PORTUGAL TELECOM SGPS SA
Form 20-F
April 30, 2013

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

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

OR

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2012

OR

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

OR

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

Commission file number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of Registrant as specified in its charter)

The Portuguese Republic

(Jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

Nuno Vieira, Investor Relations Director, Tel. +351 21 500 1701, Fax +351 21 500 0800
Av. Fontes Pereira de Melo, 40, 1069-300 Lisboa, Portugal

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing one ordinary share, nominal value €0.03 per share	New York Stock Exchange
Ordinary shares, nominal value €0.03 each	New York Stock Exchange*

*

Not for trading but only in connection with the registration of American Depositary Shares.

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

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

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

Ordinary shares, nominal value €0.03 per share	896,512,000
Class A shares, nominal value €0.03 per share	500

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No o

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes o No ý

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o (Note: None required of the registrant)

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer ý Accelerated filer o Non-accelerated filer o Smaller reporting company o

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP o International Financial Reporting Standards as issued by the International Accounting Standards Board ý Other o

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17 o Item 18 o

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

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CERTAIN DEFINED TERMS

Unless the context otherwise requires, the terms "Portugal" refers to the Portuguese Republic, including the Madeira Islands and the Azores Islands; the term "EU" refers to the European Union; and the terms "United States" and "U.S." refer to the United States of America.

We use the term "Portugal Telecom" to refer to Portugal Telecom, SGPS S.A. and not to its subsidiaries. Unless the context implies otherwise, the terms "we," "our" or "us" refer to Portugal Telecom, its consolidated subsidiaries and jointly controlled entities that are proportionally consolidated, including the Oi Group.

We use the term the "Oi Group" to refer, collectively, to Telemar Participações S.A., its subsidiary Oi S.A., a Brazilian company, and Oi S.A.'s subsidiaries.

References to "Euros," "EUR" or "€" are to the Euro. References herein to "U.S. dollars," "$" or "US$" are to United States dollars. References to "Real," "Reais" or "R$" are to Brazilian Reais.

PRESENTATION OF FINANCIAL INFORMATION

Preparation of Financial Statements in IFRS

Our audited consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as endorsed by the EU ("EU-IFRS"). EU-IFRS may differ from IFRS as issued by the International Accounting Standards Board ("IASB") if, at any point in time, new or amended reporting standards have not been endorsed by the EU. As of December 31, 2012, 2011, and 2010, there were no unendorsed standards effective as of and for the years ended December 31, 2012, 2011, and 2010, respectively, that affected our financial statements, and there was no difference between EU-IFRS and IFRS as issued by the IASB as applied by Portugal Telecom. Accordingly, our financial statements as of and for the years ended December 31, 2012, 2011, and 2010 were prepared in accordance with IFRS as issued by the IASB. IFRS comprise the accounting standards issued by the IASB and its predecessor body and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and its predecessor body.

We publish our financial statements in Euro, the single EU currency adopted by certain participating member countries of the European Union, including Portugal, as of January 1, 1999. The Federal Reserve Bank of New York's noon buying rate in the City of New York for Euros was €0.7685 = US$1.00 on April 23, 2013, and the noon buying rate on that date for Reais was R$2.0145 = US$1.00. We are not representing that the Euro, US$ or R$ amounts shown herein could have been or could be converted at any particular rate or at all. See "*Item 3 Key Information Exchange Rates*" for further information regarding the rates of exchange between Euros and U.S. dollars and between Reais and U.S. dollars.

Proportional Consolidation of Brazilian Operations

On March 28, 2011, we completed the acquisition of an economic interest of 25.3% in Telemar Norte Leste S.A. ("Telemar") (through a 25.6% economic interest in Telemar Participações S.A. ("TmarPart")), a fixed line telecommunications operator in Brazil that was controlled by Tele Norte Leste Participações S.A., the parent company of the Oi Group at that time, and that controlled, directly or indirectly, the majority of the voting shares of the companies included in the Oi Group, namely its mobile telecommunications operators, another fixed line telecommunications operator and several other support and holding companies. Since April 1, 2011, given our economic interest and our rights to participate in the management of TmarPart and Oi as described in "*Item 4 Information on the Company Our Businesses Brazilian Operations (Oi) Strategic Partnership with Oi*," we have proportionally consolidated 25.6% of TmarPart in our consolidated financial statements, which, in turn, fully consolidates the Oi Group. Our economic interest in the Oi Group decreased to 23.3% (from the initial 25.3% economic interest held in Telemar to a 23.3% economic interest currently held in Oi, S.A.) as a result of a corporate reorganization of the Oi Group that was completed on

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April 9, 2012. However, our economic interest in TmarPart remains at 25.6%, and we continue to proportionally consolidate 25.6% of TmarPart in our consolidated financial statements.

Concurrently with our investment in Oi, we acquired a 16.2% economic interest in CTX Participações S.A. ("CTX"), the controlling shareholder of Contax Participações S.A. ("Contax Participações") and Contax S.A. ("Contax"), a provider of contact center, business process outsourcing ("BPO") and IT services in Brazil and other countries in Latin America. Even before our investment in Contax, we provided call center and Information Technology/Information Systems ("IT/IS") services in Brazil through our subsidiary Dedic, S.A. ("Dedic") and its subsidiary GPTI Tecnologias de Informação, S.A. ("GPTI"). On June 30, 2011, we merged Dedic and GPTI into Contax, and our economic interest in Contax increased to 19.5%. On April 2, 2013, economic interest in Contax increased to 21.1% through the transaction described in "*Item 4 Information on the Company Recent Developments*." We have proportionally consolidated the results of operations of Contax in our results of operations since April 1, 2011, and Contax's results of operations have included the results of operations of Dedic and GPTI since July 1, 2011.

Discontinued Operations

We provided mobile telecommunications services in Brazil through Vivo Participações S.A. ("Vivo") through September 2010. We held our participation in Vivo through our 50% interest in Brasilcel N.V., a joint venture with Telefónica, S.A. ("Telefónica"). On July 28, 2010, we reached an agreement with Telefónica for them to buy from us our 50% interest in Brasilcel N.V. We closed the transaction on September 27, 2010. Our consolidated statements of income and cash flows for the year ended December 31, 2010 and for any prior periods included in "*Item 3 Selected Consolidated Financial Data*" present Vivo under the caption "Discontinued Operations," but Vivo is no longer included in our consolidated statement of financial position as of December 31, 2010 or in our consolidated statements of income and cash flows for any period thereafter.

FORWARD-LOOKING STATEMENTS

This Form 20-F includes, and documents incorporated by reference herein and future public filings and oral and written statements by our management may include, statements that constitute "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995. These statements are based on the beliefs and assumptions of our management and on information available to management at the time such statements were made. Forward-looking statements include, but are not limited to: (a) information concerning possible or assumed future results of our operations, earnings, industry conditions, demand and pricing for our services and other aspects of our business under "*Item 4 Information on the Company*," "*Item 5 Operating and Financial Review and Prospects*" and "*Item 11 Quantitative and Qualitative Disclosures About Market Risk*"; and (b) statements that are preceded by, followed by or include the words "believes," "expects," "anticipates," "intends," "is confident," "plans," "estimates," "may," "might," "could," "would," the negatives of such terms or similar expressions.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Although we make such statements based on assumptions that we believe to be reasonable, there can be no assurance that actual results will not differ materially from our expectations. Many of the factors that will determine these results are beyond our ability to control or predict. We do not intend to review or revise any particular forward-looking statements referenced in this Form 20-F in light of future events or to provide reasons why actual results may differ. Investors are cautioned not to put undue reliance on any forward-looking statements.

Any of the following important factors, and any of those important factors described elsewhere in this or in other of our SEC filings, among other things, could cause our results to differ from any results that might be projected, forecasted or estimated by us in any such forward-looking statements:

- material adverse changes in economic conditions in Portugal, Brazil or the other countries in which we have operations and investments;
- the effects of intense competition in Portugal, Brazil and the other countries in which we have operations and investments;
- changes in telecommunications technology that could lead to obsolescence of our infrastructure;
- the development and marketing of new products and services and market acceptance of such products and services;
- risks and uncertainties related to national and supranational regulation; and
- the adverse determination of disputes under litigation.

PART I

ITEM 1 IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

We are not required to provide the information called for by Item 1.

ITEM 2 OFFER STATISTICS AND EXPECTED TIMETABLE

We are not required to provide the information called for by Item 2.

ITEM 3 KEY INFORMATION

Selected Consolidated Financial Data

The selected consolidated statement of financial position data as of December 31, 2011 and 2012 and the selected consolidated statement of income and cash flow data for each of the years ended December 31, 2010, 2011 and 2012 have been derived from our audited consolidated financial statements included herein prepared in accordance with IFRS. The selected consolidated statement of financial position data as of December 31, 2008, 2009 and 2010 and the selected consolidated statement of income and cash flow data for the years then ended have been derived from our audited consolidated financial statements prepared in accordance with IFRS included in our Annual Report for the year ended December 31, 2010.

The information set forth below is qualified by reference to, and should be read in conjunction with, our audited financial statements and the notes thereto and also "*Item 5 Operating and Financial Review and Prospects*" included in this Form 20-F.

Given the sale on September 27, 2010 of our interest in Vivo to Telefónica, the selected consolidated statement of income for Vivo is presented under the caption "Discontinued Operations" for all periods through the completion of the sale, and the selected consolidated statement of financial

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position as of December 31, 2010 no longer includes the assets and liabilities related to Vivo, following the completion of the sale on September 27, 2010.

	Year Ended December 31,				
	2008	2009	2010	2011	2012
	(EUR Millions)				
Statement of Income Data(1):					
Continuing operations					
Revenues:					
Services rendered	3,503.4	3,492.0	3,516.0	5,859.3	6,194.0
Sales	217.7	197.2	165.6	141.5	198.7
Other revenues	40.1	44.3	60.6	146.1	206.2
Total revenues	**3,761.2**	**3,733.4**	**3,742.3**	**6,146.8**	**6,598.8**
Costs, expenses losses and income:					
Wages and salaries	489.4	546.7	637.1	1,020.5	1,102.4
Direct costs	520.8	522.4	547.6	1,012.3	1,092.4
Costs of products sold	244.8	207.3	179.9	169.9	183.1
Marketing and publicity	87.9	78.6	81.1	131.1	124.4
Supplies and external services	695.6	733.3	724.5	1,281.4	1,475.2
Indirect taxes	45.9	57.8	45.4	187.5	247.0
Provisions and adjustments	29.0	30.5	35.0	156.3	105.6
Depreciation and amortization	647.5	716.9	758.6	1,325.6	1,390.6
Net post retirement benefit costs	44.8	89.6	38.2	58.5	58.3
Curtailment and settlement costs	100.0	14.8	145.5	36.4	2.1
Gains on disposals of fixed assets, net	(18.3)	(2.0)	(5.5)	(9.2)	(32.7)
Other costs (gains), net	22.6	45.6	141.2	32.6	(8.7)
Income before financial results and taxes	**851.3**	**691.9**	**413.8**	**744.0**	**859.2**
Minus: Financial costs (gains), net	32.4	(200.7)	81.6	212.9	385.9
Income before taxes	**818.9**	**892.6**	**332.2**	**531.1**	**473.2**
Minus: Income taxes	204.8	185.9	77.5	108.2	147.6
Net income from continuing operations	**614.1**	**706.7**	**254.6**	**422.9**	**325.6**
Discontinued operations					
Net income from discontinued operations	81.7	82.5	5,565.4		
Net income	**695.8**	**789.2**	**5,820.1**	**422.9**	**325.6**
Attributable to non-controlling interests	119.7	104.5	147.9	83.8	95.3
Attributable to equity holders of the parent	**576.1**	**684.7**	**5,672.2**	**339.1**	**230.3**
Income before financial results and taxes per ordinary share, A share and ADS(2)	0.95	0.77	0.46	0.83	0.96
Earnings per ordinary share, A share and ADS:					
Basic(3)	0.64	0.78	6.48	0.39	0.27
Diluted(4)	0.62	0.76	6.06	0.39	0.27
Earnings per ordinary share, A share and ADS from continuing operations, net of non-controlling interests:					
Basic(3)	0.60	0.74	0.19	0.39	0.27
Diluted(4)	0.59	0.72	0.19	0.39	0.27
Cash dividends per ordinary share, A share and ADS(5)	0.575	0.575	2.300	0.650	0.325
Share capital	26.9	26.9	26.9	26.9	26.9

(1)

We applied retrospectively, from January 1, 2009, the interpretation IFRIC 12, *Service Concession Arrangements*, which became effective as from January 1, 2010, following its approval by the European Commission as of March 25, 2009.

(2) Based on 896,512,500 ordinary and A shares for all periods presented.

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(3)

The weighted average number of shares for purposes of calculating basic earnings per share is computed based on the average ordinary and A shares issued and the average number of treasury shares.

(4)

The weighted average number of shares for purposes of calculating diluted earnings per share is computed based on the average ordinary and A shares issued and the average number of treasury shares adjusted by the number of shares from the exchangeable bonds issued on August 28, 2007.

(5)

Cash dividends per ordinary share, A share and American Depositary Share ("ADS") for the years ended December 31, 2008, 2009, 2010, 2011 and 2012 were €0.575, €0.575, €2.30, €0.65 and €0.325, respectively, before applicable withholding tax. Cash dividends per ordinary share, A share and ADS for the years ended December 31, 2008, 2009, 2010, 2011 and 2012 were US$0.75, US$0.71, US$3.18, US$0.82 and US$0.42, respectively, using the exchange rate in effect on the date on which each dividend was paid (or, for the dividends to be paid with respect to the year ended December 31, 2012, the exchange rate on the most recent practicable date), before applicable withholding tax. The dividend amounts set forth above for each year are the amounts paid with respect to the results of operations for those fiscal years, even when the actual date of payment fell in a different year. See "*Item 8 Financial Information Distributions to Shareholders Dividend Information*." As mentioned in Note 22 to our audited consolidated financial statements, cash dividends for the year ended December 31, 2012 corresponded to an ordinary dividend per share of €0.325, to be paid in May 2013, as approved at our Annual Shareholders' Meeting held on April 19, 2013. Cash dividends for the year ended December 31, 2011 corresponded to an ordinary dividend per share of €0.65, of which €0.215 was paid on January 4, 2012 as an advance over the profits relating to 2011, as approved by our Board of Directors on December 15, 2011, and the remaining €0.435 was paid in May 2012, as approved at our Annual Shareholders' Meeting held on April 27, 2012. Cash dividends for the year ended December 31, 2010 included (1) an extraordinary dividend per share of €1.65, of which €1.00 was paid in December 2010 and the remaining €0.65 was paid in 2011, as approved at our Annual Shareholders' Meeting held on May 6, 2011; and (2) an ordinary cash dividend of €0.65 per share also approved at the Annual Shareholders' Meeting.

	Year Ended December 31,				
	2008	**2009**	**2010**	**2011**	**2012**
	(EUR Millions)				
Cash Flow Data:					
Cash flows from operating activities	1,828.9	1,927.5	1,506.9	1,775.2	1,574.1
Cash flows from investing activities	(108.7)	(597.8)	4,072.4	(1,009.2)	(1,267.3)
Cash flows from financing activities	(1,283.8)	(997.3)	(1,929.1)	(540.3)	(2,646.7)

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	Year Ended December 31,				
	2008	2009	2010	2011	2012
	(EUR Millions)				
Statement of Financial Position Data:					
Current assets	3,317.0	3,699.1	8,855.4	8,433.0	6,288.9
Investments in group companies	613.2	597.2	361.5	533.4	408.3
Other investments	21.1	16.9	17.7	22.9	19.4
Goodwill	942.2	1,162.2	416.6	1,503.2	1,449.4
Tangible assets	4,621.5	4,843.9	3,874.6	6,228.6	6,018.9
Intangible assets	2,544.0	2,912.1	695.1	4,126.6	3,640.1
Post retirement benefits	1.6	67.6	1.9	13.6	11.4
Deferred tax assets	1,032.7	1,019.5	653.1	1,247.8	1,184.1
Other non-current assets	628.0	522.1	294.0	1,067.2	1,075.2
Total assets	**13,721.2**	**14,840.5**	**15,169.9**	**23,176.4**	**20,095.7**
Current liabilities	5,153.6	3,398.4	2,683.7	6,841.5	4,771.5
Medium and long term debt	4,441.2	6,551.5	6,254.4	8,989.4	9,385.8
Accrued post retirement liability	1,836.9	1,558.3	968.8	1,004.1	932.8
Deferred tax liabilities	462.2	483.1	311.6	1,052.5	922.0
Other non-current liabilities	631.1	461.7	342.3	1,546.8	1,229.6
Total liabilities	**12,525.0**	**12,453.0**	**10,560.8**	**19,434.2**	**17,241.7**
Equity excluding non-controlling interests	232.0	1,318.3	4,392.4	2,828.1	2,293.4
Non-controlling interests	964.2	1,069.1	216.7	914.1	560.7
Total equity	**1,196.2**	**2,387.4**	**4,609.1**	**3,742.2**	**2,854.0**
Total liabilities and shareholders' equity	**13,721.2**	**14,840.5**	**15,169.9**	**23,176.4**	**20,095.7**
Number of ordinary shares	896.5	896.5	896.5	896.5	896.5
Share capital(1)	26.9	26.9	26.9	26.9	26.9

(1) As of the dates indicated, we did not have any redeemable preferred stock.

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Exchange Rates

Euro

A substantial portion of our revenues, assets, liabilities and expenses are denominated in Euros. We have published our audited consolidated financial statements in Euros, and our shares trade in Euros on the regulated market Euronext Lisbon.

Our dividends, when paid in cash, are denominated in Euros. As a result, exchange rate fluctuations have affected and will affect the U.S. dollar amounts received by holders of ADSs on conversion of such dividends by Deutsche Bank Trust Company Americas ("Deutsche Bank"), as the ADS depositary. Deutsche Bank converts dividends it receives in foreign currency into U.S. dollars upon receipt, by sale or such other manner as it has determined and distributes such U.S. dollars to holders of ADSs, net of Deutsche Bank's expenses of conversion, any applicable taxes and other governmental charges. Exchange rate fluctuations may also affect the U.S. dollar price of the ADSs on the New York Stock Exchange.

The following tables show, for the period and dates indicated, certain information regarding the U.S. dollar/Euro exchange rate. The information is based on the noon buying rate in the City of New York for cable transfers in Euro. On April 23, 2013, the Euro/U.S. dollar exchange rate was €0.7685 per US$1.00.

Year ended December 31,	Average Rate(1) (EUR per US$1.00)
2008	0.6805
2009	0.7166
2010	0.7567
2011	0.7142
2012	0.7736

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

Period	High	Low
	(EUR per US$1.00)	
October 2012	0.7766	0.7614
November 2012	0.7865	0.7686
December 2012	0.7734	0.7541
January 2013	0.7665	0.7362
February 2013	0.7660	0.7304
March 2013	0.7824	0.7635
April 2013 (through April 23, 2013)	0.7791	0.7610

None of the 27 member countries of the European Union has imposed any exchange controls on the Euro.

Brazilian Real

Because of our proportional consolidation of the financial position and results of operations of TmarPart, the parent company of Oi S.A., the majority of our assets and the a substantial portion of our revenues and expenses are denominated in Brazilian Reais. Concurrently with our investment in Oi, we acquired an interest in Contax, which similarly records its financial position and results of operations in Brazilian Reais. Consequently, exchange rate fluctuations between the Euro and the

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Brazilian Real affect our revenues, expenses, assets and liabilities. See "*Item 5 Operating and Financial Review and Prospects Exchange Rate Exposure to the Brazilian Real*."

The Brazilian government may impose temporary restrictions on the conversion of Reais into foreign currencies and on the remittance to foreign investors of proceeds from their investments in Brazil. Brazilian law permits the government to impose these restrictions whenever there is a serious imbalance in Brazil's balance of payments or reason to foresee a serious imbalance.

The following tables show, for the periods and date indicated, certain information regarding the Real/U.S. dollar exchange rate. On April 23, 2013, the Real/U.S. dollar exchange rate was R$2.0145 per US$1.00. The information is based on the noon buying rate in the City of New York for cable transfers in Brazilian Reais as certified for United States customs purposes by the Federal Reserve Bank of New York.

Year ended December 31,	**Average Rate(1)**
	(R$ per US$1.00)
2008	1.831
2009	1.987
2010	1.757
2011	1.668
2012	1.952

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

Period	**High**	**Low**
	(R$ per US$1.00)	
October 2012	2.0436	2.021
November 2012	2.1118	2.0304
December 2012	2.1141	2.0445
January 2013	2.0478	1.986
February 2013	1.9913	1.9564
March 2013	2.0436	2.021
April 2013 (through April 23, 2013)	2.0235	1.9690

Risk Factors

General Risks Relating to Our Company

The current economic and financial crisis has affected, and will likely continue to affect, demand for our products and services, our revenues and our profitability

The global economic and financial crisis, and the current economic recession in Portugal, have had, and are likely to continue to have, an adverse effect on the demand for our products and services and on our revenues and profitability. During 2011, a number of eurozone countries came under severe financial pressure and their ability to raise, refinance and service their debt was put into question by markets, as demonstrated by the record high spreads during most of the year. Portugal, along with Greece and Ireland, was forced to seek support packages from the European Central Bank ("ECB") and the International Monetary Fund ("IMF") under strict conditions, while fear of contagion to other eurozone countries forced governments to reduce debt levels through austerity measures that, at least in the short term, were seen as the cause of slow growth for some countries and stagnation in others. The turbulence in the European financial markets continued in the first half of 2012, driven by these fears and the uncertainty regarding the fate of the euro. More aggressive financing and monetary policies by the ECB helped to stabilize the European financial markets in the second half of 2012.

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However, the contraction in GDP of the eurozone countries continued, driven by restrictive fiscal policies and deleveraging of the private sector in those countries, lower demand from China for European imports and ongoing uncertainty surrounding the sovereign debt crisis. In the fourth quarter of 2012, GDP in the eurozone contracted 0.60% compared to the fourth quarter of 2011, and annual GDP contracted 0.4% compared to growth of 1.4% in 2011. The eurozone unemployment rate rose to 11.7% in December 2012, a record high.

In Portugal, since mid-2011, government economic policy has focused on implementing the measures agreed to as part of the €78 billion financial support package from the European Union/European Commission, the ECB and the IMF. Although Portugal has been perceived as a country committed to the ongoing adjustment program and has seen government bond yields decrease, the strongly restrictive fiscal policies, continued deleveraging in the private financial and non-financial sectors and the cooling of activity in the eurozone contributed to a contraction in real GDP of 3.2%, with significant declines in consumption and investment. Unemployment rates continued to rise in 2012, reaching almost 16% of the active population. Although the government deficit fell from 9.8% of GDP in 2010 to 5.0% of GDP in 2012, government debt continued to rise to 120.6% of GDP, compared to 93.5% in 2010 and 108.0% in 2011.

As one of Portugal's largest companies and one of its largest employers (and although a large portion of our business is conducted outside Portugal), Portugal Telecom's financial condition, revenues and profitability are closely linked to circumstances in the Portuguese economy. The recession in Portugal has had a direct effect on demand for our products and services, contributing to a decline in revenues in 2011 and 2012 across most of the customer categories of our Portuguese telecommunications business.

In these and other ways, the global economic and financial crisis and its effect on the European and Portuguese economies has significantly affected, and could continue to significantly affect, our business, liquidity and financial performance.

Financial market conditions may adversely affect our ability to obtain financing, significantly increase our cost of debt and negatively impact the fair value of our assets and liabilities

Global financial markets and economic conditions have been severely disrupted and volatile since 2008 and remain subject to significant vulnerabilities, such as the deterioration of fiscal balances and the rapid accumulation of public debt, continued deleveraging in the banking sector and limited supply of credit. At times during this period, credit markets and the debt and equity capital markets have been exceedingly distressed. In 2010, 2011 and 2012, the financial markets grew increasingly concerned about the ability of certain European countries, particularly Greece, Ireland, Portugal, Spain and Italy, to finance their deficits and service growing debt burdens amidst difficult economic conditions. This loss of confidence has led to rescue measures for Greece, Ireland and Portugal by the EU, the ECB and the IMF and a bailout of the Spanish banking sector by the EU. These issues, along with the re-pricing of credit risk and the difficulties currently experienced by financial institutions, have made it difficult for companies to obtain financing. Although Portugal and Ireland saw improvements in the ability to refinance sovereign debt in the second half of 2012, the ability of private corporations to access financing remains challenging and highly susceptible to political and economic events in the eurozone.

As a result of the disruptions in the credit markets, many lenders have increased interest rates, enacted tighter lending standards, required more restrictive terms (including higher collateral ratios for advances, shorter maturities and smaller loan amounts) or refused to refinance existing debt at all or on terms similar to pre-crisis conditions. Changes in interest rates and exchange rates may also adversely affect the fair value of our assets and liabilities. If there is a negative impact on the fair values of our assets and liabilities, we could be required to record impairment charges.

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Notwithstanding our international exposure and diversification and the fact that we believe we have sufficient sources of liquidity to meet our present funding needs, the downgrades of Portugal's sovereign debt described in the next risk factor may have a significant effect on our costs of financing, particularly given the size and prominence of our company within the Portuguese economy. The recent events in Portugal and the other factors described above could adversely affect our ability to obtain future financing to fund our operations and capital needs and adversely impact the pricing terms that we are able to obtain in any new bank financing or issuance of debt securities and thereby negatively impact our liquidity.

