and contributions		
Benefits paid by the Company (Note 14.4)	(1,109,982)	(824,091)
Benefits paid by the funds	(9,692,964)	(152,374,072)
Participants contributions		9,038,663
Pension costs		
Service cost	484,444	4,129,105
Interest cost	5,741,453	134,434,975
Prior year service gain		(31,215,000)
Work force reduction programme costs	10,245	279,299
Loss recognized as a result of the transfer to CGA		7,492,956
Net actuarial losses (gains)	(3,758,637)	322,618,134
Transfer to salaries payable (Note 14.1.3)		(70,112,300)
Pension obligations transferred to the Portuguese State		(2,803,788,999)
Closing balance of the projected benefit obligation	**121,564,812**	**129,890,253**

As at 31 December 2011 and 2010, the fair value of the portfolio of pension funds was as follows:

Euro

	2011		2010	
	Amount	%	Amount	%
Equities	19,994,550	20.3%	24,703,635	22.6%
Bonds	58,907,519	59.8%	32,084,229	29.3%
Property (i)	2,713,542	2.8%	10,851,414	9.9%
Cash, treasury bills, short-term stocks and other assets	16,864,937	17.1%	41,696,326	38.1%
	98,480,548	**100.0%**	**109,335,604**	**100.0%**

(i) During the year ended 31 December 2010, in connection with the transfer of unfunded pension obligations to the Portuguese State, Portugal Telecom acquired from the pension funds real estate properties that were rented to Group companies and recognised them under the caption Tangible fixed assets for an amount of Euro 236 million (Note 37). In 2011, PT Comunicações acquired one last real estate property in connection with this process for an amount of Euro 3 million (Note 37).

Portugal Telecom is exposed to risks related to the changes in the fair value of the plan assets associated to Portugal Telecom s post retirement defined pension supplement plans. The main purpose of the established investment policy is capital preservation through five main principles: (1) diversification; (2) stable strategic asset allocation and disciplined rebalancing; (3) lower exposure to currency fluctuations; (4) specialized instruments for each class of assets; and (5) cost control.

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During the years ended 31 December 2011 and 2010, the movement in the plan assets was as follows:

Euro

	2011	2010
Opening balance of the plan assets	**109,335,604**	**1,954,770,520**
Actual return on assets	(2,812,092)	44,477,969
Payments of benefits	(9,692,964)	(152,374,072)
Contributions made by the Company (Note 14.4)	1,650,000	35,535,127
Participants contributions		9,038,662
Funds transferred to the Portuguese State together with the related obligations		(1,782,112,602)
Closing balance of the plan assets	**98,480,548**	**109,335,604**

A summary of the components of the net periodic pension cost recorded in the years ended 31 December 2011 and 2010 is presented below:

Euro

	2011	2010
Service cost	484,444	4,129,105
Interest cost	5,741,453	134,434,975
Expected return on plan assets	(6,278,854)	(104,871,000)
Prior years service gains recognized in the period (i)		(31,215,000)
Amortization of prior years service gains (ii)	(664,094)	(1,071,344)
Current pension cost (Note 14.5)	**(717,051)**	**1,406,736**
Work force reduction program	10,245	279,299
Prior years service gains (extraordinary amortization)	(12,281)	(3,120,673)
Loss recognized as a result of the transfer to CGA (iii)		7,492,956
Curtailment cost (Note 14.5)	**(2,036)**	**4,651,582**
Total pension cost	**(719,087)**	**6,058,318**

(i) The prior year service gain recognized in 2010 is related to the Law 3B/2010 that changed the way the pension is computed, leading to reduced benefits.
(ii) In 2011 and 2010, this caption corresponds to the annual amortization of unrecognized prior year service gains obtained in previous years.
(iii) This caption corresponds to the difference between the value of the pension obligations transferred to the Portuguese State using actuarial assumptions agreed between both parties and the value of these same obligations using Portugal Telecom s actuarial assumptions (Note 14.1).

Actuarial gains and losses, which result from changes in actuarial assumptions and from differences between those actuarial assumptions and actual data, are recognised directly in the Consolidated Statement of Comprehensive Income. During the years ended 31 December 2011 and 2010, the movement in accumulated net actuarial losses was as follows:

Euro

	2011	2010
Opening balance	**116,701,883**	**1,528,264,321**
Change in actuarial assumptions (Note 14.6)	(374,801)	345,774,504
Differences between actual data and actuarial assumptions (Note 14.6):		
Pension benefit obligation related (i)	(3,383,836)	(23,156,369)
Assets related	9,090,946	60,393,031
Net actuarial losses recycled to retained earnings (Note 44.5) (ii)		(1,794,573,604)
Closing balance (Note 44.5)	**122,034,192**	**116,701,883**

(i) Differences between actual data and actuarial assumptions related to the PBO results mainly from updated information regarding beneficiaries.

(ii) Following the transfer of unfunded pension obligations to the Portuguese State completed in December 2010, the related net actuarial losses were recycled to retained earnings, net of tax effect.

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14.1.2. Health care benefits

As referred to in Note 3.i), PT Comunicações sponsored the payment of post retirement health care benefits to certain suspended employees, pre-retired employees, retired employees and their eligible relatives. Health care services are rendered by PT-ACS, which was incorporated with the only purpose of managing the Company s Health Care Plans.

These plans, sponsored by PT Comunicações, include all employees hired by PT Comunicações until 31 December 2000 and by Marconi until 1 February 1998. Certain employees of PT SI who were transferred from PT Comunicações are also covered by this health care plan.

As at 31 December 2011 and 2010, healthcare plans from PT Comunicações and PT SI covered 24,401 and 24,857 beneficiaries related to employees and former employees, of which approximately 76% and 75% were non-active, respectively. In addition, as at 31 December 2011 and 2010, these plans also covered 11,036 and 11,735 beneficiaries related to relatives of employees and former employees.

The financing of the Health Care Plan comprises defined contributions made by participants to PT-ACS and the remainder by PT Comunicações, which incorporated an autonomous fund in 2004 for this purpose.

Based on the actuarial reports, the benefit obligation and the fair value of the health care fund and prior year s service gains not yet recognized as at 31 December 2011 and 2010 are as follows:

Euro

	2011	**2010**
Projected benefit obligations	352,564,459	342,490,660
Plan assets at fair value	(246,214,842)	(338,810,084)
Unfunded obligations	**106,349,617**	**3,680,576**
Prior years service gains (i)	12,222,435	13,087,000
Net liabilities recognized (Note 14.3)	**118,572,052**	**16,767,576**

(i) This caption refers to the component of the prior years service gains resulting from the changes in the health care plan made in 2006 related to those benefits that are not yet vested. This amount will be recognized in earnings during the estimated period in which those benefits will be earned by employees.

During the years ended 31 December 2011 and 2010, the movement in the projected benefit obligations was as follows:

Euro

	2011	2010
Opening balance of the projected benefit obligations	**342,490,660**	**335,261,865**
Benefits paid by the Company (Note 14.4)	(17,964,841)	(18,882,633)
Pension costs		
Service cost	3,042,635	3,027,076
Interest cost	15,871,525	17,933,044
Work force reduction costs	186,854	2,694,286
Net actuarial losses	8,937,626	2,457,022
Closing balance of the projected benefit obligations	**352,564,459**	**342,490,660**

As at 31 December 2011 and 2010, the fair value of the portfolio of the Company s autonomous fund to cover post retirement health care benefit obligations was as follows:

Euro

	2011		2010
	Amount	%	