Any future ratings downgrades may impair our ability to obtain financing and may significantly increase our cost of debt

Against the backdrop of the eurozone crisis, the increased risk perception also led to consecutive downgrades of Portuguese sovereign debt by the rating agencies. In 2011, Portugal was downgraded (1) by 4 notches at Moody's Investors Service ("Moody's") from A1 on December 21, 2010 to Ba2 on July 5, 2011; (2) by 3 notches at Standard & Poor's Ratings Services ("S&P") from A- on November 30, 2011 to BBB- on December 5, 2011; and (3) by 6 notches at Fitch Ratings ("Fitch") from A+ on December 23, 2010 to BB+ on November 24, 2011. In 2012, Portugal was downgraded (1) by 1 notch at Moody's from Ba2 to Ba3 on February 13, 2012; and (2) by 3 notches at S&P from BBB to BB.

Because our financial condition, revenues and profitability are closely linked to the Portuguese economy, our company's ratings under Moody's and S&P's ratings methodologies are directly linked to the Portuguese sovereign debt rating. Following the downgrade of Portuguese sovereign debt on January 21, 2012, S&P downgraded our long-term rating from BBB- to BB+, with a negative outlook, and on February 11, 2013, S&P downgraded our long-term rating to BB, with a negative outlook. On April 13, 2012, Moody's downgraded our long-term rating from Ba1 to Ba2, with a negative outlook. Our long-term rating from Fitch remains BBB, with negative outlook.

The effects of the economic and financial crisis described above, or any adverse developments in our business, could lead to additional downgrades in our credit ratings. Any such downgrades are likely to adversely affect our ability to obtain future financing to fund our operations and capital needs. Any downgrade of our ratings could have even more significant effects on our ability to obtain financing and therefore on our liquidity. For further information on these covenants, please refer to "*Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources Indebtedness Covenants*."

Any worsening of the current economic and financial crisis may affect our liquidity and impact the creditworthiness of our company

In order to mitigate liquidity risks, we seek to maintain a liquidity position and an average maturity of debt that allows us to repay our short-term debt and our contractual obligations. As of December 31, 2012, the amount of available cash (excluding cash from Oi and Contax), plus the undrawn amount of our underwritten commercial paper lines (cash immediately available upon two or three days' notice) and our committed standby facilities available to our Portuguese operations amounted to €3,016 million, a reduction from €5,095 million as of December 31, 2011. The average maturity of our net debt (excluding net debt of Oi and Contax) as of December 31, 2012 was 5.6 years.

Our capital structure includes debt, cash and cash equivalents, short-term investments and equity attributable to equity holders of the parent, comprising issued capital, treasury shares, reserves and accumulated earnings. We periodically review our capital structure considering the risks associated with each of the above mentioned classes of the capital structure. We further discuss our liquidity and

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sources of funding in "*Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources*."

However, if economic and financial conditions in Portugal and in Europe generally were to worsen, if our cost of debt were to increase or if we were to encounter other difficulties in obtaining financing for the reasons described in the preceding three risk factors, our sources of funding, including our cash balances, operating cash inflows, funds from divestments, credit lines and cash flows obtained from financing operations, might not match our financing needs, including our operating and financing outflows, investments, shareholder remuneration and debt repayments. Any such event could have a material adverse effect on our financial position, liquidity and prospects.

If our customers' financial conditions decline, we will be exposed to increased credit and commercial risks

Due to continued adverse economic conditions, we may encounter increased difficulty collecting accounts receivable and could be exposed to risks associated with uncollectable accounts receivable. We regularly assess the creditworthiness of our customers and we set credit limits for our customers. Challenging economic conditions have impacted some of our customers' ability to pay their accounts receivable. Although our credit losses have historically been low and we have policies and procedures for managing customer finance credit risk, we may be unable to avoid future losses on our accounts receivable, which could materially adversely affect our results of operations and financial position.

We may not be able to pay our announced dividends

On June 27, 2012, we announced a shareholder remuneration policy for the fiscal years 2012 to 2014, comprising of an annual cash dividend of €0.325 per share, and a share buy-back program of €200 million for the same three year period, equivalent to an additional €0.225 per share. This shareholder remuneration proposal is subject to market conditions, our financial condition, legal limits to the distribution of assets to shareholders, including the necessary shareholder approvals and other factors considered relevant by the Board of Directors at the time.

The payment of future dividends will depend on our ability to continue to generate cash flow in our businesses, which is dependent not only on our revenue stream but also on our ability to further streamline our operations and reduce our costs. In addition, significant volatility in the Real/Euro exchange rate may impair our ability to pay dividends.

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

We face intense competition globally, including increasing competition from competitors other than traditional telecommunications companies

Although the broad telecommunications sector is expected to continue to expand at a global level, an increasing market share is now occupied by adjacent sector players, such as equipment manufacturers, internet service providers and media players. These players are taking advantage of improved connectivity and platform-agnostic technologies to offer over-the-top and cloud-based services. Telecommunications operators are expected to maintain traditional access services and billing relationships over which users access services from adjacent players such as well-known companies offering music, video, photos, apps and retail. These adjacent competitors have been able to build strong global brands. For example, in the equipment manufacturers market, Apple and Samsung accounted for 50% of total global revenues, up from only 16% in 2007. The expansion of the competitive boundaries is creating additional pressure for telecommunications operators. Notwithstanding our efforts to develop our own over-the-top and cloud-based services, we expect this

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broader competitive landscape to continue to pose challenges to our revenues and profitability in Portugal, Brazil and the other markets where we operate.

Our ability to remain competitive depends on our ability to implement new technology, and any failure to do so could adversely affect our business

Companies in the telecommunications industry must adapt to rapid and significant technological changes that are usually difficult to anticipate. The Pay-TV, broadband internet and mobile telecommunications industries in particular have experienced rapid and significant technological development and frequent improvements in capacity, quality and data-transmission speed. Technological changes may render our equipment, services and technology obsolete or inefficient, which may adversely affect our competitiveness or require us to increase our capital expenditures in order to maintain our competitive position. For example, in our Portuguese operations, we have made significant investments in recent years to develop our FTTH network for residential and enterprise customers, to connect our mobile network base stations and to develop our UMTS network for personal services customers. In 2011, we also upgraded some of our mobile network equipments for LTE services. We are investing significant amounts to construct our data center in Covilhã, Portugal to expand our ability to serve enterprise and other customers, and we launched LTE services in March 2012, with our LTE network covering 20% of population in Portugal at the beginning of 2012 and 90% by the end of 2012. In addition, in our Brazilian operations, Oi has made significant investments in the last three years in connection with the implementation of its UMTS services, upgrading its fixed line networks with technologically advanced fiber optic cable with a microwave overlay for use in Oi's long-distance services. We may not achieve the expected benefits of these investments in technology before more advanced technology is adopted by the market. Even if we adopt new technologies in a timely manner as they are developed, the cost of such technology may exceed the benefit to us, and we cannot assure you that we will be able to maintain our level of competitiveness.

Portugal Telecom and the Oi Group have a substantial amount of existing debt, which could restrict our financing and operating flexibility and have other adverse consequences

As of December 31, 2012, we had total consolidated debt of €11,098.5 million, including the portion of the debt of the Oi Group that we proportinally consolidate. The Oi Group's total consolidated debt as of December 31, 2012 was R$33,346 million. Our existing level of indebtedness and the requirements and limitations imposed by our debt instruments could adversely affect our financial condition or results of operations. In particular, the terms of some of these debt instruments restrict our ability, and the ability of our subsidiaries and the Oi Group, to:

- incur additional debt;
- grant liens;
- pledge assets;
- sell or dispose of assets; and
- make certain acquisitions, mergers and consolidations.

Furthermore, some of our debt instruments include financial covenants that require us and some of our subsidiaries and the Oi Group to maintain certain specified financial ratios. Additionally, the instruments governing a substantial portion of its indebtedness contain cross-default or cross-acceleration clauses, and the occurrence of an event of default under one of these instruments could trigger an event of default under other indebtedness or enable the creditors under other indebtedness to accelerate that indebtedness.

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If we are unable to incur additional debt, we may be unable to invest in our business and make necessary or advisable capital expenditures, which could reduce future net operating revenue and adversely affect our profitability. In addition, cash required to serve our existing indebtedness reduces the amount available to us to make capital expenditures.

If we are unable to meet our debt service obligations or comply with our debt covenants, we could be forced to renegotiate or refinance our indebtedness, seek additional equity capital or sell assets. We may be unable to obtain financing or sell assets on satisfactory terms, or at all. For more information regarding our debt instruments, including those of the Oi Group, and our indebtedness as of December 31, 2012, see "*Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources Indebtedness.*"

Unfunded post retirement benefit obligations may put us at a disadvantage to our competitors and could adversely affect our financial performance

We have unfunded post retirement benefit obligations that may limit our future use and availability of capital and adversely affect our financial and operating results. Although in December 2010, we transferred to the Portuguese Government the post retirement benefits obligations relating to regulated pensions of Caixa Geral de Aposentações and Marconi, we retained all other obligations, including (1) salaries to suspended and pre-retired employees amounting to €730.4 million as of December 31, 2012, which we must pay monthly directly to the beneficiaries until their retirement age and (2) €502.7 million in obligations related to pension supplements and healthcare as of December 31, 2012, which are backed by plan assets with a market value of €399.4 million, resulting in unfunded obligations of €103.3 million.

Any decrease in the market value of our plan assets relating to our pension supplements and healthcare obligations could increase our unfunded position. Although there is in place an investment policy with capital preservation targets, in the current economic and financial crisis, in particular, the market value of our plan assets is volatile and poses a risk. In addition, our obligations to pay salaries to suspended and pre-retired employees are unfunded. The value of the obligations referred to above may also fluctuate, depending on demographic, financial, legal or regulatory factors that are beyond our control. Any significant increase in our unfunded obligations could adversely affect our ability to raise capital, require us to use cash flows that we would otherwise use for capital investments, implementing our strategy or other purposes and adversely affect perceptions of our overall financial strength, which could negatively affect the price of our ordinary shares and ADSs.

See "*Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources Post Retirement Benefits*" for a description of our transfer of pension obligations to the Portuguese Government.

We must continue to attract and retain highly qualified employees to remain competitive

We believe that our future success largely depends on our continued ability to hire, develop, motivate and retain qualified personnel needed to develop successful new products, support our existing product range and provide services to our customers. Competition for skilled personnel and highly qualified managers in the telecommunications industry in the markets where we operate remains intense. We are continuously developing our corporate culture, remuneration, promotion and benefits policies as well as other measures aimed at empowering our employees and reducing employee turnover. However, particularly considering the poor economic conditions of the Portuguese economy and the increasing immigration trends, we may not be successful in attracting and retaining employees with appropriate skills in the future, and failure in retention and recruiting could have a material adverse effect on our business.

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The PCAOB's inability to conduct inspections of auditors in Portugal makes it more difficult to evaluate the effectiveness of our auditor's audit procedures and quality control procedures

Our independent registered public accounting firm, Deloitte & Associados, SROC S.A., is registered with the Public Company Accounting Oversight Board ("PCAOB") and is accordingly required by U.S. law to undergo regular PCAOB inspections to assess its compliance with U.S. law and professional standards in connection with its audits of financial statements filed with the SEC. However, because our auditor is located in Portugal, a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the local authorities, as in some other non-U.S. jurisdictions, our auditor is currently not undergoing such PCAOB inspections.

Inspections of other firms that the PCAOB has conducted outside Portugal have identified deficiencies in those firms' audit and quality control procedures, which may not be addressed as part of the inspection process to improve future audit quality. This lack of PCAOB inspections in Portugal prevents the PCAOB from evaluating our auditor's audits and its quality control procedures. As a result, investors are deprived of the benefits of PCAOB inspections. Accordingly, although the Company's audited consolidated financial statements were audited in accordance with the standards set forth by the PCAOB, the inability of the PCAOB to conduct inspections of auditors in Portugal makes it more difficult to evaluate the effectiveness of our auditor's audit procedures and quality control procedures as compared with auditors outside Portugal that are subject to PCAOB inspections.

Risks Relating to Our Portuguese Operations

Increased competition among providers of bundled telecommunications services may result in a decrease in our revenues

In 2008, we launched a nationwide Pay-TV service under the *Meo* brand, primarily using our fixed network (IPTV over ADSL2+ and fiber-to-the-home ("FTTH") and direct-to-home ("DTH") satellite technology). This service required us to make significant investments in our network in order to increase the bandwidth and offer a better service quality than our competitors. In January 2013, we announced the rebranding of *Meo* and the launch of a quadruple-play service as M_4O, offering Pay-TV, broadband internet, fixed telephone and mobile telephone services. This launch has required additional marketing expenditures and will entail ongoing investments in infrastucture to remain competitive with other market players.

The main competitors in the market are ZON Multimédia Serviços de Telecomunicações e Multimédia, SGPS, S.A. ("ZON"), Cabovisão, Optimus SGPS, S.A. ("Optimus") and Vodafone. Notwithstanding gains in our revenues and market share from Pay-TV services in recent years and the quality of our service, we have experienced pressure from our competitors to reduce monthly subscription fees. In addition, our efforts to build scale to enable us to negotiate better programming costs with our content suppliers, especially certain premium content owned by one of our competitors, may not prove successful.

The competitive landscape is expected to change significantly in Portugal with the announcement in January 2013 of the merger of ZON, the largest cable operator, and Optimus, the third-largest mobile operator, to create a new integrated telecommunications operator in Portugal, subject to regulatory approval and other closing conditions. This transaction is expected to further increase the focus on bundled offers and the evolution from triple-play to quadruple-play services as ZON and Optimus leverage their position as an integrated telecommunications operator.

Our revenues from residential services and our financial position could be significantly affected if we are not successful in competing to provide these bundled services, particularly as our Pay-TV services have become increasingly important as a retention tool of our fixed line and broadband internet customers.

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Competition from other mobile telephony and fixed line operators has reduced our revenues from our Portuguese operations and could continue to adversely affect our revenues

As a result of the trend toward the use of mobile services instead of fixed telephone services, combined with the increase in competition from other operators, we have experienced, and may continue to experience, erosion of market share of both access lines and of outgoing domestic and international traffic. The number of active mobile telephone cards in Portugal has overtaken the number of wireline main lines. Mobile operators can bypass our international wireline network by interconnecting directly with fixed line and mobile networks either in our domestic network or abroad. Competition is also forcing down the prices of our fixed line voice services for long-distance and international calls. Lowering our international call prices has caused a decline in our revenues from international fixed line voice services. The decrease in fixed line voice traffic and lower tariffs resulting from competition has significantly affected our overall revenues, and we expect these factors to continue to negatively affect our revenues. See "*Item 4 Information on the Company Competition Competition Facing Our Portuguese Operations Residential Services*."

The broadband market in Portugal is highly competitive and may become more competitive in the future

We believe that with competition in Internet broadband access is intensifying, and with the development of existing technologies such as broadband wireless access, mobile broadband through Universal Mobile Telecommunications System ("UMTS") and long-term evolution ("LTE") technology, as well as high speed broadband supported by the deployment of a fiber optic network, we may face additional pricing pressure on our services, which could result in the loss of revenues from both residential and enterprise customers.

Increased competition in the Portuguese mobile markets may result in decreased tariffs and loss of market share

We believe that our existing mobile competitors, Vodafone and Optimus, which has announced a merger with ZON, as described above, will continue to market their services aggressively, and in most cases, those operators have similarly priced offers. After we launched our low-cost brand *Uzo*, for example, Vodafone and Optimus quickly responded with similar products of their own. As another example, in 2010, we launched a tribal plan as a reaction to similar plans launched by our competitors, and that plan provides for lower revenue per user than many of our other plans. We believe that our ability to compete depends on our ability to differentiate our products based on services offered, quality and simplicity of pricing plans, and we may not be successful in doing so.

We expect competition from VoIP-based operators also to place increasing price pressure on voice tariffs and lead to reductions in mobile voice traffic. Competition from companies providing wireless local-area network services ("WLAN"), which can deliver wireless data services more cheaply than mobile data services, such as through UMTS or LTE technology, in concentrated areas, may also affect the market and pricing for third and fourth generation services. See "*Item 4 Information on the Company Competition Competition Facing Our Portuguese Operations Personal Services*."

Burdensome regulation in an open market may put us at a disadvantage to our competitors and could adversely affect our Portuguese telecommunications business

The Portuguese electronic communications sector is fully open to competition. However, many regulatory restrictions and obligations are still imposed on us. In the previous round of market analyses, carried out from 2004 to 2006, Portugal Telecom was found by the Portuguese telecommunications regulator (the *Autoridade Nacional das Comunicações*, or "ANACOM") to have significant market power in all but one of the 16 markets analyzed and, consequently, is subject to regulatory restrictions and obligations. Not all of these obligations and restrictions have been imposed on other

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telecommunications operators and service providers. Pursuant to the European Relevant Markets Recommendation issued in 2007, which significantly reduced the number of markets subject to regulation, ANACOM is re-analyzing the retail and wholesale markets to identify which electronic communications operators and service providers it considers to have significant market power in those markets and determining the regulatory obligations that should be imposed on those operators and service providers.

ANACOM has re-analyzed certain of the markets defined under the European Relevant Market Recommendation and has found Portugal Telecom to have significant market power in some of those markets, including the wholesale market for call termination on individual public telephone networks provided at a fixed location, the market for call termination on individual mobile networks, the market for the provision of wholesale (physical) network infrastructure access and the wholesale leased lines terminal market. In certain cases, such as the wholesale broadband access market and the wholesale transit market, ANACOM has segmented the markets into "C" (competitive) and "NC" (non-competitive) segments and has found Portugal Telecom to have significant market power in the non-competitive segments. ANACOM has the power to impose remedies to increase competition in those markets. For example, ANACOM is proposing to introduce virtual access to fiber (an advanced bitstream offer) as a remedy in the wholesale (physical) network infrastructure access market in certain geographic areas. In addition, ANACOM has not completed its analysis of all the markets identified by the European Relevant Market Recommendation, and we expect that it will provide further analysis in the near future.

Remedies imposed by ANACOM may require us to provide services in certain markets or geographic regions or to make investments that we would otherwise not choose to make. In addition, we incur expenses to adapt our operations to constantly changing regulatory requirements and to ensure regulatory compliance. The substantial resources we must commit to fulfill our regulatory obligations could adversely affect our ability to compete. See "*Item 4 Information on the Company Regulation Portugal*" for more details on the regulatory requirements to which we are subject.

Reduced interconnection rates have negatively affected our revenues for our Portuguese telecommunications business and will continue to do so in 2013

In recent years, ANACOM has imposed price controls on interconnection rates for the termination of calls on mobile networks. These reductions have had a significant impact on interconnection revenues of our mobile subsidiary, TMN Telecomunicações Móveis Nacionais, S.A. ("TMN"), and, consequently, on its earnings.

ANACOM has issued successive decisions that have reduced mobile termination rates over time. Most recently, in March 2012, ANACOM issued a final decision reducing mobile termination rates progressively to €0.0127 by December 2012. The reductions in mobile termination rates have had and will continue to have a negative effect on our cash flows and revenues.

The *Autoridade da Concorrência* (formerly the *Direcção Geral do Comércio e da Concorrência*) (the "Portuguese Competition Authority") has also completed an analysis of mobile rates for originating calls, finding origination rates to be excessive and stating that mobile operators must reduce their rates to the level of their costs by July 2012 or face the possibility of being sanctioned.

ANACOM's price controls on fixed-to-mobile interconnection may also negatively affect our revenues from fixed line residential services because we are required to reflect the reduction in these interconnection charges in our retail prices for calls from our fixed line network. We expect that the reduction in interconnection charges will continue to have an impact on our revenues from fixed line residential services.

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In addition, the lower interconnection rates have reduced revenues for our wholesale business, which records revenue from incoming calls transiting through our network that terminate on the networks of mobile operators. The prices we charge to international operators (and hence our revenues) also depend on the interconnection fees charged by mobile operators for international incoming calls terminating on their networks, and these fees have been decreasing. We expect that lower interconnection rates will continue to have a negative impact on our wholesale revenues.

The European Commission's review of roaming charges may continue to lead to a reduction in revenues from personal services

The EC regulates the roaming charges that may be charged in the wholesale market and the retail market in Europe. These regulations extend to data and Short Messaging Services ("SMS"), or text messaging. On July 1, 2012, the previous roaming regulations were replaced by a new version, known as "Roaming III," which will expire on June 30, 2022. In addition to setting maximum voice roaming rates (subject to a glide path) that may be charged with respect to the wholesale market, retail market, data and SMS, Roaming III also features (1) extended transparency and consumer-protection measures ("bill-shock") that go beyond the EU territory, (2) a cap on retail data roaming communications, (3) the introduction of an obligation for mobile operators in the wholesale market to provide reasonable network access in order to allow roaming services and (4) the decoupling of roaming services from other services, while enabling a consumer to use the same number.

The Roaming III regulations have had, and are expected to continue to have, an adverse effect on the revenues of our mobile business and on our results of operations.

The Portuguese government could terminate or fail to renew our fixed line concession, our licenses and our authorizations for data and mobile services

We provide a significant number of services under a concession granted to us by the Portuguese government and under licenses and authorizations granted to us by ANACOM. See "*Item 4 Information on the Company Regulation Portugal Our Concession and Existing Licenses and Authorizations*." The Portuguese government can revoke our concession if it considers the revocation to be in the public interest. It can also terminate our concession at any time if we fail to comply with our obligations under the concession.

The Portuguese government can also terminate our mobile licenses under certain circumstances. Through TMN, we hold renewable license to provide GSM and UMTS mobile telephone services throughout Portugal, valid until 2016 and 2022, respectively. In January 2012, TMN was allocated the right to use frequencies to provide, among other technologies, LTE mobile telephone services throughout Portugal, and in March 2012, ANACOM issued a renewable licence to TMN, valid until 2027, with respect to the use of these frequencies. This license also unifies the previous GSM and UMTS licenses issued to TMN. If the Portuguese government were to terminate our license, we would not be able to conduct the activities authorized by the concession or the relevant licenses. This loss would eliminate an important source of our revenues.

Our obligations as a universal service provider in Portugal could adversely affect our results of operations and profitability

Our concession and Portuguese law impose obligations on us as a universal services provider. See "*Item 4 Information on the Company Regulation Portugal Areas of Recent Regulation and Updates Universal Service Obligations.*" On February 14, 2012, after holding a public consultation on the process for selecting universal service providers, ANACOM issued a final decision dividing universal services into three functions: (1) connection to a public telecommunications network at a fixed location and the provision of public telephone services ("Tender 1"), (2) publicly available telephone offers ("Tender 2") and (3) a comprehensive directory and directory inquiry services ("Tender 3"). These functions are further divided into three geographic regions (1) North, (2) Center and (3) South and Islands. On October 12, 2012, the Ministries of Finance, Economy and Employment launched a tender offer to establish a designation for universal service providers, which included a compensation fund for universal service providers and a related renegotiation of our concession. Before the deadline on March 15, 2013, PT Comunicações submitted bids in Tender 1 and Tender 2. On April 18, 2013, ANACOM published a preliminary report regarding the bids for Tenders 1 and 2, as there was no bidder in Tender 3. In accordance with this report, PT Comunicações did not present the lowest bid in Tender 1 and, as such, will not likely continue to be the universal service provider of a connection to a public telecommunications network at a fixed location. However, PT Comunicações presented the lowest bid for Tender 2 and will likely continue to be the universal service provider of public payphones. In addition, even in the case where PT Comunicações is not selected as a universal services provider, we will be required to contribute to the compensation fund for universal services providers according to our share of the revenues of the national telecommunications sector.

Regulatory investigations and litigation may lead to fines or other penalties

We are regularly involved in litigation, regulatory inquiries and investigations involving our operations. ANACOM, the European Commission and the Portuguese Competition Authority regularly make inquiries and conduct investigations concerning our compliance with applicable laws and regulations. Current inquires by the Portuguese Competition Authority relate to alleged anti-competitive practices in the broadband internet, terrestrial television and public mobile telephone markets.

In January 2011, the European Commission opened an investigation into an agreement between Telefónica and Portugal Telecom allegedly not to compete in the Iberian telecommunications markets. Portugal Telecom has developed various strategic partnerships with Telefónica in recent years. Although we do not believe the existence of these partnerships has impeded competition and ordinary activities of our company and Telefónica, our relationship with Telefónica was investigated. In January 2013, the European Commission adopted a decision finding that we and Telefónica had infringed Article 101 of the Treaty on the Functioning of the European Union with reference to our July 28, 2010 agreement with Telefónica concerning the acquisition by Telefónica of Portugal Telecom's stake in Brazilian operator Vivo. In accordance with this decision, Portugal Telecom was fined an amount of €12.29 million, which we believe is unjustified. On April 9, 2013, we brought an action for annulment before the Court of Justice of the European Union and will continue to vigorously defend the matter.

These inquiries and investigations are described in greater detail in "*Item 8 Financial Information Legal Proceedings*." If we are found to be in violation of applicable laws and regulations in these or other regulatory inquiries, investigations, or litigation proceedings that are currently pending against us or that may be brought against us in the future, we may become subject to penalties, fines, damages or other sanctions. Any adverse outcome could have a material adverse effect on our operating results or cash flows.

Risks Related to Our Brazilian Operations

Our strategy of enhancing our operations in Brazil through our strategic partnerships with Oi and Contax may not be successful, and we do not have free access to cash flows from Oi and Contax

The successful implementation of our strategy for our mobile operations in Brazil depends on the development of our strategic partnership with Oi. On March 28, 2011, we completed the acquisition of a 25.3% economic interest in the Oi Group, and our economic interest is currently 23.3%. For the year ended December 31, 2012, 53% of our revenues were generated in Brazil, and our strategic partnership with Oi represented the bulk of these revenues. As in any strategic partnership, it is possible that we, the other controlling shareholders and Oi will not agree on its strategy, operations or other matters. Any inability of our company and the other controlling shareholders of Oi to operate Oi jointly could have a negative impact on Oi's operations, which could have a negative impact on our strategy in Brazil and could have a material adverse effect on our results of operations. In addition, we cannot be sure that Oi will be able to take advantage of its position in the Brazilian market to increase the scope and scale of its operations or that any anticipated benefits of the strategic partnership will be realized.

In addition, concurrently with our investment in Oi, we acquired a 16.2% economic interest in Contax, which provides among other contact center services in Brazil. Our economic interest in Contax increased to 19.5% in June 2011 and to 21.1% in April 2013. Although the contribution of Contax to our consolidated revenues is not as significant as that of Oi, Contax remains an important part of our international telecommunications business. The types of risks described above that apply to our strategic partnership with Oi also apply to our strategic partnership with Contax.

In addition, because we hold joint control of Oi and Contax, we may not have free access to their cash flows. It will be necessary for us and other controlling shareholders of Oi and Contax to agree to approve any distributions from those companies. See "*Item 4 Information on the Company Our Businesses Brazilian Operations (Oi) Strategic Partnership with Oi*" and "*Item 4 Information on the Company Our Businesses Other International Operations Other Brazilian Operations Strategic Partnership with Contax.*"

We are exposed to Brazilian exchange rate and interest rate fluctuations

We are exposed to exchange rate fluctuation risks, mainly due to our significant investments in Brazil. We do not expect to hedge our economic exposure against exchange rate fluctuations. We are required to make adjustments to our equity on our statement of financial position in response to fluctuations in the value of foreign currencies in which we have made investments. Devaluation of the Brazilian Real in the future could result in negative adjustments to our financial position, which could limit our ability to generate distributable reserves.

We are also exposed to interest rate fluctuation risks. We have entered into financial instruments to reduce the impact on our earnings of an increase in market interest rates, but these financial instruments may not prevent unexpected and material fluctuations of interest rates from having any material adverse effect on our earnings.

The Brazilian Central Bank's Monetary Policy Committee (*Comitê de Política Monetária do Banco Central*, or "COPOM") establishes the basic interest rate target for the Brazilian financial system by referring to the level of economic growth of the Brazilian economy, the level of inflation and other economic indicators. As of December 31, 2008, 2009, 2010, 2011 and 2012, the basic interest rate was 13.8%, 8.8%, 10.8%, 10.9% and 6.9%, respectively. Increases in interest rates may have a material adverse effect on Oi by increasing its interest expense on floating rate debt and increasing its financing costs.

Macroeconomic factors in Brazil could reduce expected returns on our Brazilian investments

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

Adverse political and economic conditions. The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. The Brazilian government frequently intervenes in the Brazilian economy and occasionally makes significant changes in policy and regulations. The Brazilian government's actions to control inflation, stabilize the Brazilian economy and implement macroeconomic policies have often involved increases in interest rates, wage and price controls, currency devaluations, blocking access to bank accounts, imposing capital controls and limits on imports, among other things. We do not have any control over, and are unable to predict, which measures or policies the Brazilian government may adopt in the future. Changes in the Brazilian government's exchange control policy, or in general economic conditions in Brazil, could have a material adverse effect on the results of our operations in Brazil. Deterioration in economic and market conditions in other countries, such as Argentina and Venezuela and emerging markets outside Latin America, may adversely affect the Brazilian economy and our business.

Uncertainty over whether possible changes in policies or rules affecting these or other factors may contribute to economic uncertainties in Brazil and to heightened volatility in the Brazilian securities markets and securities issued abroad by Brazilian issuers. The President of Brazil has considerable power to determine governmental policies and actions that relate to the Brazilian economy and, consequently, affect the operations and financial performance of businesses such as Oi and Contax. The policies that may be implemented by the Brazilian federal or state governments may adversely affect our business, financial condition and results of operations in Brazil.

Past political crises in Brazil have affected the confidence of investors and the public in general, as well as the development of the economy. Any future political crises could have an adverse impact on the Brazilian economy and on our business, financial condition and results of operations in Brazil.

Fluctuations in the Real. The Brazilian currency has historically experienced frequent fluctuations relative to the Euro and other currencies. During the four decades prior to 1999, the Central Bank periodically devalued the Brazilian currency. Throughout this period, the Brazilian government implemented various economic plans and used various exchange rate policies, including sudden devaluations (such as daily and monthly adjustments), exchange controls, dual exchange rate markets and a floating exchange rate system. Since 1999, exchange rates have been set by the market. In 2009 and 2010, the Real appreciated against the Euro by 29.2% and 13.2%, respectively, and in 2008, 2011 and 2012 the Real depreciated against the Euro by 20.0%, 8.5% and 10.6%, respectively. Any substantial negative reaction to the policies of the Brazilian government could have a negative impact, including devaluation. The devaluation of the Real could negatively affect the stability of the Brazilian economy and accordingly could negatively affect the profitability and results of our operations and our ability to distribute reserves. It would also increase costs associated with financing our operations in Brazil. In particular, a significant amount of Oi's financial liabilities are denominated in or indexed to foreign currencies, primarily U.S. dollars, Japanese yen and euros. As of December 31, 2012, R$13,277 million of Oi's financial indebtedness was denominated in a foreign currency. When the Real depreciates against foreign currencies, Oi incurs losses on its liabilities denominated in or indexed to foreign currencies, such as its U.S. dollar-denominated long-term debt and foreign currency loans, and it incurs gains on its monetary assets denominated in or indexed to foreign currencies, as the liabilities and assets are translated into Reais. If significant depreciation of the Real were to occur when the value of such liabilities significantly exceeds the value of such assets, including any financial instruments entered into for hedging purposes, Oi could incur significant losses, even if the value of those assets and liabilities has not changed in their original currency. In addition, a significant depreciation in the Real could adversely affect Oi's ability to meet certain of its payment obligations. A failure to meet certain of Oi's payment obligations could trigger a default under certain financial covenants in its debt instruments, which could have a material adverse effect on Oi's business and results of operations. Additionally, Oi currently has currency swaps and non-deliverable forwards in place for a portion of its foreign currency debt. However, if the cost of currency swap instruments increases substantially, Oi may be unable to maintain its hedge positions, resulting in an increased foreign currency exposure, which could in turn lead to substantial foreign exchange losses.

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In addition, a devaluation of the Real relative to the U.S. dollar may increase the costs of imported products and equipment. Our operations in Brazil rely on imported equipment, and, as a result of such devaluation, such equipment would be more expensive to purchase.

Increases in interest rates. In response to the global economic and financial crisis, the Brazilian government increased the SELIC basic interest rate to 13.75% as of December 31, 2008. In 2009, Brazilian Central Bank reduced the SELIC rate to 8.75% as of December 31, 2009. Based on further economic developments, the Brazilian Central Bank increased the SELIC rate up to 10.75% as of December 31, 2010 and to 11.00% as of December 31, 2011. Most recently, the Brazilian Central Bank reduced the SELIC rate several times in 2012 to 7.25% as of December 31, 2012. However, Brazilian interest rates remain high, and any increase in interest rates could negatively affect our profitability and results of operations and would increase the costs associated with financing our operations in Brazil.

Oi's financial expenses are affected by changes in the interest rates that apply to its floating rate debt. As of December 31, 2012, Oi had, among other debt obligations, R$5,538 million of loans and financing and debentures that were subject to the *Taxa de Juros de Longo Prazo* ("TJLP"), a long-term interest rate, R$9,139 million of loans and financing and debentures that were subject to the Interbank Certificate of Deposit (*Certificado de Depósito Interbancário*, or "CDI") rate, an interbank rate, R$3,794 million of loans and financing that were subject to the London Interbank Offered Rate ("Libor"), and R$3,377 million of loans and financing that were subject to the IPCA.

The TJLP includes an inflation factor and is determined quarterly by the National Monetary Council (*Conselho Monetário Nacional*). In particular, the TJLP and the CDI rate have fluctuated significantly in the past in response to the expansion or contraction of the Brazilian economy, inflation, Brazilian government policies and other factors. For example, the CDI increased from 8.55% per annum as of December 31, 2009 to 10.64% per annum as of December 31, 2010 and 10.87% per annum as of December 31, 2011 and decreased to 6.90% per annum as of December 31, 2012. A significant increase in any of these interest rates, particularly the CDI rate, could adversely affect Oi's financial expenses and negatively affect its overall financial performance.

Inflation in Brazil. Brazil has historically experienced high rates of inflation, with annual rates of inflation reaching as high as 2,708% in 1993 and 1,093% in 1994. Inflation, as well as governmental measures put in place to combat inflation, have had a material adverse effect on the Brazilian economy. Since the introduction of the Real in 1994, Brazil's inflation rate has been substantially lower than in previous periods. However, inflationary pressures persist, and actions taken in an effort to curb inflation, coupled with public speculation about possible future governmental actions, have in the past contributed to economic uncertainty in Brazil and heightened volatility in the Brazilian securities market. Brazil's rates of inflation, as measured by the General Market Price Index Internal Availability (*Índice Geral de Preços Disponibilidade Interna*, or "IGP-DI"), published by Fundação Getúlio Vargas ("FGV"), were 9.1% in 2008, (1.4)% in 2009, 11.3% in 2010, 5.0% in 2011 and 8.1% in 2012. According to the Broad Consumer Price Index (*Índice Nacional de Preços ao Consumidor Ampliado*, or "IPCA"), published by the Brazilian Institute for Geography and Statistics (*Instituto Brasileiro de Geografia e Estatística*, or "IBGE"), the Brazilian consumer price inflation rates were 5.9% in 2008, 4.3% in 2009, 5.9% in 2010, 6.5% in 2011 and 5.8% in 2012.

Since 2006, Oi's telephone rates have been indexed to the Telecommunications Service Index (*Índice de Serviços de Telecomunicações*, or "IST"), which is a basket of national indexes that reflect the Brazilian telecommunications sector's operating costs. However, Brazilian monetary policy continues to use the IPCA as an inflation targeting system. The inflation target for 2012 is 4.5%, lower than the actual inflation rate of 5.8%. In recent years, Brazil has failed to meet its inflation target. According to the Brazilian monetary authority, the official inflation target was only met in one calendar year over the past three years. In 2009, the official target inflation rate of 4.50% was 4% higher than the actual inflation rate of 4.32%. However, in 2010 and 2011, Brazil's actual inflation rate was 5.91% and 6.50%, respectively, 31.3% and 44.4% higher than the 4.50% inflation target set for both calendar years. In 2012, inflation rate stood at 5.84%. Increases in the inflation rate may result in increases in the basic interest rates, causing direct effects on Oi's cost of debt and indirect effects on the demand for telecommunications goods and services. These effects are aggravated by the uncertainties historically observed in Brazil's economy.

If Brazil experiences substantial inflation in the future, Oi's costs may increase and its operating and net margins may decrease. Although regulations enacted by the Brazilian federal telecommunications regulator (*Agência Nacional de Telecomunicações*, or "ANATEL") provide for annual price increases for most of Oi's services, these increases are linked to inflation indices, as described above, discounted by increases in Oi's productivity. During periods of rapid increases in inflation, the price increases for Oi's services may not be sufficient to cover its additional costs, and Oi may be adversely affected by the lag in time between the incurrence of increased costs and the receipt of revenues resulting from the annual price increases. Inflationary pressures may also lead to further government intervention in the economy, including the introduction of government policies that may adversely affect the overall performance of the Brazilian economy.

Restrictions on the movement of capital out of Brazil. Brazilian law provides that whenever there exists, or there is a serious risk of, a material imbalance in Brazil's balance of payments, the Brazilian government may impose restrictions for a limited period of time on the remittance to foreign investors of the proceeds of their investments in Brazil as well as on the conversion of the Real into foreign currencies. The Brazilian government imposed such a restriction on remittances for approximately six months in 1989 and early 1990. The Brazilian government may in the future restrict companies from paying amounts denominated in foreign currency or require that any such payment be made in Reais. Many factors could affect the likelihood of the Brazilian government imposing such exchange control restrictions, including the extent of Brazil's foreign currency reserves, the availability of sufficient foreign exchange on the date a payment is due, the size of Brazil's debt service burden relative to the economy as a whole and political constraints to which Brazil may be subject. There can be no certainty that the Brazilian government will not take such measures in the future.

In addition to limiting our ability to capitalize on our investments in Brazil, a more restrictive policy could increase the cost of servicing, and thereby reduce Oi's ability to pay, its foreign currency-denominated debt obligations and other liabilities. As of December 31, 2012, Oi's foreign-currency denominated debt represented 39.1% of its indebtedness. If Oi fails to make payments under any of these obligations, it will be in default under those obligations, which could reduce its liquidity.

The market value of securities issued by Brazilian companies is influenced by the perception of risk in Brazil and other emerging market countries, which may have a negative effect on the value of our investments in Oi and Contax and may restrict Oi and Contax's access to international capital markets

Economic and market conditions in other emerging market countries, especially those in Latin America, may influence the market for securities issued by Brazilian companies. Investors' reactions to developments in these other countries may have an adverse effect on the market value of securities of Brazilian issuers. Adverse economic conditions in other emerging market countries have at times resulted in significant outflows of funds from Brazil. Crises in other emerging countries or the economic policies of other countries, in particular the United States, may adversely affect investors' demand for securities issued by Brazilian companies, including Oi and Contax. Any of these factors could adversely affect the market price of the common or preferred shares of Oi and Contax and thereby reduce the value of our investment in those companies. Any of these factors could also impede the ability of Oi or Contax to access the international capital markets and finance their operations in the future on terms acceptable to it or at all.

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Oi's fixed line telecommunications services face increased competition from mobile services providers, other fixed line service providers and cable television service providers, which may adversely affect its revenues and margins

Oi's fixed line telecommunications services in Region I (which consists of 16 Brazil states located in the northeastern and part of the northern and southeastern regions) and Region II (which consists of the Federal District and nine Brazilian states located in the western, central and southern regions) face increasing competition from mobile services as the prices for mobile services decline and approach those of fixed line services. Based on information available from ANATEL, from December 31, 2009 to May 31, 2012 (the latest date for which such information is available from ANATEL), the number of fixed lines in service in Brazil increased from 41.5 million to 43.7 million. Oi expects (1) the number of fixed lines in service in Region I and Region II to experience slow growth, as certain customers eliminate their fixed line services in favor of mobile services, and (2) the use of existing fixed lines for making voice calls to decline as customers substitute calls on mobile phones in place of fixed line calls as a result of promotional mobile rates (such as free calls within a mobile provider's network). The rate at which the number of fixed lines in service in Brazil may decline depends on many factors beyond Oi's control, such as economic, social, technological and other developments in Brazil. In addition, new fixed lines that Oi installs are expected to be less profitable than existing ones because new fixed line customers generally have lower average incomes than Oi's existing customers, subscribe to Oi's lower cost service plans and generate fewer chargeable minutes of usage. For the year ended December 31, 2012, Oi's traditional local fixed line telecommunications services represented 31.4% of Oi's gross operating revenue. Because Oi derives a significant portion of its net operating revenue from its traditional local fixed line telecommunications services, the reduction in the number of Oi's fixed lines in service has negatively affected and is likely to continue to negatively affect its net operating revenue and margins.

Oi also competes in the market for local fixed line services with other fixed line service providers, primarily with Empresa Brasileira de Telecomunicações Embratel ("Embratel") and GVT S.A. ("GVT"). In addition to direct competition for corporate customers in Region I, Embratel competes with Oi for residential customers in Region I and Region II with services that it provides using the cable infrastructure of its subsidiary, Net Serviços de Comunicação S.A. ("Net"). Net is a cable television company that is Oi's main competitor in the broadband services market. Embratel is a subsidiary of América Móvil S.A.B. de C.V. ("América Móvil"), one of the leading telecommunications services providers in Latin America. Under an agreement entered into between Embratel and Net in November 2005, Net offers integrated voice, broadband and pay television services to the Brazilian residential market through a single network infrastructure. In addition, Oi competes in each of these service regions with smaller companies that have been authorized by ANATEL to provide local fixed line services. Embratel, GVT and Net are each controlled by multinational companies that may have more significant financial and marketing resources, and greater abilities to access capital on a timely basis and on more favorable terms, than Oi.

Oi's loss of a significant number of fixed line customers would adversely affect its net operating revenue and may adversely affect its results of operations. In addition, because callers in Brazil placing long-distance calls from their fixed line telephones generally tend to select the long-distance carrier affiliated with the provider of their fixed line service, Oi's loss of a significant number of fixed line customers may adversely affect its revenues from long-distance services and its results of operations. For a detailed description of Oi's competition in the local fixed line services market, see "*Item 4 Information on the Company Competition Competition Facing Oi in Brazil Local Fixed Line Services.*"

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Oi's mobile services face strong competition from other mobile services providers, which may adversely affect its revenues

The mobile services market in Brazil is extremely competitive. Oi faces competition from large competitors such as Vivo, Telecom Americas Group, which markets its services under the brand name *Claro*, and TIM Participações S.A. ("TIM"). As of December 31, 2012, based on information regarding the total number of subscribers as of that date available from ANATEL, Oi had a market share of 18.8% of the total number of subscribers in Brazil, ranking behind Vivo with 29.1%, TIM with 26.9% and Telecom Americas Group with 24.9%, and Oi captured 19.0% of all net additions of mobile subscribers in Brazil (calculated based on the number of mobile subscribers at the end of a period less the number of mobile subscribers at the beginning of that period) during 2012. Vivo, TIM and Telecom Americas Group are each controlled by multinational companies that may have more significant financial and marketing resources, and greater abilities to access capital on a timely basis and on more favorable terms, than Oi.

Oi's ability to generate revenues from its mobile services business depends on its ability to increase and retain its customer base. Each additional customer subscribing to Oi's service entails costs, including sales commissions and marketing costs. Recovering these costs depends on Oi's ability to retain such customers. Therefore, high rates of customer churn could have a material adverse effect on the profitability of Oi's mobile service business. During 2012, Oi's average customer churn rate in the mobile services segment, representing the number of subscribers whose service was disconnected during each month, whether voluntarily or involuntarily, divided by the number of subscribers at the beginning of such month, was 3.8% per month.

Oi has experienced increased pressure to reduce its rates in response to pricing competition. This pricing competition often takes the form of special promotional packages, which may include, among other things, mobile handset subsidies, traffic usage promotions and incentives for calls made within a mobile services provider's own network. Competing with the service plans and promotions offered by competitors may cause an increase in Oi's marketing expenses and customer-acquisition costs, which has adversely affected and could continue to adversely affect Oi's results of operations. Oi's inability to compete effectively with these bundles of products and services could result in a loss of market share and adversely affect its operating revenues and profitability. For a detailed description of Oi's competition in the mobile services market, see "*Item 4 Information on the Company Competition Competition Facing Oi in Brazil Mobile Services.*"

Oi's long-distance services face significant competition, which may adversely affect its revenues

In Brazil, unlike in the United States and many other countries, a caller chooses its preferred long-distance carrier for each long-distance call, whether originated from a fixed line telephone or a mobile handset, by dialing such carrier's long-distance carrier selection code (*Código de Seleção de Prestadora*). The long-distance services market in Brazil is highly competitive. Oi's principal competitors for long-distance services are TIM and Embratel, are currently offering long-distance services throughout Brazil at rates that are charged on a per call, rather than per minute, basis. As a result of its commencement of mobile services in Region III, Oi has also begun to compete with Telefónica, which is the incumbent fixed line service provider in Region III. Generally, Oi believes that callers placing long-distance calls in Brazil from their fixed line telephones tend to select the long-distance carrier affiliated with the provider of their fixed line service. Similarly, Oi believes that callers placing long-distance calls in Brazil from their mobile telephones tend to select the long-distance carrier affiliated with the provider of their mobile or fixed line service. However, increased competition from long-distance service providers has resulted in pressure on Oi's long-distance rates and adversely affected its revenue from these services. Competition in the long-distance market may require Oi to increase its marketing expenses and/or provide services at lower rates than those it currently expects to charge for such services. Competition in the domestic long-distance market has had and could continue to have a material adverse effect on Oi's revenues and margins. See "*Item 4 Information on the Company Competition Competition Facing Oi in Brazil Long-Distance Services*."

Data transmission services are not subject to significant regulatory restrictions in Brazil, and as a result, Oi faces an increasing amount of competition in this business

Competition in data transmission services is not subject to significant regulatory restrictions, and, therefore, the market is open to a large number of competitors. Some competitors, such as cable operators, offer telephone and broadband services that do not require them to use Oi's fixed line network, thereby allowing them to reach Oi's customers without paying interconnection fees to Oi. Increasing competition in data transmission services may lead to rate reductions in this segment, adversely affecting the net operating revenue that Oi generate from this business. In addition, increased competition for data transmission customers may require Oi to increase its marketing expenses and capital expenditures and may lead to the loss of broadband customers, in each case leading to a decrease in Oi's profitability.

Regulation and regulatory changes may have a material adverse effect on Oi's results

Telecommunications service providers in Brazil are subject to extensive regulation. ANATEL regulates, among other things, rates, quality of service and universal service goals, as well as competition among telecommunications service providers. Changes in laws and regulations, grants of new concessions, authorizations or licenses or the imposition of additional universal service obligations, among other factors, may adversely affect Oi's business, financial condition and results of operations.

For example, ANATEL recently proposed a General Plan on Competition Targets (*Plano Geral de Metas de Competição*), which contemplated the creation of three entities to manage information about telecommunications networks, act as an intermediary in contracts between telecommunications providers and supervise the offering of wholesale and retail data traffic services. The proposed General Plan on Competition Targets also addressed a variety of other matters, including criteria for the evaluation of telecommunications providers to determine which providers have significant market power, regulations applicable to the wholesale markets for trunk lines, backhaul, access to internet backbone and interconnection services, and regulations related to partial unbundling and/or full unbundling of the local fixed line networks of the public regime service providers. This General Plan on Competition Targets was adopted by ANATEL in November 2012.

As another example, ANATEL has proposed new regulations under which it would modify the Factor X applicable to the determination of rate increases available to public concessionaires providing fixed line services. These regulations were submitted for public consultation in July 2011, and the public consultation period ended on September 1, 2011. Oi expects these new regulations, as they may be modified as a result of ANATEL's further analysis, to be adopted in 2013. We cannot predict when these regulations will be adopted or whether they will be adopted as proposed. Some of these regulations, if adopted, may have adverse effects on Oi's revenues, costs and expenses, results of operations or financial position.

Certain legislative bills seeking to terminate monthly subscription fees charged by local fixed line service providers have been submitted to the Brazilian Congress and remain pending. In March 2008, a special committee was formed in the Brazilian House of Representatives to discuss the various proposed bills on this issue. As of the date of this annual report, no action had been taken by the committee. The enactment of legislation terminating the monthly subscription fees would have a material adverse effect on Oi's results of operations.

We cannot predict whether ANATEL, the Brazilian Ministry of Communications (*Ministério das Comunicações*) or the Brazilian government will adopt other telecommunications sector policies in the future or the consequences of such policies on Oi's business and the business of its competitors.

Oi's local fixed line and domestic long-distance concession agreements are subject to periodic modifications by ANATEL, and Oi's bids for new concessions upon the expiration of its existing concessions may not be successful

Oi provides fixed line telecommunications services in Region I and Region II of Brazil pursuant to concession agreements with the Brazilian government. These concession agreements expire on December 31, 2025 and may be amended by the parties every five years prior to the expiration date. In connection with each five year amendment, ANATEL has the right, following public consultations, to impose new terms and conditions in response to changes in technology, competition in the marketplace and domestic and international economic conditions.

Oi's obligations under the concession agreements may be subject to revision in connection with each future amendment. Any future amendments could impose requirements on Oi that could require it to undertake significant capital expenditures or could modify the rate-setting procedures applicable to it in a manner that would significantly reduce the operating revenues that Oi generates from its fixed line businesses. If the amendments to Oi's concession agreements have these effects, its business, financial condition and results of operations could be materially adversely affected.

Oi expects the Brazilian government to offer new concessions in competitive auctions prior to the expiration of the existing concession agreements. Oi may participate in such auctions, but its existing fixed line and domestic long-distance concession agreements will not entitle Oi to preferential treatment in these auctions. If Oi does not secure concessions for its existing service areas in any future auctions, or if such concessions are on less favorable terms than current concessions, Oi's business, financial condition and results of operations would be materially adversely affected.

Oi's local fixed line and domestic long-distance concession agreements, as well as its authorizations to provide personal mobile services, contain certain obligations, and its failure to comply with these obligations may result in various fines and penalties imposed on Oi by ANATEL

Oi's local fixed line and domestic long-distance concession agreements contain terms reflecting the General Plan on Universal Service (*Plano Geral de Metas de Universalização*), the General Plan on Quality Goals (*Plano Geral de Metas de Qualidade*) and other regulations adopted by ANATEL, the terms of which could affect Oi's financial condition and results of operations. Oi's local fixed line concession agreements also require it to meet certain network expansion, quality of service and modernization obligations in its concession regions. In the event of noncompliance with ANATEL targets in any one of these states, ANATEL can establish a deadline for achieving the targeted level of such service, impose penalties and, in extreme situations, terminate the applicable concession agreement for noncompliance with its quality and universal service obligations. See "*Item 4 Information on the Company Regulation Brazil Regulation of Fixed Line Services.*"

On an almost weekly basis, Oi receives inquiries from ANATEL requiring information from it on its compliance with the various service obligations imposed by its concession agreements. If Oi is unable to respond satisfactorily to those inquiries or comply with its service obligations under its concession agreements, ANATEL may commence administrative proceedings in connection with that noncompliance. Oi has received numerous notices of the commencement of administrative proceedings from ANATEL, mostly due to its inability to achieve certain targets established in the General Plan on Quality Goals and the General Plan on Universal Service, among others. As of December 31, 2012, the Oi Group had recorded provisions in the amount of R$987 million in connection with fines sought to be imposed by ANATEL on a consolidated basis. Additional fines from ANATEL or fines in excess of the provisioned amount could adversely impact Oi's financial condition and results of operations. See "*Item 8 Financial Information Legal Proceedings Oi Legal Proceedings Civil Claims Administrative Proceedings.*"

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In addition, Oi's authorizations to provide personal mobile services contain certain obligations requiring it to meet network scope and quality of service targets. If Oi fails to meet these obligations, it may be fined by ANATEL until it is in full compliance with its obligations and, in extreme circumstances, Oi's authorizations could be revoked by ANATEL. For example, on July 23, 2012, ANATEL temporarily suspended Oi's ability to accept new customers for its mobile services in the States of Amazonas, Amapá, Mato Grosso do Sul, Roraima and Rio Grande do Sul due to its perception of Oi's failure to meet capital investment and quality of service commitments in those states. This suspension lasted for approximately two weeks until Oi was able to propose new quality of service goals to ANATEL. See "*Item 4 Information on the Company Regulation Brazil Regulation of Mobile Services Obligations of Personal Mobile Services Providers.*"

Oi and Contax are subject to numerous legal and administrative proceedings, which could adversely affect their business, results of operations and financial condition

Oi and Contax are subject to numerous legal and administrative proceedings. It is difficult to quantify the potential impact of these legal and administrative proceedings. Both Oi and Contax classify the risk of loss from legal and administrative proceedings as "probable," "possible" or "remote." Each company makes provisions for probable losses but does not make provisions for possible and remote losses. As of December 31, 2012, Oi and Contax, together, had recorded provisions of R$7,060.0 million for probable losses relating to various tax, labor and civil legal and administrative proceedings against them, including provisions of R$4,320.5 million relating to civil proceedings, R$1,861.0 million relating to labor proceedings and R$878.5 million relating to tax proceedings. Portugal Telecom's proportionally consolidated portion of these probable liabilities amounted to €681.2 million.

In addition, as of December 31, 2012, Oi and Contax, together, had claims against them totaling R$19,964.9 million for proceedings classified as "possible" and for which they had made no provisions, including R$792.0 million relating to civil proceedings, R$1,761.2 million relating to labor proceedings and R$17,411.7 million relating to tax proceedings. Portugal Telecom's proportionally consolidated portion of these possible liabilities amounted to €1,968.6 million.

Oi and Contax are not required to disclose or record provisions for proceedings in which their management judges the risk of loss to be remote. However, the amounts involved in certain of the proceedings in which Oi and Contax believe their risk of loss is remote could be substantial.

Consequently, the losses to Oi and Contax, and therefore to Portugal Telecom, could be significantly higher than the amounts for which we have recorded provisions. If Oi or Contax were to be subject to unfavorable decisions in any legal or administrative proceedings and the losses in those proceedings were to significantly exceed the amount for which it has provisioned or involve proceedings for which it has made no provision, its results of operations and financial condition may be materially adversely affected. Even for the amounts recorded as provisions for probable losses, a judgment against Oi or Contax would have an effect on their cash flow if they are required to pay those amounts. Unfavorable decisions in these legal proceedings may, therefore, reduce the liquidity of Oi or Contax and adversely affect their, and consequently Portugal Telecom's, business, financial condition and results of operations.

Oi is subject to delinquencies of its accounts receivable. If it is unable to limit payment delinquencies by its customers, or if delinquent payments by its customers increase, its financial condition and results of operations could be adversely affected

Oi's business significantly depends on its customers' ability to pay their bills and comply with their obligations to it. In 2012, Oi recorded provisions for doubtful accounts in the amount of R$503 million, or 2.6% of its gross operating revenue, primarily due to subscribers' delinquencies. As of December 31, 2012, Oi's provision for doubtful accounts, as a percentage of its net operating revenues, was 2.6%.

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ANATEL regulations prevent Oi from implementing certain policies that could have the effect of reducing delinquency, such as service restrictions or limitations on the types of services provided based on a subscriber's credit record. If Oi is unable successfully to implement policies to limit subscriber delinquencies or otherwise select its customers based on their credit records, persistent subscriber delinquencies and bad debt will continue to adversely affect Oi's operating and financial results.

In addition, if the Brazilian economy declines due to, among other factors, a reduction in the level of economic activity, depreciation of the Real, an increase in inflation or an increase in domestic interest rates, a greater portion of Oi's customers may not be able to pay their bills on a timely basis, which would increase its provision for doubtful accounts and adversely affect its financial condition and results of operations.

Risks Related to Our Other International Investments

Adverse political, economic and legal conditions in the countries where we have investments may hinder our ability to receive dividends from our international subsidiaries

The governments of many of the countries where we have investments have historically exercised, and continue to exercise, significant influence over their respective economies and legal systems. Countries where we have investments may enact legal or regulatory measures that restrict the ability of our subsidiaries to make dividend payments to us. Similarly, adverse political or economic conditions in these countries may hinder our ability to receive dividends from our subsidiaries. We receive significant amounts in dividends each year from our international investments, particularly in Africa, and a limitation on our ability to receive a material portion of those dividends could adversely affect our cash flows and liquidity.

In addition, our investments in these regions are exposed to political and economic risks that include, but are not limited to, exchange rate and interest rate fluctuations, inflation and restrictive economic policies and regulatory risks that include, but are not limited to, the process for the renewal of licenses and the evolution of regulated retail and wholesale tariffs. In addition, our ventures in international markets face risks associated with increasing competition, including due to the possible entrance of new competitors and the rapid development of new technologies.

The development of partnerships in these markets raises risks related to the ability of the partners to jointly operate the assets. Any inability of us and our partners to operate these assets may have a negative impact on our strategy and on our results of operations.

All these risks may have material adverse effects on our results of operations.

We may continue to engage in acquisitions and divestments, which may be disruptive and require us to incur significant expenses

From time to time, we have made strategic acquisitions in order to obtain various benefits such as a desire to access to growing international markets and broaden our customer base. Future acquisitions could result in the incurrence of contingent liabilities and an increase in amortization expenses related to intangible assets, which could have a material adverse effect upon our business, financial condition and results of operations. Risks we could face with respect to acquisitions include:

- difficulties in the integration of the operations, technologies, products and personnel of the acquired company;
- risks of entering markets in which we have no or limited prior experience;
- potential loss of employees;
- diversion of management's attention away from other business concerns; and
- expenses of any undisclosed or potential legal liabilities of the acquired company.

From time to time, we also divest parts of our business to monetize investments, obtain funds to make other investments or optimize our operations. Any decision to dispose of or otherwise exit investments may result in the recording of special charges, particularly for any business that we consolidate or proportionally consolidate, such as workforce reduction costs and industry and technology-related write-offs. We may not be successful in consummating future acquisitions or divestments on favorable terms or at all. The risks associated with such acquisitions and divestments could have a material adverse effect upon our business, financial condition and results of operations.

We are a party to joint ventures and partnerships that may not be successful and may expose us to future costs

We are partners in joint ventures and partnerships. Our partnering arrangements may fail to perform as expected for various reasons, including an incorrect assessment of our needs or the capabilities or financial stability of our strategic partners. Our share of any losses from or commitments to contribute additional capital to such partnerships may also adversely affect our results of operations or financial position.

Our ability to work with these partners or develop new products and solutions may become constrained, which could harm our competitive position in the market. We may have disputes with our partners in our joint ventures, and we may have difficulty agreeing with our partners on actions that we believe would be beneficial to those joint ventures in partnerships. In addition, our joint ventures and partnerships in other countries are typically governed by the laws of those countries, and our partners are often established players in those markets and may have greater influence in those economies than we do. To the extent we experience difficulties with our joint venture partners, we may encounter difficulties in protecting our investments in those countries.

Any of these factors could cause our joint ventures and partnerships not to be profitable to us and could cause us to lose all or part of the value of our investments in those ventures.

Risks Relating to Our ADSs and Ordinary Shares

An ADS holder may face disadvantages compared to an ordinary shareholder when attempting to exercise voting rights

Holders of our ADSs may instruct the depositary to vote the ordinary shares underlying the ADSs. For the depositary to follow the voting instructions, it must receive them on or before the date specified in our voting materials. The depositary must try, as far as practical, subject to Portuguese law and our articles of association, to vote the ordinary shares as instructed. In most cases, if the ADS holder does not give instructions to the depositary, it may vote the ordinary shares in favor of proposals supported by our Board of Directors, or, when practicable and permitted, give a discretionary proxy to a person designated by us. We cannot be certain that ADS holders will receive voting materials in time to ensure that they can instruct the depositary to vote the underlying ordinary shares. Also, the depositary is not responsible for failing to carry out voting instructions or for the manner of carrying out voting instructions. This means that ADS holders may not be able to exercise their right to vote and there may be nothing they can do if their ordinary shares or other deposited securities are not voted as requested.

If you are a U.S. tax resident, you will not be eligible for the reduced rates of Portuguese withholding tax on dividends under the U.S.-Portugal income tax treaty unless you fill out a form required by the Portuguese tax authorities and get it certified by the U.S. Internal Revenue Service

If you are a U.S. tax resident, you will not be eligible for the reduced rates of Portuguese withholding tax on dividends under the U.S.-Portugal income tax treaty unless you fill out a form required by the Portuguese tax authorities and have it certified by the U.S. Internal Revenue Service.

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Under Portuguese law, dividends are subject to withholding tax at a rate of 25% for corporate investors and at a rate of 28% for individual investors. Dividends placed in bank omnibus accounts (except where the identity of the effective beneficiary is disclosed) are subject to withholding tax at a rate of 35%.

However, under the U.S.-Portugal income tax treaty, the withholding tax rate on dividends distributed to U.S. tax residents may be reduced, as a general rule, to 15%. In order to apply the reduced treaty rate, confirmation that each shareholder is eligible for the benefits of the treaty is required. A specific form (Form 21-RFI of the Tax and Customs Authority (*AT Autoridade Tributária e Aduaneira*) of the Portuguese Ministry of Finance), duly certified by the U.S. Internal Revenue Service, must be received by Deutsche Bank AG, Amsterdam, Netherlands branch, the custodian for Deutsche Bank Trust Company Americas, the ADS depositary, if you are a holder of ADSs, or your financial intermediary, if you are a holder of Portugal Telecom ordinary shares, prior to the date the dividends are made available to shareholders. If you are a holder of ADSs and need to obtain information about where to send your Form 21-RFI, please contact the depositary at the address set forth in "*Item 12 Description of Securities Other Than Equity Securities*." If this form is not available as of the relevant date, Portuguese withholding tax will be levied at the rate of 25% (in the case of corporate investors) or 28% (in the case of individual investors). If you are able to submit the form to the custodian for the depositary, if you are a holder of ADSs, or to your financial intermediary, if you are a holder of ordinary shares, no later than the 20th day of the month following the payment of the dividend, we believe that the custodian or the financial intermediary, as the case may be, should release the excess Portuguese withholding tax to you (i.e., 10% in the case of corporate investors or 13% in the case of individual investors). However, we cannot guarantee that the custodian or the financial intermediary will do so.

In addition, the 10% or 13% excess Portuguese withholding tax may be subsequently reimbursed by the Portuguese tax authorities pursuant to specific claims of individual shareholders on Form 22-RFI of the Tax and Customs Authority of the Portuguese Ministry of Finance, duly certified by the U.S. Internal Revenue Service and presented to the Portuguese tax authorities within two years following the last day of the year in which the dividends were made available. See "*Item 10 Additional Information Taxation Dividends*."

If you are an investment fund, pension fund or trust holding ADSs or ordinary shares, you should be aware that, under a guidance note issued by the Portuguese tax authorities, in order to benefit from the Treaty provisions, you must comply with certain additional requirements that are described in "*Item 10 Additional Information Taxation Dividends*." Although this is not demanded by the Treaty, the Portuguese tax authorities take the position that the compliance with the applicable requirements should be certified by the U.S. Internal Revenue Service, using a form or other means specifically permitted for this purpose. If you are an investment fund, pension fund or trust, you should contact your tax advisor for more information regarding the requirements of the Portuguese tax authorities.

You should know that receiving certification of a Form 21-RFI or Form 22-RFI from the U.S. Internal Revenue Service can be a lengthy process. In addition, although Portuguese law states that the excess withholding tax should be reimbursed within one year from the date the claim was submitted, we cannot guarantee if or when you will receive any reimbursement of the excess Portuguese withholding tax even if you fill out Form 22-RFI and are eligible to receive reimbursement as described above. You should contact your tax advisor if you wish to fill out Form 21-RFI or Form 22-RFI to claim eligibility for the benefits of the Treaty.

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ITEM 4 INFORMATION ON THE COMPANY

Overview

We provide telecommunications services in Portugal, in Brazil through our strategic partnerships with Oi and Contax, and in certain countries in sub-Saharan Africa and Asia. Our business is analyzed and discussed based on two reportable segments: Telecommunications in Portugal and Telecommunications in Brazil Oi. Within these segments, we report revenues in the following customer categories for our telecommunications services in Portugal and Brazil: residential customers, personal customers, enterprise customers and other revenues. In addition to our operating reportable segments, we have other businesses that do not rise to a threshold that would require disclosure as a reportable segment. Revenues from our Portuguese and international operations accounted for 42% and 58% of our consolidated revenues in 2012, respectively, primarily reflecting 41% and 46% of our consolidated revenues related to the above mentioned Portuguese and Brazilian (Oi) telecommunications businesses, respectively, as well as 7% of our consolidated revenues from the proportional consolidation of Contax and 4% of our consolidated revenues from our Africatel businesses.

Portugal. In Portugal, we provide services in the following customer categories:

- *Residential services*, which include integrated networks inside the customer's home, enabling the simultaneous connection of multiple devices, including fixed line telephone, TV (including Internet Protocol Television and direct-to-home satellite Pay-TV services), game consoles, PCs, laptops, tablets and smartphones. We provide these services through our subsidiaries, in particular PT Comunicações, S.A. ("PT Comunicações").

- *Personal services*, which are mobile telecommunications services, such as voice, data and Internet-related multimedia services provided to personal (*i.e.*, individual) customers through our subsidiary TMN.

- *Enterprise services, including Corporate and SME/SoHo services*, which provide our corporate and medium and small business customers with integrated data and business solutions, as well as IT/IS and business process outsourcing (BPO) services.

- *Wholesale and other services*, which primarily include wholesale telecommunications services, public pay telephones, the production and distribution of telephone directories and other services in Portugal.

Brazil. After the completion of the corporate reorganization of Oi that occurred on April 9, 2012, we hold a 23.3% economic interest in Oi S.A., one of the largest telecommunications companies in Brazil, and we entered into a series of shareholder agreements with other shareholders of Oi that allow us to jointly control Oi. We completed our investment in Oi on March 28, 2011 through the acquisition of a 25.6% of TmarPart, the parent company of Oi S.A., and the acquisition of a subsidiary of TmarPart that merged into Oi S.A. as part of the 2012 corporate reorganization. Although we hold a 23.3% economic interest in Oi S.A., we have proportionally consolidated 25.6% of the results of operations of TmarPart and its subsidiaries (including Oi S.A.) in our consolidated results of operations since April 1, 2011 due to our 25.6% interest in TmarPart.

Oi provides telecommunications services in Brazil, including:

- *Residential services*, which include local fixed line services and domestic and international long-distance services, primarily in Region I and Region II of Brazil, data transmission services, Pay-TV services, bundled fixed line and mobile services, and public telephone services.

- *Personal services*, which include prepaid and postpaid mobile telecommunications services throughout Brazil (Region I, Region II and Region III) utilizing 2G and 3G technology, including voice and data transmission services, and usage of Oi's network to complete calls initiated by customers of other telecommunications services providers to Oi's mobile network (mobile interconnection services).

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Enterprise services, which include fixed line telecommunications services, mobile telecommunications services, advanced voice services, such as 0800 (toll free) services, customized infrastructure and storage capacity and interconnection and traffic transportation services to other telecommunications providers, in most cases to corporate and small and medium enterprises.

The Brazilian regions described above consist of Region I (which is composed of 16 Brazilian states located in the northeastern and part of the northern and southeastern regions), Region II (which includes the Federal District and nine Brazilian states located in the western, central and southern regions) and Region III (consisting of the State of São Paulo).

Other International Assets. Concurrently with our investment in Oi, we acquired a 16.2% direct economic interest in CTX Participações S.A. ("CTX"), the controlling shareholder of Contax Participações S.A. ("Contax Participações") and Contax S.A. ("Contax"), a provider of contact center services in Brazil. As a result of this acquisition, we obtained an initial economic interest of 14.1% in Contax Participações, through the direct interest described above and through the indirect interests described in " *Brazilian Operations (Oi) Strategic Partnership with Oi Background and History.*" Even before our investment in Contax, we provided call center services in Brazil through our subsidiary Dedic, S.A. ("Dedic"), and Dedic's subsidiary GPTI Tecnologias de Informação, S.A. ("GPTI") provided IT/IS services in Brazil. On June 30, 2011, we merged Dedic and GPTI into Contax, and our economic interest in Contax increased to 19.5%. On April 2, 2013, in connection with a corporate reorganization of Contax, we increased our economic interest in Contax to 21.1%. We have proportionally consolidated the results of operations of Contax in our results of operations since April 1, 2011, and Contax's results of operations have included the results of operations of Dedic and GPTI since July 1, 2011.

In addition, we have significant interests in telecommunications companies in Angola, Cape Verde, Namibia and São Tomé and Principe in Africa and in East Timor in Asia. Throughout 2012, we held a significant interest in Companhia de Telecomunicações de Macau, S.A.R.L. ("CTM"), a telecommunications company in Macau, but in January 2013 we announced the sale of our interest in CTM.

The following table provides a breakdown of our operating revenues by reportable segment for the years ended December 31, 2010, 2011 and 2012:

	Year ended December 31,		
	2010	2011	2012
	(Euro millions)		
Telecommunications in Portugal			
Services rendered	2,933.6	2,740.0	2,545.9
Sales	149.4	116.3	109.1
Other revenues	41.4	35.8	45.5
	3,124.5	2,892.0	2,700.5
Telecommunications in Brazil Oi			
Services rendered		2,297.5	2,817.1
Sales		12.0	56.9
Other revenues		102.6	168.0
		2,412.1	3,042.1
Other operations	1,088.3	1,441.1	1,485.1
Eliminations in consolidation	(470.5)	(598.4)	(628.9)
Total consolidated operating revenues	3,742.3	6,146.8	6,598.8

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Corporate Information

Our legal and commercial name is Portugal Telecom, SGPS, S.A. We are a limited liability holding company, organized as a *Sociedade Gestora de Participações Sociais* under the laws of the Portuguese Republic. The company was originally incorporated as Portugal Telecom, S.A., a *sociedade anónima* in June 1994. Our principal offices are located at Avenida Fontes Pereira de Melo, 40, 1069-300 Lisboa, Portugal. Our telephone number is +351 21 500 1701, and our facsimile number is +351 21 500 0800. Our agent for service of process in the United States is Depositary Management Corporation at 570 Lexington Avenue, 44th Floor, New York, New York 10022. Our home page is located at *www.telecom.pt*. The information on our website is not part of this report. The website address is included as an indicative textual reference only.

Strategy

We are an international operator focused on three main geographies: Portugal, Brazil and sub-Saharan Africa. We remain committed to discipline in our strategy, cost, operations and financial performance, and we aim to focus our resources on our core businesses and core regions. Our strategy is guided by five key medium-term objectives:

- grow the scale of our customer base;
- increase our exposure to international operations;
- lead the consumer market in convergence of services and the business/enterprise market in information and communication technologies ("ICT");
- be a top-tier reference company in technology, customer experience and operational effectiveness; and
- be a reference company in sustainability efforts.

Our success in achieving these goals is subject to a number of uncertainties, including the factors described in "*Item 3 Key Information Risk Factors*."

Some of our specific strategies to achieve these goals in our core regions include the following:

Portuguese Operations

- *Residential services: reshaping TV experience.* We have been leveraging the increased capacity of our new generation access networks to provide a TV experience anchored in premium content and a multi-screen strategy with seamless access to content on PCs, TVs and smartphones. *Meo* ("*Meo*"), our triple-play service, offers (1) a non-linear experience with video on demand and pause and restart-TV, (2) a complete ecosystem for TV apps (Facebook, games, music, Kids and Sapo), (3) interactive features providing additional depth over key channels and contents and (4) user-generated content with *Meo Kanal* ("*Meo Kanal*"), an application that allows customers to produce, edit and share multimedia user-generated content on television with other *Meo* customers, creating the first network effect on TV. *Meo* is not limited to fiber and ADSL customers, as we have also invested in a premium satellite service, with a current DTH service offering of eight HD channels, digital recording, video on demand and interactive apps.

- *Personal services: seeking growth through mobile data and convergence.* Our Personal services strategy is focused on two main drivers: (1) an increase in mobile data usage, with a strong push for smartphone adoption, the promotion of value-added apps and the development of tiered data bundles for all customer needs, and (2) tiered pricing voice plans that are simple and easy to choose, which reinforces a postpaid value proposition and endeavors to mitigate the tendency to make calls to persons on the same network through prepaid tariffs and with segment-specific

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strategies. We believe that smartphones drive retention, higher data usage and higher Average Revenue Per User ("ARPU"), and TMN is leveraging partnerships and key suppliers to provide customers with a broad range of smartphones, including branded models designed according to Portuguese consumer preferences. TMN is also leveraging its internal skills, including the well-known *Sapo* brand, to develop apps that can generate new revenue streams while enhancing the value of mobile data. In addition, TMN remains focused on designing new tariff plans, like the "e", an innovative prepaid plan, and the "Unlimited" postpaid plan, which are simple, customizable and aimed at catalyzing the upselling of Internet services and seeking to lock in high value customers, shifting way from pricing competition.

Enterprise services: increase penetration of IT/IS services, namely, cloud outsourcing and BPO. Through investments in infrastructure and telecom-IT convergence, we intend to develop and market advanced integrated solutions for the corporate and SME markets aimed at increasing our penetration of IT/IS and BPO services in Portugal. In order to achieve this, we have developed and implemented a three-tiered approach to our enterprise services: (1) "Residential+" customers, with an offering based on the convergence of voice and broadband services, (2) "Connected+" customers, served mainly with multi-employee connectivity services, including mobility solutions for traveling employees, and simple software solutions and (3) "Integrated+" customers, served with a full range of telecommunications and technological services, such as unified communications, outsourcing of ICT services, application integration, machine-to-machine and specific IT/IS solutions, BPO and IT consultancy. We will also seek to leverage our new data center in Covilhã, Portugal to develop differentiated cloud computing services for companies in close cooperation with our leading industry partners.

Reinforce leadership in the market sectors in which we operate. Through the launch of our *Meo* Pay-TV service in 2008, we were able to turn our residential business around. To continue the path toward innovation and reinforce our leadership in the market sectors in which we operate, we recently launched a quadruple-play service, M_4O. This service leverages our skills in satisfying consumers' increasing need for seamless communication and data services across multiple devices and locations. M_4O provides customers with simplicity, convenience and economy, allowing customers to integrate all telecommunications services under a single invoice, along with a single customer support and single touch-point network.

International Operations

Maximize the strategic value of our international assets and reinforce our focus on Brazil and sub-Saharan Africa. The Brazilian market remains a key priority as a driver of growth. Africa will continue to be a source of growth as well, where we seek to reinforce partnerships and explore value-creating investment opportunities.

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

Africa and Asia: pursue consolidation of practices among our investments and consider opportunistic M&A transactions. We continue to focus on improving the efficiency of our international operations through sharing best practices among all our subsidiaries and through increased proximity with our international operations to enable us better to follow up on key developments in each region.

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Focus on operational and commercial excellence of all assets and promote the sharing of best practices. By reinforcing operational and commercial excellence in all our operations and promoting the sharing of best practices among all our businesses, we seek to tap the full potential of each business, taking into account the development of each market and the competitive position of our investments.

Focus on Innovation and Execution

Innovation: structured approach and partnerships. With the goal of anticipating future consumer and technological trends, innovation has been a primary focus of our investments and projects in recent years, enhancing our ability to anticipate solutions to evolving consumer needs. We pursue a structured approach to promote a culture of innovation across the whole company with the aim of establishing a balanced portfolio of projects. We regularly review allocation of capital, human resources and a cooperative sharing of ideas with the organization across three time horizons and risk levels: (1) incremental innovation (ordinary course of business, low-risk and short-term optimizations), (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). To develop a successful go-to-market strategy and reduce investment risk, we work with a broad network of partners, both in Portugal and abroad.

Execution: next generation networks. We seek to act at the forefront of fiber rollout in Portugal and in Europe, having already covered 1.6 million homes with FTTH, totaling 890 thousand kilometers of fiber, 46% of the population and approximately 74% of GDP, making Portugal one of the most penetrated countries in Europe (an initiative that was recognized by the FTTH Council Europe with the innovation award for "Deployment and Operation of FTTH Networks"). We aim to leverage our FTTH investment not only to provide advanced and high-speed data and video services to our corporate and residential customers but also to cover TMN's base stations with fiber to allow higher download and upload speeds for TMN's data customers (92% of TMN sites are already connected with fiber and 100% of 4G LTE sites with IP/Ethernet technology) and to enable Long Term Evolution ("LTE") services. We launched LTE services in March 2012 with a network covering 20% of population in Portugal. We increased LTE coverage to 80% of the population by April 2012 and to 90% of the population by the end of 2012. In addition, we operate the most comprehensive Wi-Fi network in Portugal, which has recently been extended to 200,000 hot spots, enabling automatic traffic offload from mobile to fixed networks, enhancing customer mobility through seamless subscriber authentication and handover between hot spots. We have developed an integrated all-IP fixed and mobile network, supporting better service levels and advanced traffic management (and opportunities for optimization of capacity investments), allowing more availability and flexibility and increasing cost efficiency.

Integrated customer-centric organization: We abandoned a company structure organized around fixed and mobile platforms in favor of a structure centered on customer needs, implementing a new organization around five customer categories: Residential, Personal, SMEs/SoHos, Corporate and Wholesale. By eliminating several decision processes and layers, the reorganization process has focused on achieving a leaner company with greater operational efficiency.

Excel in customer service. We are currently implementing an extensive transformation program to ensure an integrated view of customer touch points, which was underpinned by a common IT platform. We now have convergent stores, a unique self-care portal that allows customers to manage all their services through one log-in, and a 360° view of our customers with the new CRM system. Field forces and call centers have an integrated management, and their processes

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have been reviewed for leaner operations. A multi-year transformation program on IT is also being implemented to enable business transformation and to increase efficiency.

Corporate Structure

The diagram below presents our different businesses as of the date of filing of this annual report.

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(1) PT Comunicações, TMN and their subsidiaries provide residential, personal and enterprise services as part of our Portuguese telecommunications business.

(2) Various companies providing services to Portugal Telecom group companies, including PT Sistemas de Informação (information systems), PT Inovação (research and development), PT Pro (shared services), PT Compras (central purchasing) and PT Contact (call centers).

(3) Oi S.A. and its subsidiaries provide telecommunications services in Brazil. We proportionally consolidate the results of operations of Oi S.A.

(4) Includes our investment in Contax, our investments in global telecommunications operators in the Cape Verde, São Tomé and Principe, mobile operators in Namibia and Angola, and other investments.

For additional information on our significant subsidiaries, see Exhibit 8.1, which is incorporated herein by reference.

Recent Developments

Sale of Minority Stake in CTM, Macau

In January 2013, we announced that we had entered into a definitive agreement to sell our 28% equity stake in Companhia de Telecomunicações de Macau, S.A.R.L. ("CTM") to Citic Telecom International Holdings Limited ("CITIC Telecom"). Under this agreement, we expect to receive total proceeds of US$411.6 million, subject to adjustments, on a cash-free and debt-free basis and a normal level of working capital. The transaction has been approved by our Board of Directors and is conditioned upon the satisfaction of certain conditions, including the successful completion of the transfer to CITIC Telecom of an equity stake representing 51% of the share capital of CTM held by Sable Holding Limited, a wholly owned subsidiary of Cable & Wireless Communications Plc, and the approval of both transactions by the Government of Macau and by the relevant governmental and regulatory authorities in the People's Republic of China.

Judgment by the European Commission

In January 2013, the European Commission announced a decision finding that we and Telefónica had infringed Article 101 of the Treaty on the Functioning of the European Union ("TFEU") with reference to our July 28, 2010 agreement with Telefónica concerning the acquisition by Telefónica of Portugal Telecom's stake in Brazilian operator Vivo, which the European Commission found to be a non-compete commitment with impact on the Iberian market. In accordance with this decision, we were fined an amount of €12.29 million, which we believe is unjustified. On April 9, 2013, we brought an action for annulment before the Court of Justice of the European Union and will continue to vigorously defend the matter. Accordingly, we have not recorded any provision in this matter. The European Commission's decision concluded an investigation, begun in January 2011, in which the European Commission analyzed the relationship between both companies since 1996.

This investigation is described in greater detail in "*Item 8 Financial Information Legal Proceedings*."

S&P Rating

On February 11, 2013, S&P announced its review of our credit rating, downgrading our long-term rating from BB+ to BB, with negative outlook, and maintaining our short-term rating at B.

Contax Corporate Reorganization

On April 2, 2013, CTX's shareholders, including Portugal Telecom, received a premium in shares of 25% of common shares held by them, and Contax absorbed CTX's total indebtedness as part of a corporate reorganization in connection with Contax's migration to Level 2 Corporate Governance of the São Paulo Stock Exchange (*BM&FBOVESPA S.A. Bolsa de Valores, Mercadorias e Futuros*) ("BM&FBOVESPA"). Level 2 is a listing segment of BM&FBOVESPA for the trading of shares issued by companies that voluntarily adopt specified corporate governance practices and commit to additional information disclosure beyond the levels required by Brazilian law. As a result of Contax's corporate reorganization, we increased our economic interest in Contax to 21.1%.

Recent Oi Financing Transactions and Assignment of Rights to Use Communications Towers

In 2013, the Oi Group has entered into the financing transactions described in "*Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources Indebtedness Debt Instruments Recent Financings by Oi*." In addition, in April 2013, the Oi Group entered into agreements to assign the right to use approximately 4,000 fixed line communications towers that form part of its infrastructure for commercial operations by companies whose core operations consist of providing transmission tower and radiofrequency management and maintenance services. The completion of these assignment agreements is subject to certain conditions precedent. Upon the completion of these assignments, the Oi Group will receive proceeds of approximately R$1.09 billion. The Oi Group also entered into an arrangement with the assignees that will become effective upon completion of the assignment agreements.

Issuance of Eurobond

On April 30, 2013, we announced that we had successfully completed the issuance of a €1.0 billion Eurobond with a maturity of seven years through our wholly owned subsidiary PT International Finance B.V. at an interest rate of 4.625% per annum. The transaction was undertaken to enhance our financial flexibility by extending debt maturities.

Our Businesses

Portuguese Operations

We report our Portuguese operations as an operating segment, and break down the revenues reported in that segment by customer category as follows:

- *Residential services*, which include integrated networks inside the customer's home enabling the simultaneous connection of multiple devices, including fixed line telephones, TVs (including Internet Protocol Television and direct-to-home satellite Pay-TV services), game consoles, PCs, laptops, tablets and smartphones.

- *Personal services*, which are mobile telecommunications services, including voice, data and Internet-related multi-media services across several access devices, such as mobile phones, smartphones and tablets, as well as wireless datacards and dongles (devices that attach to the USB port of a laptop/computer to provide mobile broadband service) for internet access.

- *Enterprise services, including Corporate and SME/SoHo services*, which provide our corporate and medium and small business customers with data and business solutions, as well as IT/IS and business process outsourcing (BPO) services, previously reported under the wireline and mobile segments:

  - *Corporate services,* which targets large companies and provides data, Internet, video and voice communications, services, fixed-mobile convergence solutions and selected information technology services, network managing and outsourcing; and

  - *SME/SoHo services*, which targets (1) small and medium enterprises ("SMEs"), providing vertical data and business solutions that are similar to our corporate services and (2) small office/home office ("SoHo") customers and provides cost-effective data and business solutions for those working in small businesses or at home.

- *Wholesale and other services*, which primarily include wholesale telecommunications services, public pay telephones, the production and distribution of telephone directories and other services in Portugal.

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The following table sets forth the operating revenues of each of our major customer categories with our Telecommunications in Portugal segment for the years ended December 31, 2010, 2011 and 2012:

	Year Ended December 31,		
	2010	2011	2012
	(EUR Millions)		
Residential services	647.0	682.3	711.7
Personal services	865.0	768.4	688.1
Enterprise services	1,079.6	982.1	896.0
Wholesale, other and eliminations	532.8	459.2	404.7
Total consolidated operating revenues	3,124.5	2,892.0	2,700.5

For information about the effects of seasonality on our business, see "*Item 5 Operating and Financial Review and Prospects Overview Business Drivers and Measures Seasonality*."

The following table sets forth the total number of retail lines (or accesses), net retail additions and other information as of the dates indicated for our Portuguese telecommunications segment:

	As of December 31,		
	2010	2011	2012
Fixed retail accesses (thousands):			
PSTN/ISDN(1)	2,695	2,648	2,604
Broadband customers	1,001	1,105	1,225
Pay-TV customers	830	1,042	1,223
Total fixed retail accesses	4,527	4,795	5,052
Mobile customers (thousands):			
Postpaid	2,291	2,378	2,469
Prepaid	5,129	5,066	5,129
Total mobile customers	7,419	7,444	7,598
Net additions (thousands):			
Fixed retail accesses:			
PSTN/ISDN	(51)	(48)	(43)
Broadband customers	139	104	119
Pay-TV customers	249	212	181
Total fixed retail accesses	337	268	257
Mobile customers:			
Postpaid	56	87	91
Prepaid	111	(63)	63
Total mobile customers	167	24	154
Other data:			
Data as percentage of mobile service revenues	24.6	27.7	32.6

(1) The public switched telephone network ("PSTN") is the traditional telephone system that runs through copper lines. The integrated digital services network ("ISDN") is the digital telecommunications network that allows simultaneous voice and data transmission

over an access line.

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Residential Customers

Our residential customer category provides fixed line telephone and broadband services, Pay-TV services (IPTV over ADSL and fiber and DTH satellite TV) services and Internet access services to residential customers. The table below sets forth the total number of retail lines (or accesses), net additions and other information as of the dates indicated.

	As of December 31,		
	2010	**2011**	**2012**
Fixed retail accesses (thousands):			
PSTN/ISDN	1,673	1,674	1,692
Broadband customers	809	911	1,015
Pay-TV customers	775	972	1,135
Total fixed retail accesses	3,257	3,557	3,841
Net additions (thousands):			
PSTN/ISDN	11	1	18
Broadband customers	130	102	104
Pay-TV customers	235	198	162
Total net additions	376	300	284
Other data:			
Unique customers	1,862	1,881	1,881
Retail RGU per PSTN/ISDN line	1.95	2.12	2.27
ARPU (EUR)	29.2	30.8	31.6
Retail traffic (millions of minutes)	2,850	2,848	2,935
Non-voice revenues as percentage of revenues	51.3	58.5	63.4

In 2012, residential retail accesses or retail revenue generating units ("RGUs") increased 8.0% compared to 2011, reaching 3,841 thousand, with Pay-TV and broadband accesses already accounting for 56.0% of total residential retail accesses as of December 31, 2012. Retail net additions reached 284 thousand, primarily as a result of growth of our *Meo* Pay-TV service, which accounted for 162 thousand net additions, bringing the total Pay-TV residential customers to 1,135 thousand, an increase of 16.7% from 2011. The fixed residential broadband customer base grew 11.4% from the previous year to 1,015 thousand customers with 104 thousand net additions due to continued growth in triple-play customers. Pay-TV and fixed broadband customers grew in spite of the backdrop of a difficult economic environment and the already high penetration of Pay-TV. Residential fixed voice customers (PSTN/ISDN lines) accounted for 18 thousand net additions, growing 1.1% to 1,692 thousand customers since 2011, also reflecting the positive impact of the triple-play offers, which have supported the reversal of the operational trends in the wireline business notwithstanding aggressive commercial offers by the main competitor.

As a result of these factors, residential ARPU increased 2.8% to €31.6 in 2012 from 2011, notwithstanding economic conditions in Portugal, which led to some pressure on those services more exposed to the economic environment, such as premium and thematic channels, video-on-demand and other value-added services. Operating revenues in the residential customer category increased by 4.3% in 2012 to €712 million. Primarily as a result of our *Meo* triple-play service, the weight of non-voice services to residential customers was 63.4% in 2012 (a 4.9 percentage point increase compared to 2011), and the weight of flat revenues was 87.2% (a 2.1 percentage point increase compared to 2011).

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Pay-TV Services

Our television strategy is based on a multiplatform concept that aims to provide similar content and user experiences across television, PCs and mobile phones. Launched in 2008, *Meo* is our TV brand across the various platforms, namely at home (through IPTV and satellite), through mobile telephones (through *Meo Go! Mobile*) or through personal computers (through *Meo Go!*). *Meo* provides access to a comprehensive content offering, with more than 160 TV channels and thousands of video-on-demand titles. We offer tiered packages of channels, as well as on-demand availability that can be subscribed for directly through the TV set in real time. *Meo* also provides access to advanced features, such as digital recording and pause live-TV. The set-top boxes in the *Meo* service are all HD-compliant, using MPEG4. We were the first operator in Portugal to introduce HDTV and have the most extensive video-on-demand offer in the market. *Meo* currently has 1,223 thousand customers and a 39.2% market share, according to ANACOM.

In January 2013, we announced the launch of a "quadruple-play" offer of converged fixed-mobile services by *Meo*, which includes TV, internet, fixed telephone and mobile telephone services under the brand M_4O. We designed this product after careful study of recent trends in the Portuguese market, which revealed rising consumer preference for quadruple-play services all reflected on the same invoice, a desire to include the entire family in a single plan, and the importance of high-quality connectivity to the Internet. M_4O offers 85 TV channels, 100 Mbps broadband speed, unlimited calls and two to four mobile SIM cards, including free of charge calls and text messages to all wireline and wireless networks, using our 3G and 4G/LTE networks.

In 2012, *Meo* enhanced its programming by launching 19 new channels and several new interactive apps, including seven HD and three exclusive channels: (1) *A Bola TV*, produced in partnership with Jornal a Bola, a leading daily sports newspaper; (2) *TVI Ficção*, which is an entertainment channel produced by TVI, a leading Portuguese free-to-air channel, featuring local fiction from the well-established TVI production house and (3) the *TVI Secret Story 3* interactive channel, which was the fourth most watched channel on *Meo* in the last quarter of 2012 and received 16.6 million app visits. All these channels are available on several screens not only the basic TV package but also PCs, smartphones and tablets through the *Meo GO!* service. *Meo* continues to innovate and, in the first quarter of 2013, added a new exclusive channel, *Correio da Manhã TV*, in partnership with Cofina, the owner of several newspapers and magazines in Portugal, including the most widely read tabloid in Portugal, Correio da Manhã. *Meo*'s content offering also includes thousands of video-on-demand titles and is enriched with interactivity based on anchor programs (e.g., *Idols*, *Secret Story*, *Biggest Loser*).

Meo also offers advanced interactive applications accessed through the remote control and covering multiple categories, such as (1) News, including a personalized newscast app, developed in partnership with RTP, the state-owned free-to-air channel, and the *Sapo Kiosk* application featuring the daily covers of all local and several international newspapers and magazines, (2) Sports, including a soccer app, a surf app and specific sports channel applications, such as the *BenficaTV* app and the *SportTV* app, (3) Music, including *MusicBox*, a multiscreen music streaming service, *Meo Radios*, a radio streaming app, and *Meo Karaoke*, an application that offers *Meo* customers the ability to subscribe and sing from a wide catalog of local and international hits, (4) Kids, including a comprehensive children's portal where kids can access channels, video-on-demand content, music clips, karaoke, games and tailored educational content, (5) Convenience, including apps for weather, traffic and pharmacies and (6) Personal content, including an online photo storage app. In 2012, *Meo* launched eight new apps of this type, including *Sapo Voucher*, the first interactive TV app allowing financial transactions and interactions with TV advertisements.

In 2012, we kept a focus on developing applications which enable a complete interactive user experience, whether through special content apps (e.g., *MEO Local*, *Oscars 2012*, *Toca a Mexer*, *Morangos com Açucar* and *Ídolos*) or through the development of interactive features for regular

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programming. Advances in interactive advertising allow viewers to access additional information directly from commercials as they were watching them (e.g., Continente, Warner and the Nokia Lumia 800 from TMN). In addition, we launched the country's first interactive news channel, called *SIC Notícias Interactivo*, in partnership with Impresa, a large media group in Portugal that owns several print publications, the SIC free-to-air channel and several SIC Pay-TV channels.

Meo continued to innovate in 2012, launching *Meo Kanal*, an application that allows customers to produce, edit and share multimedia user-generated content on television with other *Meo* customers. The contents can be accessed through the *Meo* remote control. *Meo Kanal* allows customers to create free private areas, requiring an access PIN that is shared only among family members, friends or any other desired group, or free public areas, accessible to the whole *Meo* community. *Meo Kanal* finally brings the social network experience to TV. *Meo* also launched the *Meo Get Meo* application that leverages its customer base to recruit new customers. In January 2013, *Meo* launched *Gravações Automáticas*, an automatic recording feature that allows customers to record programs and access those recordings up to seven days after the programs were broadcast.

We also developed new and innovative interactive solutions, such as *MEO Energy*, a service for monitoring home energy consumption, which includes tariff recommendations based on one's actual consumption profile and suggestions on how to lower a consumer's energy bill.

Fixed Line Services

We had approximately 3,841 thousand fixed retail accesses in service as of December 31, 2012, excluding external supplementary lines, direct extensions and active multiple numbers. Within retail accesses, we report:

- traffic-generating lines held by subscribing customers;
- carrier pre-selection lines, which are lines of competitors for which those customers have elected to use our services;
- fixed broadband retail lines; and
- Internet protocol television ("IPTV"), FTTH and DTH customers using our *Meo* Pay-TV services.

We cover 1.6 million homes in Portugal with our FTTH network. Our network, which is developed in urban areas, is a strategic investment to improve our competitiveness among residential customers, where we can offer distinctive Pay-TV and bundled offers.

Over the last decade, total traffic on our fixed line network has decreased, primarily because consumers have increasingly used mobile services instead of fixed line services and because of the migration of dial-up Internet users to Asymmetric Digital Subscriber Lines ("ADSL"). In fact, the number of active mobile cards (the mobile equivalent of main lines) exceeds the number of fixed line main lines in Portugal. We have responded to this trend by encouraging the use of our fixed line network for bundled services, including triple-play packages that include fixed telephone services, broadband internet access and Pay-TV services.

We are required to provide carrier selection to our customers for all kinds of traffic. See " *Regulation Portugal Areas of Recent Regulation and Updates Number Portability and Carrier Selection*." Carrier selection has been an additional factor that has contributed to the reduction in traffic on our network.

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Components of Revenue

Our revenues from residential customers are derived from the following components:

- *Service revenues*, which are the revenues we generate from providing fixed telephone services, broadband internet access and Pay-TV services. These revenues generally consist of:
  - *Fixed charges*, including network access charges based on a monthly line rental and an initial installation fee, as well as, in most cases, a monthly fee from pricing packages, which can include broadband and Pay-TV services; and
  - *Traffic*, including charges for the use of our fixed line network based on rates dependent on the amount and type of usage.
- *Sales and other revenues*, which are revenues from the sale of telephone, broadband and Pay-TV equipment and other revenues, such as sales commissions.

Suppliers

For our fixed line network and Pay-TV services in 2012, we obtained telephones and equipment for our voice, broadband and Pay-TV services from several suppliers, including Novabase, Alcatel-Lucent and Motorola, and we obtain television content, including premium channels, from several national and international suppliers.

Personal Customers

We provide telecommunications and mobile data services for a variety of personal devices, including traditional cell phones, smartphones, tablets and laptops through our mobile business. We conduct our mobile business in Portugal through our wholly owned subsidiary TMN. TMN is the leading provider of mobile voice, data and Internet services in Portugal in terms of the number of active mobile cards connected to its network, as well as by revenues and margins, based on information from the other operators' releases.

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The following table sets forth the total number of mobile customers, net additions and other information as of the dates indicated.

	As of December 31,		
	2010	**2011**	**2012**
Mobile customers (thousands):			
Postpaid	1,021	1,064	1,093
Prepaid	4,942	4,868	4,931
Total mobile customers	5,963	5,932	6,024
Mobile broadband customers (included in total)	893	942	947
Net additions (thousands):			
Postpaid	62	42	30
Prepaid	96	(73)	62
Total mobile customers	157	(31)	92
Mobile broadband customers (included in total)	127	49	5
Other data:			
MOU(1) (minutes)	84	89	93
ARPU (Euro)	11.0	9.7	8.7
Customer	9.6	8.7	8.0
Interconnection	1.4	1.0	0.7
SARC(2) (Euro)	29.0	27.8	27.9
Data as percentage of service revenues	29.1	30.9	33.2

(1) Minutes of Usage ("MOU") is monthly average of outgoing traffic in minutes per average number of users in the period.

(2) Subscriber Acquisition and Retention Cost ("SARC") equals (70% of marketing and publicity costs + commissions + subsidies) / (gross additions + upgrades).

In 2012, total mobile customers, including voice and broadband customers, increased 1.5% compared to 2011. In 2012, total mobile customers registered 92 thousand net additions due to TMN's performance in the prepaid market, with 62 thousand net additions in 2012, and the postpaid market, with 30 thousand net additions in 2012. This increase was a result of (1) the strong performance of our "*e nunca mais acaba*" tariff plans, (2) the new positioning of our "*Moche*" tariff plans and (3) the commercial success of our "Unlimited" tariff plans. Flat-fee tariff plans represented 22.9% of total mobile customers in 2012, an increase of 2.9% from 2011.

In 2012, customer revenues in the personal market decreased 9.1% to €561 million from 2011. Monthly recharges decreased 5.8% in 2012 and remained volatile throughout the year. Additionally, aggressive pricing measures both in voice and wireless broadband continued to place pressure on retail tariffs and customer ARPUs. Customer revenues also reflected lower revenues derived from mobile broadband services against a backdrop of the high popularity of fixed broadband, price competition and migration to lower tariff plans, notwithstanding the growth of TMN's mobile internet offering, *internetnotelemóvel*, due to increased penetration of smartphones. Interconnection revenues decreased 29.3% to €48 million, contributing to a total service revenues decline of 11.1% in 2012. Mobile termination rates decreased in 2012, from €3.50 in the beginning of 2012 to €1.27 as of December 31, 2012. In 2012, ARPUs in the personal market decreased 10.8% to €8.65 and customer ARPUs decreased 8.8% to €7.97, as compared to 2011. Non-voice revenues in service revenues increased to 33.2% in 2012, reflecting the solid performance of *internetnotelemóvel*.

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Mobile Network

We provide mobile telephone services using the GSM, UMTS and LTE technologies. Within our GSM offering, we provide services in the 900 MHz and 1800 MHz band spectrums. GSM and UMTS are European and worldwide standards using digital technology.

In March 2012, ANACOM formally allocated to TMN rights to the following spectrum for 15 years following a multiband auction for the provision of electronic communications services based on LTE (Long Term Evolution) technology:

- 2 × 10 MHz in the 800 MHz band for a final price of €90.0 million;
- 2 × 14 MHz in the 1800 MHz band for a final price of €11.0 million; and
- 2 × 20 MHz in the 2.6 GHz band for a final price of €12.0 million.

These rights are reflected in a license that unifies the previous GSM and UMTS licenses issued by ANACOM. The license imposes certain requirements on TMN, including the following:

- Mobile network obligations for 800 MHz: TMN must enter into agreements with Mobile Virtual Network Operators and national roaming agreements with operators with rights of use on frequencies greater than 1 GHz.
- Coverage obligations for 800 MHz: For each lot of 2 × 5 MHz in the 800 MHz band, TMN must cover a maximum of 80 municipal areas out of 480 municipal areas without adequate broadband coverage.

A summary of the material provisions of the license is filed as Exhibit 4.19 to this annual report. For more information about our licenses, see "*Regulation Portugal Our Concession and Existing Licenses and Authorizations TMN's Mobile Service License.*"

We paid spectrum fees in 2012, 2011 and 2010 of €15 million, €17 million and €21 million, respectively, for the use of our 900 MHz and 1800 MHz GSM network and our UMTS network. These spectrum fees are recorded as an operating expense in our financial statements.

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In addition, through roaming agreements, our subscribers can make and receive mobile calls throughout Europe and in many other countries around the world. Roaming agreements between operators allow their subscribers to make and receive voice calls automatically, send and receive data, or access other services when traveling outside the geographical coverage area of the home network, by using a visited network. As of the end of 2012, we had entered into GSM roaming agreements with a total of 618 operators (in 229 countries) and 299 UMTS roaming agreements (in 131 countries).

Personal Services

Our products and services include:

- a variety of voice and data tariff plans, both prepaid and postpaid, designed to integrate unlimited voice and data plans targeted at high-value postpaid customers and, in the prepaid market, to discourage migration to low-value tariff plans by offering additional voice and data services;

- a portfolio of approximately 30 smartphones, including exclusive handsets, with the capability to use an array of value-added and convergent services (mobile TV, music on demand, navigation app, social network aggregator, cloud storage, etc.); and

- mobile broadband offers of up to 150Mbps speed, using 4G-LTE technology and offering free access to our national Wi-Fi network.

We were the first operator in the world to offer prepaid services, and our prepaid and discount products remain popular. As of December 31, 2012, approximately 81.9% of our subscribers were using prepaid products.

We continuously invest in new services, and the services we have launched in recent years include (1) *Music Box*, an integrated service for mobile phones, PCs and television that provides access to a catalog of millions of music tracks, (2) our application store, offering sports, news, entertainment, games, books and utility applications, which builds upon the presence of our online portal Sapo and partnerships with third parties, (3) *Meo Mobile*, which makes available 50 TV channels, in areas such as information, sports, entertainment, children and other, on the mobile phone, (4) *Pond*, an aggregation service that enables access to multiple personal accounts and aggregation of social network accounts and (5) our *internetnotelemóvel* service, which offers internet access on smartphones and access to our mobile portal.

In March 2012, we unveiled our 4G-LTE strategy by launching a mobile broadband offering. Currently, our 4G-LTE offering allows (1) speeds of up to 150Mbps, (2) access to live TV channels through *Meo Go*, and to a music streaming service, through *Music Box* and (3) Multi-SIM, to share traffic among various devices, including PCs, through wireless dongles, tablets and smartphones. At launch, our 4G-LTE service was available to 20% of the Portuguese population and was expanded to 90% of the population by the end of 2012. We market our 4G-LTE mobile broadband services through TMN's 4G and *Meo 4G* brands. These offerings range in speed from 50Mbps to 150Mbps, with monthly retail prices starting €34.99 (with discounts for early subscribers under a month loyalty program) and include *Music Box* for free. TMN 4G or *Meo 4G* customers that are also *Meo* customers have free access to 50 live TV channels through the *Meo Go* service.

Also in March 2012, as part of a strategic focus on innovation, we announced a new mobile payment service under the brand "TMN Wallet" which allows customers to pay for small purchases through any of the following means: (1) SMS messages, (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 undergoing a trial period.

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In January 2013, following the launch of the *M$_4$O* quadruple-play offering, TMN repositioned its voice and data tariff plans. In the postpaid category, unlimited plans now have four different price points, or sizes: (1) the *unlimited S*, for €15.9 per month, offers 600 MB of mobile internet (*internetnotelemóvel*), unlimited Wi-Fi access plus 100 minutes or SMS on all other networks; (2) the *unlimited M*, for €29.90 per month, offers 1GB of mobile internet, unlimited Wi-Fi access plus unlimited voice and SMS, and 120 minutes or SMS on all other networks; (3) the *unlimited L*, for €39.90 per month, offers 1GB of mobile internet and unlimited Wi-Fi plus unlimited voice and SMS on all other networks; and (4) the *unlimited XL*, for €69.90 per month, offers 5GB of mobile internet and unlimited Wi-Fi access plus all net unlimited voice and SMS. All of these plans include the *Music Box*, which is otherwise priced at €4.99 or €6.99 per month, depending on whether it is an existing TMN customer.

In the prepaid market, TMN extended the all-day version of the "*e nunca mais acaba*" tariff plan to include unlimited all-day voice and SMS for TMN and fixed networks, while being able to apply, monthly, the equivalent of €20.00 toward voice minutes and SMS on other mobile networks. This tariff plan also includes unlimited in-network video calls and can be configured with a 500 MB mobile internet option for €25.00 per month. TMN also extended the *Moche* offering, for customers younger than 25 years of age, to include 1GB of mobile internet in the case of the monthly fee, and if the customer recharges the card with at least €11.00. The *Moche* tariff plans also include SMS options with respect to other networks. These changes in TMN's tariff structure were in response to price movements in the market and were aimed at ensuring that TMN maintains a competitive edge in the market.

Components of Revenue

Our revenues from personal services are derived from the following components:

- *Service revenues*, which are the revenues we generate from providing mobile voice telecommunications services, mobile broadband access and other mobile services. These service revenues can be further broken down into:
  - *Customer revenues*, which are revenues we receive directly from our customers and consist primarily of traffic charges, subscription and usage charges; and
  - *Interconnection revenues*, which are the revenues we receive from other telecommunications providers when their customers make calls or otherwise connect to our network from fixed lines or mobile devices.
- *Sales and other revenues*, which are revenues from the sale of mobile phones and related equipment.

We believe that mobile services in Portugal are priced lower than the European average and are among the lowest in Europe. Fixed-to-mobile and mobile-to-mobile interconnection charges are regulated by ANACOM and have a significant impact on our business. Since 2005, when ANACOM declared all mobile operators to have significant market power in call termination in mobile networks market, ANACOM has accordingly imposed price controls on interconnection rates for the termination of calls on mobile networks. Interconnection rates have been reduced steadily since then. ANACOM has issued successive decisions that have reduced mobile termination rates over time. Most recently, in March 2012, ANACOM issued a final decision reducing mobile termination rates progressively to €0.0127 by December 2012. These reductions have had, and are expected to continue to have, a significant impact on our interconnection revenues and consequently our cash flows and earnings.

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Suppliers

We do not manufacture handsets, but we have agreements with a number of manufacturers to sell handsets in Portugal, including Nokia, Samsung, ZTE, Huawei, Apple, Sony Ericsson, LG and RIM.

Marketing

In 2012 we divided the marketing strategy for our personal segment into two key brands. We expect to use *TMN*, the primary and pre-existing brand, a leader in mobile telecommunications in Portugal, to serve the broader market and focuses on the growth of our postpaid base through dedicated tariff plans and attractive pricing policies in smartphones. We developed *Moche*, our new youth brand, to encourage a broad-based use of mobile internet. *Moche* employs a different business model and is supported by a new brand positioning and values and is tailored to the target youth demographic. We market personal services through more than 3,179 points of sale, including our sales force, retail shops, supermarket chains and independent dealers.

We also have a low-cost brand, Uzo, that targets low-cost subscribers and uses our GSM network. Uzo focuses primarily on selling SIM cards and low-cost mobile phones to its customers. Uzo's products and services are offered through the Internet, Uzo's call centers (which are separate from TMN's call centers) and independent news stands and shops located throughout Portugal.

Enterprise Customers

We provide enterprise services to corporate, SMEs and small office/home office ("SoHo") customers that need diversified telecommunications solutions and integration with IT services. We have developed a full range of telecommunications services for businesses, and we integrate these services to provide our customers with service packages. By combining our communications capabilities with our software-based integrated systems and applications, we offer integrated voice, data and image solutions, virtual private networks, convergence solutions, consultancy and outsourcing. We believe we are the primary service provider in Portugal capable of offering customers a full range of integrated and customized services.

The table below sets forth the total number of retail lines (or accesses), net retail additions and other information as of the dates indicated.

	As of December 31,		
	2010	**2011**	**2012**
Fixed retail accesses (thousands):			
PSTN/ISDN	873	826	725
Broadband customers	190	193	207
Pay-TV customers	54	68	86
Total fixed retail accesses	1,117	1,087	1,019
Mobile customers (thousands)	1,390	1,445	1,514
Net additions (thousands):			
Fixed retail accesses:			
PSTN/ISDN	(45)	(46)	(101)
Broadband customers	8	2	15
Pay-TV customers	14	14	18
Total fixed retail accesses	(23)	(30)	(68)
Mobile customers	16	56	69
Other data:			
Retail RGU per access	1.28	1.32	1.41
ARPU (EUR)	28.7	25.8	23.8
Non-voice revenues as percentage of revenues	43.5	46.4	50.3

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In 2012, operating revenues in the enterprise category decreased by 8.8% to €896 million compared to 2011. The revenue performance in the enterprise category has continued to be affected by current economic conditions, including (1) the government agencies' strong cost-cutting initiatives and significant reductions in investments in new projects, (2) large corporate cost-reduction initiatives and (3) the particular circumstances of SMEs, which were more greatly affected by economic conditions in 2012 than in 2011. Notwithstanding this economic backdrop, we maintained leadership among both large corporations and SMEs, anchored by our distinctive products and services in both markets. In addition, in 2012, we won significant projects and customers, which should translate into positive revenue performance in 2013. In 2012, non-voice services represented 50.3% of enterprise retail revenues, which increased by 3.8 percentage points as compared to 2011.

In 2012, we continued to transform our business by providing new services and expanding our markets, a trend that is observable in our 2012 results: (1) in the SME market, the weight of non-voice services in revenues increased from 32% in 2011 to 35% in 2012 (41% to 49% for large corporations) and the revenues derived from convergent customers increased 57% as compared to 2011 (77% for enterprises in the *Connected+* category explained below), and (2) for large corporations, the weight of non-voice services was broadly stable at 67%, and revenues from value-added services, including outsourcing, managed services, IT/IS, BPO and cloud, increased 5 percentage points as compared to 2011.

In 2012, fixed retail customers of the enterprise category declined to 1,019 thousand, representing a decline of 68 thousand as compared to 2011. This performance reflected 101 thousand net fixed line disconnections, which resulted from (1) the migration of large corporations from classic PSTN/ISDN services to VoIP services, which require less lines per customer, (2) the level of insolvencies in the SME market and (3) fixed-to-mobile migration. Broadband and Pay-TV net additions increased slightly as a result of upselling additional services to SMEs.

Services

Our enterprise services include:

- *Network services*, which include fixed voice services, fixed and mobile convergence services, broadband data, Ethernet services, digital leased lines and VSAT services, business high band fiber-based Internet, VPN accesses and applications, and global services for multinational customers.

- *IT services*, which include data center services (housing and hosting), storage, application servers, cloud-based solutions, namely private virtual servers systems administration, desktop management services, security managed services based on a Security Operations Center, business continuity services and disaster recovery, IT infrastructure outsourcing and IT and security consultancy.

- *Business solutions and applications*, which include unified communications, IP Centrex and voice servers, digital signage Corporate TV, business videocommunications and telepresence solutions, business process outsourcing (BPO), vertical solutions for special business market customer categories (health care, the public sector), special bundling services for small and medium-size enterprises, using the "Office Box" brand name, and outsourcing.

The provision of services to our corporate customers is guided by the following strategic objectives: (1) maximize value from traditional telecommunications services by upselling additional services, including fixed- mobile convergence on FTTH, VPN, LAN management and video services, (2) IT transformation accelerated by cloud computing, where we aim to build upon partnerships with key suppliers to enable business process transformation and cost reductions to our corporate customers, with a special focus on "system on a chip," or "SOC," based security solutions, (3) capture mobile data growth through LTE-based solutions and new machine-to-machine projects, (4) use specialization to achieve gains from scale, including by focusing on outsourcing and BPO to improve productivity and (5) introduce a business consulting approach in order to extend the services provided to corporations to video, multiscreen and other convergent services.

In 2012, we developed and implemented a three-tiered approach to the enterprise market focused on value added services: (1) "*Residential*+," which makes fixed and mobile voice and fixed and mobile broadband available to SoHos, (2) "*Connected*+," which provides simple software solutions and multi-employee connectivity to SMEs, including mobility solutions for traveling employees and (3) "*Integrated*+," which provides unified communications, outsourcing of ICT services, application integration, machine-to-machine and specific IT/IS solutions, business process outsourcing and IT consultancy services to large corporations, including an end-to-end approach to customers by supporting their IT transformation through business consulting to extend the services provided to corporations to video, multiscreen and convergent services. Cloud services, including IaaS, SaaS, and PaaS, are available to all tiers by leveraging strategic partnerships to accelerate access to leading-edge technologies and are hosted in our data center in Covilhã described below.

As part of our enterprise services, we provide a broad offer of integrated and vertical solutions. We continue to market our *Office-box* product for SMEs, which allows integrated solutions with one bill and on a pay-per-employee basis bundling voice and data communication needs: (1) connectivity: mobile and fixed voice and broadband, (2) devices: PCs, phones and mobile phones, routers and switches and (3) mobility: cloud solutions including customized domains, e-mail accounts, hosting sites and optional software. Vertical solutions inside *Office-box* include: clinics, providing access to the Alert software; restaurants, which offer access to the WinRest software and to *Meo*; hotels, including access to the Guestcentric online marketing and booking system; and Newhotel, a full hotel-management suite. For large corporations, we provide: (1) integrated solutions, bundling customized connectivity and IT needs coupled with dedicated account managers, and (2) a unified communications integrated offering without requiring capital expenditures on a pay-per-employee basis, including voice flat rate, customer equipment and a full set of collaboration functionalities. Our secure and innovative cloud offering provides a broad portfolio of services, including (1) web services, such as webhosting, instant website, database hosting and e-mail relay, (2) security services, comprising e-mail security, remote backup, video surveillance and clean pipes, (3) IT resources, including remote desktop, public and private servers, SAP HANA and virtual drives and (4) applications like the Microsoft Office 365 Pack, the Invoice Xpress, PHC Business FX and easy report. We have developed this end-to-end offering with strategic partnerships that enable us to leverage our technological skills and integration capacity in key markets in Portugal, Brazil and Africa.

The IT and business process outsourcing for corporate customers leverages our PT-SI subsidiary, which provides an integrated ICT service and IT/IS outsourcing capabilities, and our PT PRO subsidiary, which allows the provision of BPO and shared services. See "*Shared Services Companies*."

Networks

We provide services over the largest IP/MPLS backbone in Portugal. We have points of presence in all major cities throughout Portugal, and we link our network to our customers' premises through switches and access points that we own. This broadband data transmission network provides high capacity, flexibility and security and can progressively incorporate current voice and data infrastructures at lower costs than alternative networks. We also provide high speed Internet access through ADSL and Ethernet.

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Partnerships and Suppliers

We have a strong and competitive position in the development of information technology solutions where communications are an integral part of the services provided. To reinforce our position as a leader in this area, we are pursuing a partnership strategy with the primary information technology suppliers in the market, particularly software and hardware providers.

We offer services in partnership with leading operators and service providers such as Telefónica, British Telecom and Orange. We use systems and networks in partnership with Siemens, Alcatel-Lucent, Cisco Systems, Nortel Networks, Critical Software, Microsoft and SAP, among others.

In 2012, we pursued partnerships with Microsoft and SAP towards developing, implementing and continuously launching new services in our cloud computing offer, *SmartCloudPT*, which is intended to help companies adopt more efficient business models by reducing costs related to information technology.

In December 2010, we signed a collaboration agreement with SingTel, the Singapore telecommunications company. This agreement provides for: (1) sharing best practices and benchmarks in operational and commercial areas related to fiber and IPTV, (2) cooperation in research and development, including the joint creation of multiplatform applications and solutions, (3) development of innovative applications for fixed and mobile high speed networks, (4) leveraging economies of scale through joint procurement and (5) promotion of internship programs allowing the employees of both companies to share best practices and experiences. During 2011 and 2012, we continued to collaborate with SingTel on several joint initiatives for the sharing of knowledge, benchmarks and operational and commercial best practices.

Data Centers and Systems Integration Services

To support our services and to respond to the increasing demand of e-business integrators, we have opened Data Centers in Lisbon and Oporto as well as in Funchal and Ponta Delgada, in the Madeira and Azores islands, respectively. These facilities allow us to provide services, such as co-location, sophisticated web hosting, ISP services, data storage, disaster recovery and ASP services.

In February 2011, we announced the construction of a new Data Center in Covilhã, Portugal, which will be a 75,500-square meter facility with installation capacity for over 50,000 servers. The Data Center has been designed to be a world reference in energy efficiency with a projected annual average power usage effectiveness ("PUE") below 1.25. The Data Center will be supported by a redundant fiber network to connect it to major global communications networks and is expected to focus on providing large processing and data storage capacity to customers inside and outside Portugal based on cloud computing services under the brand *SmartCloudPT*. We expect that the Data Center will become operational in the first half of 2013.

Components of Revenue

Our revenues from enterprise services include:

- traffic charges for voice and data services;
- outsourcing or management services and fees for business process outsourcing (BPO); and
- consultancy fees.

Wholesale and Other Services

In addition to the services we provide in our primary customer categories of residential services, personal services and enterprise services, we provide wholesale services and generate a small amount of

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revenue from other activities, such as the production and distribution of telephone directories. We report revenues from these services and products, together with eliminations in consolidation for transactions among our residential, personal and enterprise customers, as "Wholesale, other and eliminations" in our financial statements.

Wholesale Services

Wholesale services provided €472.7 million, €466.5 million and €491.3 million to our wireline operating revenues in 2012, 2011 and 2010, respectively. Our wholesale services consist of:

- domestic and international interconnection telephone services (including capacity-based domestic interconnection) that we provide to other telecommunications services providers in Portugal;
- provision of carrier pre-selection and number portability;
- leasing of domestic and international lines to other telecommunications services providers and Portuguese cable television operators;
- provision of ADSL (including "naked" DSL) on a wholesale basis to other ISPs;
- provision of unbundled access (including shared access) to metallic loops and sub-loops to provide broadband and voice services to other telecommunications operators in Portugal;
- provision of wholesale line rental to other telecommunications services providers in Portugal;
- provision of co-location services and access to ducts, poles and associated facilities to other telecommunications operators in Portugal;
- transmission of television and radio signals for major broadcast television companies in Portugal;
- narrowband Internet access origination services, which we provide to ISPs;
- international carrier services (transport, transit and/or termination) for international switched traffic; and
- other services provided to telecommunications services providers and operators, such as IP international connectivity.

Interconnection Traffic. Interconnection traffic comprised about 40% of our wholesale business in terms of revenues in 2012. The service providers who purchase interconnection services include fixed and mobile network operators, voice and data communications service providers, ISPs, value-added service providers and service providers whose international calls are terminated on or carried by our network. Providing interconnection services means allowing third parties to connect their networks to our network, and vice versa. We have interconnection rates namely for call termination, call origination, transits and international interconnection.

Interconnection Prices. Domestic interconnection revenue per minute for calls terminated on our network remained stable in nominal terms in 2012 compared to 2011 and declined by 8% in 2011 compared to 2010. International interconnection revenue per minute for wholesale operators' outgoing traffic decreased by 8% in nominal terms in 2012 compared to 2011 and by 20% in 2011 compared with 2010. In accordance with EU and Portuguese regulations, our national interconnection prices are cost-oriented (with costs audited by ANACOM) plus a margin.

Leased Lines. We lease lines to other telecommunications providers for fixed, mobile and data communications services, including our own subsidiaries and competitors. Leased line services involve making a permanent point-to-point connection with dedicated and transparent capacity between two geographically separate points. We offer both national terminating segments and trunk segments at the wholesale level. We also lease international circuits to national and international operators to allow them to complete their circuits (often circuits that pass through Portugal linking other countries), and we sell segments of international circuits to international operators. The three current mobile telephone operators in Portugal, which include our subsidiary TMN, Vodafone Portugal and Optimus, are among our wireline business's largest leased line customers.

Telephone Directories

We subcontract to Páginas Amarelas for the publication and distribution of telephone directories throughout Portugal in return for an annual payment of approximately 78% of its gross revenues from the sale of advertising space. Our revenues from our directories business amounted to €34.7 million, €45.9 million and €66.2 million in 2012, 2011 and 2010, respectively. In 2012, we entered into an agreement to sell our 25% interest in Páginas Amarelas to a third party, under which we disposed of a 5% interest in this company during 2012, and we expect to dispose of the remaining interest up to the end of 2013.

Digital Terrestrial Television Services

In 2008, pursuant to the European Commission's proposal to cease analog transmissions in all member states by 2012, ANACOM launched a public tender to grant the rights of use of frequencies allocated to the transmission of digital terrestrial television ("DTT") signals. Following a public tender launched by ANACOM in 2008, our subsidiary PT Comunicações was granted the frequency usage rights for DTT associated with the transmission of the signal for free-to-air television programs (the RTP, SIC and TVI broadcast channels), the so-called "Multiplex A" or "Mux A." In 2009, the Portuguese media regulatory authority (*Entidade Reguladora para a Comunicação Social*, or "ERC") notified us of its final decision to grant us a license to act as a TV distribution operator.

We launched DTT (using DVB-T, or terrestrial signals) in 2009, initially covering 29 municipalities and over 40% of the population. By the end of 2011 we achieved 100% coverage of the Portuguese population (approximately 90% using DVB-T and 10% using DVB-H (satellite)).

The switch-off of the analog television network in Portugal occurred on April 26, 2012.

DTT only encompasses broadcasting of free-to-air television programs, while our *Meo* offer comprises both free-to-air television programs, as well as Pay-TV channels, being provided over FTTH, ADSL and DTH technologies.

Other Revenues

We also record revenue from providing public pay telephone services, advertising on www.sapo.pt, our Internet portal, contractual penalties imposed on customers and rentals of equipment and other infrastructure.

Brazilian Operations (Oi)

Overview

In 2011, we entered into a strategic partnership with Oi, Brazil's largest telecommunications group, and we hold a significant interest in Oi. Under the governance arrangements of Oi reflected in a series of shareholder agreements described below, we have a significant role in determining, among other things, the operational strategy of Oi.

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Oi is one of the largest integrated telecommunications services providers in Brazil, based on information available from ANATEL regarding the total number of Oi's fixed lines in service and mobile subscribers as of December 31, 2012, and one of the principal telecommunications services providers offering "quadruple-play" services in Brazil. Oi offers a range of integrated telecommunications services that includes fixed line and mobile telecommunications services, data transmission services (including broadband access services), ISP services and other services for residential customers, small, medium and large companies, and governmental agencies. Oi is the largest telecommunications provider in both Region I and Region II in Brazil, based on information available from ANATEL and other publicly available information regarding revenues and customers as of and for the year ended December 31, 2012. Oi has also been offering mobile telecommunications services in Region III since October 2008.

Oi's concessions and authorizations from the Brazilian government allow it to provide:

- fixed line telecommunications services in Region I and Region II;
- long-distance telecommunications services throughout Brazil;
- mobile telecommunications services in Region I, Region II and Region III;
- data transmission services throughout Brazil; and
- DTH satellite television services throughout Brazil.

In addition, Oi has authorizations to provide fixed line local telecommunications services in Region III.

Region I consists of 16 Brazilian states located in the northeastern and part of the northern and southeastern regions. Region I covers an area of approximately 5.4 million square kilometers, which represents approximately 64% of the country's total land area and accounted for 39.8% of Brazil's GDP in 2010. The population of Region I was 104.4 million as of 2010, which represented 54.7% of the total population of Brazil as of that date. In 2010, per capita income in Region I was approximately R$14,376, varying from R$6,883 in the State of Maranhão to R$25,461 in the State of Rio de Janeiro.

Region II consists of the Federal District and nine Brazilian states located in the western, central and southern regions. Region II covers an area of approximately 2.9 million square kilometers, which represents approximately 33.5% of the country's total land area and accounted for approximately 27.1% of Brazil's GDP in 2010. The population of Region II was 45.1 million as of 2010, which represented 23.7% of the total population of Brazil as of that date. In 2010, per capita income in Region II was approximately R$22,651, varying from R$11,555 in the State of Acre to R$58,326 in the Federal District.

Region III consists of the State of São Paulo. Region III covers an area of approximately 248,000 square kilometers, which represents approximately 2.9% of the country's total land area and accounted for approximately 33.1% of Brazil's GDP in 2010. The population of Region III was 41.3 million as of 2010, which represented 21.6% of the total population of Brazil as of that date. In 2010, per capita income in Region III was approximately R$30,236.

Oi's services include:

- *Residential services*, which include:
  - local fixed line services primarily in Region I and Region II, including installation, monthly subscription, metered services, collect calls and supplemental local services;

domestic and international long-distance services primarily from Region I and Region II, placed through fixed line and mobile telephones using Oi's long-distance carrier selection codes, which are represented by the numbers 31 and 14;

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- data transmission services, comprised of ADSL services and other data transmission services;
- Pay-TV services, including cable and DTH satellite television services;
- bundled services, which combine fixed line services, fixed line broadband services and mobile services; and
- public telephone services.

Personal services, which include:

- prepaid and postpaid mobile telecommunications services throughout Brazil (Region I, Region II and Region III) utilizing 2G and 3G technology, including voice and data transmission services;
- value-added services which include voicemail, caller ID, directory assistance and other services; and
- usage of Oi's network to complete calls initiated by customers of other telecommunications services providers to Oi's mobile network (mobile interconnection services).

Enterprise services, which include:

- fixed line telecommunications services, primarily in Region I and Region II of Brazil;
- mobile telecommunications services throughout Brazil (Region I, Region II and Region III) utilizing 2G and 3G technology, including voice and data transmission services;
- advanced voice services, such as 0800 (toll free) services;
- information technology and infrastructure services to corporate customers, including cloud-based data storage services;
- interconnection and traffic transportation services to other telecommunications providers; and
- leasing dedicated digital and analog lines to other telecommunications services providers and ISPs,

provided to corporate and small and medium enterprises.

We use the term "Oi" to refer, collectively, to Telemar Participações S.A. ("TmarPart") and its subsidiary Oi S.A. (formerly known as Brasil Telecom S.A.), a Brazilian company whose shares are traded on BM&FBOVESPA and whose ADSs are listed on the New York Stock Exchange. Before the corporate reorganization of Oi described below, the Oi companies included TmarPart, its subsidiaries Tele Norte Leste Participações S.A. ("TNL"), which merged with and into Oi S.A as part of the corporate reorganization; Telemar Norte Leste S.A. ("Telemar"); Coari Participações S.A. ("Coari"), which merged with and into Oi S.A. as part of the corporate reorganization; and Oi S.A. Following the corporate reorganization of Oi, the term "Oi Group" refers to TmarPart, Oi S.A. and Telemar. We provide additional background on the structure of our investment in Oi below under " *Strategic Partnership with Oi*."

The following table sets forth the net operating revenues of the Oi Group for the years ended December 31, 2010, 2011 and 2012. For perods prior to the Corporate Reorganization of the Oi Group described below under " *Strategic Partnership with Oi Reorganization of the Oi Group*," the net operating revenues below correspond to the net operating revenues of TNL, which fully consolidated the net operating revenues of Brasil Telecom prior to the Corporate Reorganiation. In the Corporate Reorganization, TNL merged into Brasil Telecom, and Brasil Telecom was renamed Oi S.A. The net

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operating revenues in the table below reflect 100% of the consolidated net operating revenues of TNL or Oi S.A., as applicable, rather than the portion we proportionally consolidate into our results of operations.

Oi Group (100%)	2010	Year Ended December 31, 2011	2012
		(Reais Millions)	
Residential services	11,949	10,501	9,974
Personal services:			
Service revenues:			
Billing services (voice and data/value-added)	5,612	5,757	6,276
Network usage (interconnection)	2,305	2,398	2,337
Sales of handsets, SIM cards and other revenues	104	36	489
Total	8,021	8,190	9,102
Enterprise services	8,620	8,470	8,510
Other services	890	746	556
Total consolidated net operating revenues	29,479	27,907	28,142

For information about the effects of seasonality on Oi's business, see "*Item 5 Operating and Financial Review and Prospects Overview Business Drivers and Measures Seasonality*."

The following table sets forth information regarding the revenue generating units, ARPU and certain other information for Oi for the periods presented:

	2010	2011	2012
Residential services:			
RGU (thousands)(1)	18,277	17,796	18,337
ARPU (R$ in three months ended December 31)	67.5	64.8	69.2
Personal services:			
RGU (thousands):			
Postpaid	5,153	5,285	6,472
Prepaid	32,605	37,978	39,832
Total	37,757	43,264	46,305
ARPU (R$ in three months ended December 31)	23.5	22.3	21.5
Enterprise services:			
RGU (thousands)	7,094	7,848	8,971
Other data:			
Public telephones (thousands)	827	771	727
Total RGU (thousands)	63,956	69,680	74,339

(1) Revenue generating units ("RGUs") are individual subscribers of Oi's services.

(2) The average revenue per user ("ARPU") is the monthly average service revenues per average number of users in the period.

Residential Services

Oi's primary services to the residential market are fixed line voice services, data transmission services from fixed line devices, Pay-TV services. Oi offers these services on an à la carte basis and as

bundles, including bundles with other services that include mobile voice services and mobile data communications services.

Fixed Line Voice Services

As of December 31, 2012, Oi had approximately 11.8 million local fixed line customers in Region I and approximately 6.7 million local fixed line customers in Region II. Local fixed line services include installation, monthly subscription, metered services, collect calls and supplemental local services. Metered services include local calls that originate and terminate within a single local area and calls between separate local areas within specified metropolitan regions which, under ANATEL regulations, are charged as local calls. ANATEL has divided Region I into 2,920 local areas and Region II into 1,772 local areas.

Under Oi's concession agreements, it is required to offer two local fixed line plans to users: the Basic Plan per Minute (*Plano Básico de Minutos*) and the Mandatory Alternative Service Plan (*Plano Alternativo de Serviços de Oferta Obrigatória*), each of which includes installation charges, monthly subscription charges, and charges for local minutes. As of December 31, 2012, 17.9% of Oi's fixed line customers subscribed to the Basic Plan per Minute or the Mandatory Alternative Service Plan.

Calls within Brazil that are not classified as local calls are classified as domestic long-distance calls. Oi provides domestic long-distance services for calls originating from fixed line devices in Region I and Region II through its network facilities in São Paulo, Rio de Janeiro and Belo Horizonte and through interconnection agreements with other telecommunications providers, both fixed line and mobile, that permit it to interconnect directly with their networks. Oi provides international long-distance services originating from fixed line devices in Region I and Region II through agreements to interconnect its network with those of the main telecommunications services providers worldwide.

In addition to the Basic Plan per Minute and the Mandatory Alternative Service Plan, Oi offers a variety of alternative fixed line plans that are designed to meet its customers' usage profiles. As of December 31, 2012, 82.1% of Oi's fixed line customers subscribed to alternative plans, including its bundled plans.

Oi offers a variety of voice only plans, including:

- Oi's unlimited plans, such as its "*Oi Fixo Ilimitado*" plan, which permits a subscriber to make unlimited local calls from a fixed line device to fixed line customers of any carrier and local calls to Oi's mobile customers at the rates established for calls to fixed lines. Subscribers to *Oi Fixo Ilimitado* have the option of upgrading this plan for an additional monthly fee to permit unlimited long-distance calls to fixed line customers of any carrier using Oi's carrier selection codes.

- Oi's controlled plans, such as its "*Oi Fixo a Vontade*" plan, which permits a subscriber to make unlimited local calls from a fixed line device to fixed line customers of any carrier and purchase a minutes for long-distance calls and calls to mobile devices.

- Oi's "*Orelhão Gratis*" plan, which it introduced in Rio de Janeiro in November 2012 and which, in addition to the features of *Oi Fixo Ilimitado*, permits a subscriber to make unlimited local calls from a public telephone to Oi's fixed line customers.

Oi also owns and operates public telephones throughout Region I and Region II. As of December 31, 2012, Oi had approximately 727,000 public telephones in service, all of which are operated by prepaid cards.

Oi continually monitors market trends and the usage profile of its customer to assist to design new plans and promotions in order to retain its existing customers and attract new customers to its fixed line voice services.

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Data Transmission Services

Oi provides high-speed internet access services using ADSL technology, which it refers to as data transmission services or broadband services, to residential customers in the primary cities in Region I and Region II under the brand name "*Oi Velox*." As of December 31, 2012, Oi offered broadband services in 2,833 municipalities in Region I and 1,848 municipalities in Region II. As of December 31, 2012, Oi had 5.7 million ADSL customers in Region I and Region II.

Oi offers ADSL services through ADSL modems installed using its customers' conventional lines, which permit customers to use the telephone line and the internet simultaneously. Customers pay a fixed monthly subscription fee, irrespective of their actual connection time to the internet.

Oi offers broadband subscriptions to customers that do not subscribe to its bundled services plans, at speeds ranging from 300 kbps to 15 Mbps. To attract customers to this service, Oi offers new subscribers complementary anti-virus software and a free wireless router with subscriptions at speeds of 5 Mbps or more. Oi offers bundles of voice and broadband services to its fixed line subscribers at rates that are lower than the combined rate for separate comparable voice and broadband subscriptions.

In the fourth quarter of 2011, Oi launched its "*Oi Internet Total*" plan, which permits a subscriber to receive broadband services through the subscriber's fixed line and mobile devices, including laptops, tablets and 3G phones. This bundled service is available in geographic areas in which Oi offers 3G mobile coverage. Subscribers to the *Oi Internet Total* plan select the speed of their fixed line connection from among 2 Mbps, 5 Mbps, 10 Mbps and 15 Mbps and select a mobile connection of 500 kbps or 2 Mbps. In addition to unlimited use of the fixed line connection, subscribers have unlimited access to Oi's 3G network. As with Oi's à la carte broadband subscriptions, Oi offers anti-virus software, a free wireless router to *Oi Internet Total* subscribers. In addition, Oi offers a free mini-modem, for use with a laptop or tablet, to *Oi Internet Total* subscribers.

Oi is engaged in capital expenditure programs to upgrade its broadband speeds and periodically offers promotions designed to encourage its existing broadband customers to migrate to plans offering higher speeds and to attract new customers.

Pay-TV Services

Oi offers Pay-TV services under its "*Oi TV*" brand. Oi delivers Pay-TV services throughout Region I and Region II using its DTH satellite network, in Belo Horizonte, Poços de Caldas, Uberlândia and Barbacena in the State of Minas Gerais using a hybrid network of fiber optic and bidirectional coaxial cable, and in December 2012, Oi introduced delivery of *Oi TV* through its fixed line network in Rio de Janeiro. As of December 31, 2012, Oi had approximately 718,000 subscribers to its DTH subscription television services in Region I and Region II and approximately 59,000 subscribers to its cable network in the State of Minas Gerais.

Oi offers more than 100 channels of content, including 24 high definition channels, through its two subscription packages for its *Oi TV* services. Oi's *Oi TV Mais HD* package was launched in July 2012 and includes 56 channels, including 11 high-definition ("HD") channels. Oi's *Oi TV Mega HD* package was launched in May 2012 and includes 72 channels, of which 18 are HD channels. Subscribers to each of these packages have the option to customize the package through the purchase of additional channels featuring films offered by HBO/MAX and Telecine. Although these packages are available for à la carte purchase, Oi promotes these packages and approximately 48% of its subscribers for these packages purchase these packages as part of a bundle with its *Oi Velox* service or as part of its *Oi Conta Total* plan.

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Bundled Services

In addition to its combined internet and voice services and its *Oi Internet Total* plan, Oi offers its *Oi Conta Total* plan and its *Oi Conta Total Smartphone* plans, which provide fixed line voice services, fixed line devices broadband services and mobile voice services. Subscribers to these plans have the option to subscribe to Oi's *Oi TV* service.

Oi's *Oi Conta Total* plan permits subscribers to make unlimited local calls to any of its fixed line or mobile customers and includes an allowance of minutes selected by the customer for use to make long-distance calls and local calls to customers of other service providers. Subscribers also elect the speed of their fixed line broadband service, which is available under this plan at speeds ranging from 2 Mbps to 15 Mbps. Subscribers to this plan are entitled to 5 MB of data usage through Oi's Wi-Fi hotspots and subscribers who elect speeds of 5 Mbps or greater are provided with a complimentary wireless router. Subscribers can elect add-on features for this plan, including unlimited text messages to subscribers of any provider and unlimited long-distance calls to Oi's fixed line or mobile customers.

In April 2012, Oi launched its "*Oi Conta Total Smartphone*" plan, which has the same structure as its *Oi Conta Total* plan, with the addition of its *Oi Smartphone* data plan and unlimited text messages. Oi provides a smartphone, mini-modem or tablet at a subsidized price and access to its network of Wi-Fi hotspots to its *Oi Conta Total Smartphone* subscribers.

In December 2012, Oi launched its offering of Pay-TV services on its fiber optic network using an internet protocol ("IP TV") in the Rio de Janeiro. This service is only available as part of Oi's *Oi Conta Total* bundled service. Subscribers to Oi's IP TV service may subscribe to its *Oi TV Mais HD* package, together with a broadband subscription at 100 Mbps, or its *Oi TV Mega HD* package, together with a broadband subscription at 200 Mbps. Subscriptions to Oi's IP TV packages are only available in areas where it has implemented its FTTH network. Oi plans to gradually expand its IP TV service to other cities. Oi is engaged in capital expenditure programs to expand its FTTH network to permit it to offer IP TV to a broader range of potential subscribers.

In March 2012, Oi also launched a bundled plan combining fixed line voice service with prepaid mobile service under the brand "*Fixo Ilimitado + Pré Ilimitado*." This plan is available in most Brazilian states and, in addition to the features of the *Oi Fixo Ilimitado* plan, permits a subscriber to make unlimited local calls to Oi's fixed line and mobile customers from a mobile device.

Personal Services

Oi's personal services are comprised of postpaid and prepaid mobile voice services and postpaid and prepaid mobile data communications services. As of December 31, 2012, Oi had an aggregate of approximately 49.2 million subscribers for its mobile services, including subscribers to its bundled plans. As of December 31, 2012, 83.6% of Oi's mobile voice customers subscribed to prepaid plans and 16.4% subscribed to postpaid plans.

Postpaid Voice Services

Postpaid customers pay a monthly subscription fee and are billed on a monthly basis for services provided during the previous month. Postpaid plans include voice mail, caller ID, conference calling, call forwarding, calls on hold and special services.

Oi's "*Oi Conta*" plans permit a subscriber to make unlimited local calls to its fixed line and mobile subscribers and purchase a fixed allocation of minutes per month for local calls and text messages to customers of other providers. Oi offers its "*Oi Familia*" plans, which include the features of its *Oi Conta* plans and are available to share on as many as four separate mobile devices. Subscribers can elect add-on features for this plan, including unlimited text messages to subscribers of any provider and unlimited long-distance calls to Oi's fixed line or mobile customers.

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In April 2012, Oi launched its "*Oi Smartphone*" plan, which (1) permits a subscriber to make unlimited local calls to its fixed line and mobile subscribers and purchase a fixed number of minutes per month for local calls to subscribers of other providers, and (2) permits unlimited access to its 3G network, its network of Wi-Fi hotspots and unlimited text messaging. Oi offers smartphones at subsidized prices to new subscribers to its *Oi Smartphone* plan. Oi offers its "*Oi Familia Smartphone*" plans, which include the features of its *Oi Smartphone* plans and are available to share on as many as four separate mobile devices. Subscribers can elect add-on features for this plan, including unlimited long-distance calls to Oi's fixed line or mobile customers.

Oi also offers hybrid plans under the brand name "*Oi Controle*" that permit a subscriber to purchase a fixed number of local and long-distance minutes per month but restrict outgoing calls after the purchased minutes have been consumed, other than calls made using a prepaid card. Oi accounts for these hybrid plans as postpaid plans, as customers selecting these plans pay monthly subscription fees for their fixed allocations of minutes. In general, these plans are attractive to postpaid customers that migrate to these plans to place self-imposed limits on their mobile calling habits and to prepaid customers who are able to place calls at lower cost than with Oi's prepaid services.

Prepaid Voice Services

Prepaid customers activate their cellular numbers through the purchase and installation of a SIM card in their mobile handsets. Oi's prepaid customers are able to add credits to their accounts through point-of-sale machines, ATMs, Apple and Android applications installed on their mobile devices such as *Minha Oi* and *Recarga Oi* using a credit card, Oi's toll-free number or the purchase of prepaid cards at a variety of prices. These credits are valid for a fixed period of time following activation and can be extended when additional credits are purchased.

Oi sells credits in minimum denominations of R$1.00 and permits its prepaid customers to add credits to their account in any amount, including *centavos*, in order to facilitate the continued activation of their mobile handsets, allowing them to continue to receive incoming calls. Oi regularly launches various packages and promotions designed to incentivize the purchase and use of credits by its prepaid customers.

Oi markets "*Bônus Diário*" subscriptions to its prepaid customers. When a *Bônus Diário* subscriber purchases additional credits in any amount, the subscriber receives bonus credits in that amount (or double that amount, depending on the customer's area code) on each day during the remainder of the month in which the additional credits were purchased. These bonus credits may be used for (1) local or long-distance calls to Oi's fixed line or mobile subscribers, and (2) sending text messages to mobile subscribers of any Brazilian mobile service provider. Oi charges its customers a nominal subscription fee to participate in the *Bônus Diário* program for six months and may waive this fee during the first six-month period as part of its marketing activities.

Oi's customers may also exchange the credits that they purchase for additional services, such as:

- "*Bônus Extra*," which permits Oi's customers to purchase additional minutes for use for local or long-distance calls to its fixed line or mobile subscribers at discounted rates;

- "*Pacote de Dados*," which permits Oi's customers to purchase a specified data allowance for use on their handsets; and

- "*Pacote de SMS*," which permits Oi's customers to purchase the ability to send a specified number of text messages.

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Mobile Internet (3G) Services

Oi offers postpaid and prepaid mobile data communication services to customers that seek to access the internet through its 3G network, using mobile devices, including smartphones or tablets and laptop computers with the aid of a mini-modem. As with its postpaid voice plans, Oi's postpaid mobile internet customers pay a monthly subscription fee and are billed on a monthly basis for services provided during the previous month.

Oi offers a variety of postpaid plans that provide data allowances from 100 MB to 2 GB for mobile devices and 250 MB to 5 GB for tablets and laptop computers and provide data transmission at speeds of 1 Mbps. In addition to data traffic, Oi's postpaid mobile internet plans for use with mobile devices include allowances for text messages. Oi's postpaid mobile internet plans for mobile devices are available to its *Oi Conta* customers. Oi's postpaid mobile internet plans for tablets and laptop computers are sold on a stand-alone basis only. However, subscribers to its *Oi Conta* plans receive a discount on such plans. Oi may also offer mini-modems and tablets at subsidized prices to new subscribers to its postpaid mobile data communication services based on the size of the data package purchased. Subscribers to Oi's access to its postpaid mobile internet plans for tablets and laptop computers also receive free access to its network of Wi-Fi hotspots. In addition to these postpaid plans, subscribers can purchase anti-virus software and backup data storage services.

Oi launched its prepaid mobile internet service in November 2012. Prepaid customers activate their mobile internet services through the purchase and installation of a SIM card in their mini-modem or tablet. Oi's prepaid customers are able to add credits to their accounts through the purchase of prepaid credits at prices that vary based on the data allowance purchased and duration (daily, weekly and monthly). These credits are valid for a fixed period of time following activation. The basic services consist of data traffic and text messaging. Customers that purchase a 500 MB allowance also receive free access to Oi's network of Wi-Fi hotspots.

Mobile Long-Distance

Each mobile subscriber in Brazil is registered in a geographic area (identified by the corresponding area codes, such as 11 (São Paulo) or 21 (Rio de Janeiro)), which Oi refers to as the subscriber's home registration area. A call originated by a mobile subscriber registered in one home registration area to a mobile subscriber registered in another home registration area is classified as a mobile long-distance call.

Oi provides mobile long-distance services originating from Region I and Region II through network facilities and through interconnection agreements with Telefónica in Region III and each of the other principal mobile services providers operating in Brazil that permit it to interconnect directly with their local fixed line and mobile networks. Oi provides international long-distance services originating or terminating on its customer's mobile handsets through agreements to interconnect its network with those of the main telecommunications services providers worldwide. Oi also uses its submarine fiber optic network to transport international mobile long-distance calls.

Value-Added Services

Oi provides value-added services include voice, text and data applications, including voicemail, caller ID, and other services, such as personalization (video downloads, games, ring tones and wallpaper), text messaging subscription services (horoscopes, soccer teams and dating matching services), chat, mobile television, location-based services and applications (mobile banking, mobile search, email and instant messaging).

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Enterprise Services

In the enterprise services market, Oi serves SMEs and large enterprises, or corporate customers. Oi markets a variety of services to SMEs, including its core fixed line and mobile services, and its higher-value added services, such as broadband services, voice, text and data applications, advanced voice services and commercial data transmission services. Oi also markets these services to corporate customers, combining these service offerings with information technology services.

Services for SMEs

Oi offers SMEs services similar to those offered to its residential and personal customers, including fixed line and mobile voice services, and fixed line and mobile broadband serves. In addition, Oi offers SMEs:

- digital trunk services, which optimize and increase the speed of the customer's telephone system;
- advanced voice services, primarily 0800 (toll free) services, as well as voice portals where customers can participate in real-time chats and other interactive voice services; and
- dedicated Line Services (*Serviços de Linhas Dedicadas*, or "SLD"), under which Oi leases dedicated digital and analog lines to customers for use in private networks.

Oi offers a variety of mobile plans to SMEs, including its *Oi Equipe Flat* plan for groups of employees, its *Oi Empresa Especial* plan for individual users in an SME and its *Oi Controle* plan which, similar to its residential fixed line plan, is designed to permit an SME to control mobile minutes usage. In general, Oi's sales team works with an SME customer to determine their telecommunications needs and negotiates a package of services and pricing structure that is tailored to the needs of that SME.

Services for Corporate Customers

Oi offers corporate customers all of the services offered to its SME customers. In addition, Oi provides a variety of customized, high-speed data transmission services through various technologies and means of access to corporate customers. Oi's data transmission services include interconnection between local area networks at data transmission speeds of 34 Mbps, 155 Mbps and 10 Gbps, videoconferencing, video/image transmission and multimedia applications. Oi's principal commercial data transmission services are:

- SLD, under which Oi leases dedicated lines to corporate customers for use in private networks that link different corporate websites;
- IP services which consist of dedicated private lines which Oi provides to most of the leading ISPs in Brazil, as well as Virtual Private Network ("VPN") services that enable its customers to operate private intranet and extranet networks; and
- frame relay services that Oi provides to its corporate customers to allow them to transmit data using protocols based on direct use of its transmission lines, enabling the creation of VPNs.

In 2012, Oi broadened the scope of services it offers to its corporate clients to include information technology infrastructure services, seeking to offer its customers end-to-end solutions through which Oi is able to provide and manage their connectivity and information technology needs. In February 2012, Oi launched "*Oi Smartcloud*," a suite of data processing and data storage services that it performs through its six cyber data centers located in Brasília, São Paulo, Curitiba, Porto Alegre and Fortaleza. In addition, through these data centers, Oi provides hosting, collocation and IT outsourcing services, permitting its customers to outsource their IT structures to Oi or to use these centers to provide backup for their IT systems.

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In addition, in the second quarter of 2012, Oi launched its "*Oi Gestão*" service through which it offers corporate clients managed services for their mobile devices. This service is focused on providing logistics and security solutions relating to mobile devices.

In order to provide complete solutions to its corporate clients, Oi has entered into service agreements for the joint supply of international data services with a number of important international data services providers. These commercial relationships with international data services providers are part of Oi's strategy of offering telecommunications services packages to its customers.

Services for Other Telecommunications Providers

Oi offers specialized services to other telecommunications providers, consisting primarily of interconnection to its networks, network usage charges for the use of portions of its long-distance network, and traffic transportation through its physical infrastructure.

Network Usage (Interconnection) Charges

All telecommunications providers in Brazil are required, if technically feasible, to make their networks available for interconnection on a non-discriminatory basis whenever a request is made by another telecommunications services provider. Interconnection permits a call originated on the network of a requesting local fixed line, mobile or long-distance service provider's network to be terminated on the local fixed line or mobile services network of the other provider.

Oi is authorized to charge for the use of its local fixed line network on a per-minute basis for (1) all calls terminated on Oi's local fixed line networks in Region I and Region II that originate on the networks of other local fixed line, mobile and long-distance service providers, and (2) all long-distance calls originated on Oi's local fixed line networks in Region I and Region II that are carried by other long-distance service providers.

Conversely, other local fixed line service providers charge Oi interconnection fees (1) to terminate calls on their local fixed line networks that are originated on Oi's local fixed line, mobile or long-distance networks, and (2) for long-distance calls originated on their local fixed line networks that are carried by Oi's long-distance network.

In addition, Oi charges network usage fees to long-distance service providers and operators of trunking services that connect switching stations to Oi's local fixed line networks.

Oi is authorized to charge for the use of its long-distance network on a per-minute basis for all calls that travel through a portion of its long-distance networks for which the caller has not selected Oi as the long-distance provider. Conversely, other long-distance service providers charge Oi interconnection fees on a per-minute basis for all calls that travel through a portion of their long-distance networks for which the caller has selected Oi as the long-distance provider.

Oi is authorized to charge for the use of its mobile network on a per-minute basis for all calls terminated on its mobile network that originate on the networks of other local fixed line, mobile and long-distance service providers. Conversely, other mobile services providers charge Oi interconnection fees to terminate calls on their mobile networks that are originated on Oi's local fixed line, mobile or long-distance networks.

Transportation

Oi provides Industrial Exploitation of Dedicated Lines (*Exploração Industrial de Linha Dedicada*, or "EILD") services under which it leases trunk lines to other telecommunications services providers, primarily mobile services providers, which use these trunk lines to link their radio base stations to their switching centers.

Long-distance and mobile services providers may avoid paying long-distance network usage charges to Oi by establishing an interconnection to Oi's local fixed line networks. In order to retain these customers, Oi offers a long-distance usage service, called national transportation, under which it provides discounts to its long-distance network usage fees based on the volume of traffic and geographic distribution of calls generated by a long-distance or mobile services provider.

Oi also offers international telecommunications services providers the option to terminate their Brazilian inbound traffic through its network, as an alternative to Embratel and TIM. Oi charges international telecommunications services providers a per-minute rate, based on whether a call terminates on a fixed line or mobile telephone and the location of the local area in which the call terminates.

Oi also owns and operates a submarine fiber optic network, which connects Brazil with the United States, Bermuda, Venezuela and Colombia. Through this network, Oi offers international data transportation services, primarily leased lines to other telecommunications services providers.

Marketing

In 2012, Oi incurred R$443 million in marketing expenses, primarily to:

- strengthen the *Oi* brand, reinforcing the image of the convergence of the integrated company;
- promote its bundled plans, such as *Oi Internet Total*, *Oi Fixo + Oi Velox + Oi TV* and *Fixo Ilimitado + Pré Ilimitado* as part of its effort to expand and strengthen Oi's customer base;
- expand its *Oi TV* customer base with offers through Oi's other services;
- promote its prepaid mobile services through a promotional campaign that awards prizes to new and existing customers who recharge their Oi SIM cards;
- promote its postpaid mobile plans, primarily those that include unlimited calls and 3G data services at higher speeds, through specific marketing campaigns and mobile device subsidies for customers who subscribe to Oi's postpaid plans, as part of its effort to increase Oi's market share in mobile services; and
- expand its broadband and 3G internet customer base, focusing on geographic regions covered by the National Broadband Plan.

Throughout 2012, Oi focused its marketing efforts on three types of customers: (1) retail customers, including mobile telephone and residential fixed line customers, (2) SMEs and (3) corporate customers.

Oi advertises through a diverse array of media outlets as part of its strategy to reach all types and classes of customers and potential customers. Oi uses television, radio, billboards, exterior signage, telemarketing, direct mail and internet advertising to market its fixed line, mobile, long-distance, broadband and Pay-TV services. Oi uses its branded fixed assets in advertising campaigns, such as the "*Orelhão Mágico*" Christmas campaign, in which children are able to "place calls to Santa Claus" from Oi's telephone booths. Oi also sponsors sporting events and individual athletes, as well as cultural events, such as fashion shows and popular music concerts. Oi is the official telecom provider and a sponsor of the 2014 World Cup in Brazil. The goal of Oi's marketing initiatives is to increase brand awareness of the company as a convergent provider capable of meeting all of the telecommunications needs of its customers and expand the use of Oi's distribution channels to increase net operating revenue.

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Distribution Channels

During the last months of 2011, Oi revised its distribution model and now distributes its services through channels focused on three separate sectors of the telecommunications services market: (1) residential customers, including customers of its mobile services to whom Oi sells bundled plans, (2) personal customers that purchase its mobile services independently of Oi's bundled plans, and (3) enterprise customers.

Residential Customers

Oi's distribution channels for residential customers are focused on sales of fixed line services, including voice, *Oi Velox* and *Oi TV*, and postpaid mobile services. As part of the restructuring of Oi's distribution channels, it has begun to provide more extensive training to its employees and the employees of third-party sales agents and has revised Oi's commission structures to incentivize sales of plans and services that generate higher average revenue per user. The principal distribution channels that Oi uses for sales to residential customers are:

- Oi's own network of stores, which it began opening in 2011. As of December 31, 2012, Oi had opened 197 *Oi* branded stores and expects to open additional *Oi* branded stores during 2013.

- approximately 500 *Oi* franchised service stores and kiosks located in the largest shopping malls and other high density areas throughout Brazil.

- approximately 430 stores located throughout Oi's service area that primarily sell telecommunications products and services and have entered into exclusivity agreements with Oi.

- Oi's telemarketing sales channel, which is operated by its call center and other third-party agents and consists of approximately 2,300 sales representatives that answer more than 2.1 million calls per month. This channel provides Oi with the ability to proactively reach new customers, thereby increasing its client base and revenues, and also receives calls prompted by Oi's offers made in numerous types of media.

- Oi's "teleagents" channel, which consists of approximately 1,200 local sales agents that operate in specific regions and complement Oi's existing telemarketers.

- door-to-door sales calls made by Oi's sales force of approximately 500 salespeople and by exclusive agents with approximately 6,500 salespeople trained to sell its services throughout Brazil in places where customers generally are not reachable by telemarketing.

- Oi's e-commerce sites through which customers may purchase a variety of its services.

Personal Customers

Oi's distribution channels for personal customers are focused on sales of mobile services to postpaid customers and prepaid customers, including mobile broadband customers. As part of the restructuring of Oi's distribution channels, its distribution channels for Oi's postpaid personal services have converged with its distribution channels for residential services. The principal distribution channels that Oi uses for sales of its prepaid personal services are:

- approximately 8,500 stores that are part of large national chains that sell its SIM cards and prepaid mobile cards;

- approximately 40 multi-brand distributors that distribute its SIM cards and prepaid mobile cards to approximately 150,000 pharmacies, supermarkets, newsstands and similar outlets; and its website, through which Oi's prepaid customers may recharge their SIM cards.

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Enterprise Customers

Oi has established separate distribution channels to serve SMEs and large corporate customers. Oi markets a variety of services to SMEs, including its core fixed line and mobile services, and its higher-value added services, such as broadband services, voice, text and data applications, advanced voice services and commercial data transmission services. As part of the restructuring of its distribution channels, in 2012 Oi opened nine regional offices from which approximately 250 employees supervise its marketing efforts to SMEs and its third-party sales force serving this sector. Oi has also begun to provide more extensive training to its employees and the employees of third-party sales agents. The principal distribution channels that Oi uses to market its services to SMEs are:

- approximately 200 exclusive Oi agents with approximately 3,000 door-to-door sales consultants that are dedicated to understanding and addressing the communications needs of its existing and prospective SME customers.

- Oi's telemarketing sales channel, which consists of 14 agents that use approximately 600 sales representatives that are specifically trained to discuss the business needs of prospective SME customers to make sales calls, as well as representatives in Oi's call center and representatives at call centers under contract with Oi to receive calls from existing and prospective SME customers to sell services to new customers and promote higher-value and additional services to existing customers. In addition, Oi's telemarketing channel utilizes approximately 480 customer retention representatives.

Oi markets its entire range of services to enterprise customers through its own direct sales force, which meets with current and prospective corporate customers to discuss the business needs of these enterprises and design solutions intended to address their communications needs. As part of the restructuring of its distribution channels, in 2012 Oi redesigned its client service model to increase its focus on post-sale service, regularly discussing service needs and improvements with its customers through calls and meetings with such customers. Oi's corporate sales team, including post-sale service personnel, is composed of approximately 1,000 employees operating in six regional offices.

Rates

Oi's rates for local fixed line services, domestic long-distance services, mobile services, interconnection, EILD and SLD services are subject to regulation by ANATEL, subject to certain exceptions relating to the rates it charges under alternative fixed line and mobile plans that Oi is authorized to offer to its customers. Many of the services Oi provides charge on a per-minute basis. For these services, Oi charges for calls based on the period of use. The charge unit is a tenth of a minute (six seconds), and rounding is permitted to the next succeeding tenth of a minute. There is a minimum charge period of 30 seconds for every call. For local fixed line to fixed line calls during off-peak hours, charges apply on a per-call basis, regardless the duration of the call.

Local Fixed Line Rates

Local Rates

Oi's revenues from local fixed line services consist mainly of monthly subscription charges, charges for local calls and charges for the activation of lines for new subscribers or subscribers that have changed addresses. Monthly subscription charges are based on the plan to which the customer subscribes and whether the customer is a residential, commercial or trunk-line customer. Under its concession agreements, Oi is required to offer two local fixed line plans to users: (1) the Basic Plan per Minute and (2) the Mandatory Alternative Service Plan. Each of these plans includes installation charges, monthly subscription charges, and charges for local minutes. As of December 31, 2012, 17.9% of Oi's local fixed line customers subscribed to the Basic Plan per Minute or the Mandatory Alternative

Service Plan. The monthly subscription fees under the Basic Plan per Minute and the Mandatory Alternative Service Plan vary in accordance with the subscribers' profiles, as defined in the applicable ANATEL regulations.

In addition to the Basic Plan per Minute and the Mandatory Alternative Service Plan, Oi is permitted to offer non-discriminatory alternative plans to the basic service plans. The rates for applicable services under these plans (e.g., monthly subscription rates and charges for local and long-distance calls) must be submitted for ANATEL prior approval.

Local Fixed Line to Mobile Rates

When one of Oi's fixed line customers makes a call to an Oi mobile subscriber or another mobile services provider that terminates in the mobile registration area in which the call was originated, Oi charges its fixed line customer per-minute charges for the duration of the call based on rates designated by ANATEL as VC-1 rates. In turn, Oi pays the mobile services provider a per-minute charge based on rates designated by ANATEL as VU-M rates for the use of its mobile network in completing the call. VC-1 rates vary depending on the time of the day and day of the week, and are applied on a per-minute basis. On an annual basis, ANATEL may increase or decrease the maximum VC-1 rates that Oi is permitted to charge.

Domestic Long-Distance Rates

Fixed Line to Fixed Line

If a caller selects one of Oi's carrier selection codes for a long-distance call that originates and terminates on fixed line telephones, Oi receives the revenues from the call and must pay interconnection fees to the service providers that operate the networks on which the call originates and terminates. Rates for these long-distance calls are based on the physical distance separating callers (categorized by four distance ranges), time of the day and day of the week, and are applied on a per-minute basis for the duration of the call. Rates on these calls are applied on a per-minute basis. On an annual basis, ANATEL increases or decreases the maximum domestic fixed line to fixed line long-distance rates that Oi is permitted to charge.

Mobile Long Distance

Rates for long-distance calls that originate or terminate on mobile telephones are based on whether the call is an intrasectorial long-distance call, which is charged at rates designated by ANATEL as VC-2 rates, or an intersectorial long-distance call, which is charged at rates designated by ANATEL as VC-3 rates. If the caller selects one of Oi's carrier selection codes, Oi receives the revenues from the call and must pay interconnection fees to the service providers that operate the networks on which the call originates and terminates. The applicable VC-2 and VC-3 rates vary depending on the time of the day and day of the week, and are applied on a per-minute basis. On an annual basis, ANATEL may increase or decrease the maximum VC-2 and VC-3 rates Oi is authorized to charge.

Mobile Rates

Mobile telecommunications services in Brazil, unlike in the United States, are offered on a "calling-party-pays" basis under which a mobile subscriber pays only for calls that he or she originates (in addition to roaming charges paid on calls made or received outside the subscriber's home registration area). A mobile subscriber receiving a collect call is also required to pay mobile usage charges.

Oi's revenues from mobile services consist mainly of charges for local and long-distance calls paid by its prepaid and postpaid mobile subscribers and monthly subscription charges paid by Oi's postpaid

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plan subscribers. Monthly subscription charges are based on a postpaid subscriber's service plan. If one of Oi's mobile subscribers places or receives a call from a location outside of his or her home registration area, Oi is permitted to charge that customer the applicable roaming rate.

Under ANATEL regulations, TNL PCS S.A. ("TNL PCS"), a subsidiary of Telemar, and Brasil Telecom Mobile were each required to submit a basic postpaid and prepaid service plan to ANATEL for approval. As of December 31, 2012, fewer than 1% of Oi's mobile customers subscribed to its basic postpaid or prepaid plans.

In addition to the basic service plans, Oi is permitted to offer non-discriminatory alternative plans to the basic service plans. The rates for applicable services under these plans (e.g., monthly subscription rates, charges for local and long-distance calls and roaming charges) must be submitted for ANATEL for prior approval. In general, ANATEL does not raise objections to the terms of these plans. As of December 31, 2012, substantially all of Oi's postpaid and prepaid customers subscribed to these alternative plans.

Network Usage (Interconnection) Rates

Fixed Line Networks

Oi's revenues from the use of its local fixed line networks consist primarily of payments on a per-minute basis, which are charged at rates designated by ANATEL as TU-RL rates, from:

- long-distance service providers to complete calls terminating on its local fixed line networks;
- long-distance service providers for the transfer to their networks of calls originating on Oi's local fixed line networks;
- mobile services providers to complete calls terminating on Oi's local fixed line networks; and
- other fixed line service providers for local fixed line calls that originate on their local fixed line networks and terminate on Oi's local fixed line networks.

TU-RL rates vary depending on the time of the day and day of the week, and are applied on a per-minute basis. Charges for the use of Oi's local fixed line networks to terminate local calls originating on the network of another local fixed line service provider are only billed and due when usage of one of Oi's networks exceeds 55% of the total traffic registered between that network and the network of the other telecommunications services provider. Since January 1, 2007, the TU-RL rates of Oi and Telemar have been equal to 40% of the rate included in their respective Basic Plan per Minute for a local fixed line call, which is adjusted on an annual basis by ANATEL.

Mobile Networks

Oi's revenues from the use of its mobile networks consist primarily of payments on a per-minute basis from (1) local fixed line, long-distance and mobile services providers to complete calls terminating on Oi's mobile networks, and (2) long-distance service providers for the transfer to their networks of calls originating on Oi's mobile networks.

The terms and conditions of interconnection to Oi's mobile networks, including the rates charged to terminate calls on these mobile networks, which are designated by ANATEL as VU-M rates, commercial conditions and technical issues, are freely negotiated between Oi and other mobile and fixed line telecommunications services providers, subject to compliance with regulations established by ANATEL relating to traffic capacity and interconnection infrastructure that must be made available to requesting providers, among other things. Oi must offer the same VU-M rates to all requesting service providers on a non-discriminatory basis. Oi applies VU-M charges on a per-minute basis.

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If Oi is not able to establish interconnection rates for use of its mobile networks with other mobile and fixed line telecommunications services providers, ANATEL is empowered to arbitrate, at its discretion, the interconnection rates that Oi may charge.

Data Transmission Rates

Broadband services, IP services and frame relay services are deemed to be value-added services under ANATEL regulations, and therefore, the rates and prices for these services are not subject to regulation and are market-driven. Oi offers broadband services subscriptions at prices that vary depending on the download speeds available under the purchased subscription.

DTH Services Rates

DTH services are deemed to be value-added services under ANATEL regulations, and therefore, the rates and prices for these services are not subject to regulation and are market-driven. Oi offers DTH subscriptions at prices that vary depending on the content of the subscription package. Oi offers basic subscription packages for its *Oi TV* services, as well as a variety of premium packages which allow subscribers to tailor the content that they receive to their individual tastes.

Billing and Collection

Residential Services

Oi sends each of its fixed line customers a monthly bill covering all the services provided during the prior monthly period. Customers are grouped in billing cycles based on the date their bills are issued. Each bill separately itemizes local calls, long-distance calls, calls terminating on a mobile network, toll-free services and other services such as call waiting, voicemail and call forwarding. Oi has agreements with several banks for the receipt and processing of payments from its customers. A variety of businesses, such as lottery houses, drugstores and grocery stores, accept payments from Oi's customers as agents for these banks.

Oi is required to include in its monthly bills charges incurred by Oi's customers for long-distance services provided by other long-distance service providers upon the request of these providers. Oi has billing agreements with each long-distance telecommunications services provider that interconnects with its networks under which Oi bills its customers for any long-distance calls originated on Oi's network that are carried by another long-distance service provider and transfer the balance to the relevant provider after deducting any access fees due for the use of Oi's network. On average, payments are due 15 days after the billing date. Oi charges late-payment interest at a rate of 1% per month plus a one-time late charge of 2% of the amount outstanding. As of December 31, 2012, 11.3% of all accounts receivable due from Oi's fixed line customers were outstanding for more than 30 days and 5.1% were outstanding for more than 90 days.

ANATEL regulations permit Oi to restrict outgoing calls made by a fixed line customer when the customer's account is more than 31 days past due, restrict incoming calls received by a fixed line customer when the customer's account is more than 61 days past due, and disconnect a fixed line customer when the customer's account is more than 91 days past due, provided in each case that 15 days' prior notice has been given to that customer prior to the imposition of each restriction. The disconnection process thus comprises several stages, including customer notification regarding the referral of their delinquency to credit bureaus, before the fixed line customer may be ultimately disconnected due to non-payment. Notices range from voice messages to active calls for negotiation with the customer. Oi's collection system enables it to access delinquent subscribers' accounts according to their payment profile. This profile takes into consideration, among other things, the length of subscription, the outstanding balance of the account and the longest payment delays.

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Personal Services

Oi bills its mobile postpaid customers on a monthly basis and itemizes charges in the same manner as it bills its fixed line customers. See " *Residential Services*." In addition, the monthly bills also provide details regarding minutes used and roaming charges. On average, payments are due 15 days after the billing date. Oi charges late-payment interest at a rate of 1% per month plus a one-time late charge of 2% of the amount outstanding. As of December 31, 2012, 9.8% of all accounts receivable due from Oi's mobile customers were outstanding for more than 30 days and 6.1% were outstanding for more than 90 days.

ANATEL regulations permit Oi to partially suspend services to a mobile customer when the customer's account is more than 15 days past due, restrict all incoming calls received and outgoing calls made by a mobile customer when the customer's account is more than 45 days past due, and cancel services to a mobile customer when the customer's account is more than 90 days past due, provided in each case that 15 days' prior notice has been given to that customer prior to the imposition of each restriction. The cancellation process thus comprises several stages, including customer notification regarding the referral of their delinquency to credit bureaus, before services to the mobile customer may be ultimately cancelled due to non-payment. Notices range from text messages to active calls for negotiation with the customer. Oi's collection system enables it to access delinquent subscribers' accounts according to their payment profile. This profile takes into consideration, among other things, the length of subscription, the outstanding balance of the account and the longest payment delays. Oi has also implemented an information tool to assist with account management that is designed to warn subscribers of high outstanding amounts due and unpaid.

Oi's Network and Facilities

Oi's networks are comprised of physical and logical infrastructures through which it provides fully integrated services, whether fixed line or mobile, voice, data or image, thereby optimizing available resources. Oi monitors its networks remotely from its centralized national network operations center in Rio de Janeiro. Network operating and configuration platforms, located at the network operations center, perform failure monitoring, database and configuration management, security management and performance analysis for each network.

Access Networks

Oi's access networks connect its customers to Oi's signal aggregation and transportation networks. Oi has a large number of network access points, including twisted copper pair wires to residences and commercial buildings, fiber optic lines to residences and commercial buildings, wireless transmission equipment and Wi-Fi hotspots. Oi's fixed line networks are fully digitalized.

Voice and data signals that originate through fixed line access points are routed through Multi-service Access Nodes ("MSANs") to Oi's aggregation networks, or are rerouted to Oi's aggregation networks through Digital Subscriber Line Access Multiplexer ("DSLAM") equipment which split the voice signal from the digital signal which is transmitted using ADSL or VDSL technology. Oi is engaged in a long-term program to update its MSAN equipment to DSLAM equipment as demand for data services increases. As of December 31, 2012, approximately 49.5% of Oi's fixed line network had been updated to support ADSL2+ or VDSL2, and Oi provided ADSL or VDSL2 services in 4,683 municipalities.

ADSL technology allows high-speed transmission of voice and data signals on a single copper wire pair for access to the network. Since voice transmission through telephone lines uses only one of many available frequency bands, the remaining frequency bands are available for data transmission. Oi's network supports ADSL2+ and VDSL2, or very-high-bitrate digital subscriber line, technologies. ADSL2+ is a data communications technology that allows data transmission at speeds of up to

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24 Mbps downstream and 1 Mbps upstream, which is much faster than data transmission through conventional ADSL. ADSL2+ permits Oi to offer a wider range of services than ADSL, including IP TV. VDSL2 is a DSL technology providing faster data transmission, up to 100 Mbps (downstream and upstream), permitting it to support high bandwidth applications such as HDTV, Voice over Internet Protocol ("VoIP") and broadband internet access over a single connection.

Oi is engaged in a long-term program to upgrade portions of its fixed line access networks with optical fiber networks based on gigabit passive optical network ("GPON") technology to support VDSL2 service and facilitate Oi's offering of its *Oi TV* service. The implementation of this technology permits Oi to provide broadband with speeds up to 100 Mbps to residential customers and up to 1 Gbps to commercial customers.

For its non-residential customers, Oi has a fully integrated and managed network providing access for networks based on internet protocol, or IP, and Asynchronous Transfer Mode ("ATM") protocol over legacy copper wire through which it is able to provide:

- symmetric and transparent access to Frame Relay services at speeds from 64 kbps to 1.5 Mbps;
- symmetrical access with PPP (Point to Point) for the Internet connection services at speeds from 64 kbps to 1.5 Mbps; and
- symmetrical access with PPP (Point to Point) to provide connection services for virtual private networks ("VPNs") through Multiprotocol Label Switching ("MPLS") protocol at speeds from 64 kbps to 1.5 Mbps.

The following table sets forth selected information about Oi's fixed line networks as of the dates and for the periods indicated.

	As of December 31,		
	2012	**2011**	**2010**
Region I:			
Installed access lines (in millions)	17.7	17.8	18.0
Access lines in service (in millions)	11.3	10.6	12.8
Public telephones in service (in thousands)	489.6	504.3	560.8
Broadband access lines in service (in millions)	3.5	2.9	2.4
Region II:			
Installed access lines (in millions)	10.6	10.4	10.4
Access lines in service (in millions)	6.5	6.8	7.2
Public telephones in service (in thousands)	237.9	265.0	266.1
Broadband access lines in service (in millions)	2.3	2.1	1.9

Mobile devices access Oi's Global System for Mobile Communications ("GSM" or "2G") mobile networks on frequencies of 900 MHz/1800 MHz, access its Universal Mobile Telecommunications System ("UMTS" or "3G") mobile networks on frequencies of 2100 MHz. Oi's 2G access points use General Packet Radio Service ("GPRS"), which allows speeds in the range of 115 kilobytes per second (Kbps), and Enhanced Data Rates for Global Evolution ("EDGE"), which allows speeds in the range of 230 Kbps, to send and receive data signals. Oi's 3G access points use high speed packet access ("HSPA"), which allows speeds in the range of 14.2 Mbps, to send and receive data signals. Voice and data signals sent and received through Oi's 2G and 3G access points are routed to its aggregation networks. Oi's mobile networks have a unique data core and are fully integrated with its fixed line data networks.

As of December 31, 2012, Oi's 2G mobile access networks, consisting of 13,092 active radio base stations, covered 1,475 municipalities in Region I, or 88.0% of the urban population in Region I, 1,287 municipalities in Region II, or 96.0% of the urban population in Region II, and 547 municipalities in Region III, or 99.0% of the urban population in Region III. Oi has GPRS coverage in 100% of the localities covered and EDGE coverage in all state capitals.

As of December 31, 2012, Oi's 3G mobile access networks, consisting of 7,575 active radio base stations, covered 297 municipalities in Region I, or 67.1% of the urban population in Region I, 231 municipalities in Region II, or 73.6% of the urban population in Region II, and 165 municipalities in Region III, or 85.4% of the urban population in Region III. Oi has HSPA coverage in all state capitals.

In the fourth quarter of 2012, Oi began deploying its 2.1 GHz mobile access networks to support 4G service in cities scheduled to host the 2014 World Cup.

In addition to these mobile access networks, Oi also operates Wi-Fi hotspots in public areas such as coffee shops, airports and shopping centers. Since 2012, Oi has provided outdoor urban wireless networks, including in the neighborhoods of Copacabana and Ipanema in the city of Rio de Janeiro. As of December 31, 2012, Oi's Wi-Fi network consisted of approximately 40,000 hotspots. Oi has also begun to offer broadband access compatible with access points provided by Fon Wireless Ltd. ("Fon"), which allows Oi's customers to access Fon lines worldwide.

Aggregation Networks

Voice and data signals sent through Oi's access network are routed through its aggregation networks to digital switches that connect voice calls and route digital signals to their destinations. Portions of Oi's aggregation network use conventional copper trunk lines to connect its access network to its switches and transportation networks. Oi uses ATM protocol to permit high speed transmission of these signals. Other portions of Oi's aggregation network use fiber optic cable to connect its access network to its switches and transportation networks using Synchronous Digital Hierarchy ("SDH") protocol. In large metropolitan areas where the density of access point results in increased demand, Oi has deployed Metro Ethernet networks. Oi is currently deploying Metro Ethernet networks in additional cities to serve rising customer demand. Oi's Metro Ethernet networks are fully-integrated management systems and provide:

- ethernet data services from 4 Mbps up to 1 Gbps for point-to-point and multipoint dedicated access;
- ethernet access services from 4 Mbps up to 1 Gbps for IP access and MPLS/VPN access;
- aggregation network services for ADSL2+ and VDSL2 platforms; and
- aggregation network services for GPON platforms.

Historically, Oi has used ATM protocol to transport digital signals through its access network from non-residential customers that require dedicated bandwidth to its switching stations. Oi's ATM networks have a fully-integrated management system and provide:

- frame relay data services (a data transmission service using fast protocols based on direct use of transmission lines) from 64 Kbps up to 2 Mbps;
- ATM data services supporting access rates from 2 Mbps to 622 Mbps; and
- aggregation network services for ADSL2+ platforms.

In response to changing customer needs, Oi is converting elements of its network that use ATM and SDH protocols, that permit it to offer dedicated bandwidth to its customers, to MPLS protocol, which supports IP and permits the creation of VPNs through Oi's Metro Ethernet networks.

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Oi has begun to use MPLS-TP capable devices that have been designed to interface with its existing Metro Ethernet network to increase the bandwidth of its networks to support its 4G network data traffic and replace its legacy SDH networks.

Transportation Networks

Oi's long-distance transportation network consists of optical fiber cable networks supporting high capacity Dense Wavelength Division Multiplex ("DWDM") systems that can operate with up to 80 channels at 10 and 40 Gbps. Oi is currently in the process of quadrupling the capacity of its backbone as a result of the deployment of 40 Gbps optical technology. In 2013, Oi is implementing DWDM links of 80 Gbps between Rio de Janeiro, São Paulo, Belo Horizonte and Salvador. Oi's optical cable network is complemented by microwave links that it uses in Region I and Region II. Oi has a nationwide long-distance backbone, consisting of an optical fiber network that connects the Federal District and the state capitals in Region I and Region II, other than Macapá (located in the State of Amapá) and is complemented by Oi's satellite system. Oi expects that its optical fiber network will reach Macapá in 2013. Most of the large urban areas of Region I and Region II are also connected by Oi's fiber optic cable networks. Oi's transmission infrastructure connects these digital switches to four international gateway switches: two in Rio de Janeiro, one in Curitiba and one in Brasília.

Oi employs automatic traffic protection to improve the reliability of its network and increase its traffic capacity. The network is fully supervised and operated by management systems that allow rapid response to customer service requests and reduce the recovery time in case of failures.

Oi operates an internet backbone network and a fully IP-routed network, which provides a backbone for all internet dedicated services and VPN offerings. Oi's internet backbone connects to the public internet via international links that it maintain abroad. With these international links, Oi does not need to rely on other companies to connect its outbound internet traffic with the internet backbones of international ISPs.

Oi has implemented an address control and name resolution system for its IP networks with the objective of optimizing resources and improving the availability of internet access services.

Oi's transportation network is directly interconnected to the national and international long-distance networks of all long-distance service providers and all mobile services providers operating in Region I, Region II and Region III.

Satellite Network

Oi has deployed an expanded range of satellite based services to comply with its public service obligations to the rural and remote areas of Brazil, including the Amazon rainforest region. These satellite services include internet access and access to corporate data applications. As of December 31, 2012, Oi's satellite network covered approximately 4,500 localities in 24 states and the Federal District and provided voice and data services to approximately 6.8 million customers.

In 2000, Brasil Telecom and TNL began the implementation of the land-based segment of their respective satellite networks in order to extend transmission to remote areas in the states of Acre, Paraná, Rondônia, Rio Grande do Sul, Santa Catarina, Pará, Amazonas, Amapá and Roraima, as well as to other areas with limited access to telecommunications services due to geographical conditions, such as Mato Grosso, Mato Grosso do Sul, Goiás and Tocantins. The satellite network comprises satellite earth stations located in less-populated rural areas, as well as hub stations in the cities of Brasília, Manaus, Boa Vista, Macapá, Belém, Santarém, Marabá, Rio de Janeiro, Curitiba, Porto Alegre, Florianópolis, Cuiabá, Porto Velho and Goiânia. These satellite networks use digital technology and began operating in August 2000. The fiber optic and satellite backbones are interconnected in Brasília, Belém, Fortaleza, Rio de Janeiro, Curitiba, Porto Alegre, Florianópolis, Cuiabá, Porto Velho and Goiânia. The integration of the land-based segment of Oi's satellite network allows it to service its subscribers in any location in Region I and Region II.

Hispamar Satellite S.A. ("Hispamar"), a Spanish-Brazilian consortium created in November 1999 by Hispasat (the leading satellite telecommunications provider in the Iberian Peninsula), and TNL operate the Amazonas 1 satellite, which was manufactured by Astrium (EADS Space Company). In December 2002, TNL entered into an agreement with Hispasat that granted and transferred to Hispamar the rights to exploit geostationary orbital position 61 degrees west, and TNL acquired a minority equity interest in Hispamar. The Amazonas 1 satellite was launched into geostationary orbit over the Americas and started to operate in November 2004. The Amazonas 1 satellite provides both C and Ku band transponders and on-board switching. The Amazonas 1 satellite is owned by a subsidiary of Hispasat, and Hispamar has been granted the right to operate and lease all of the transponder space on this satellite.

In 2009, the Amazonas 2 satellite was launched and this satellite commenced commercial operations in early 2010. The Amazonas 2 satellite was manufactured by Astrium and launched into geostationary orbit of 61 degrees West. This satellite provides both C and Ku band transponders and on-board switching, with an expected lifetime of 15 years. The Amazonas 2 satellite is owned by a subsidiary of Hispasat and Hispamar has been granted the right to operate and lease all of the transponder space on this satellite.

Oi leases transponders from:

- Hispamar with 754 MHz of capacity in the C band on the Amazonas 1 satellite and 540 MHz of capacity in the C band on the Amazonas 2 satellite to provide voice and data services through 653 remote switches covering 390 municipalities;

- Hispamar with 98.3 MHz of capacity in the Ku band on the Amazonas 1 satellite and 576 MHz of capacity in the Ku band on the Amazonas 2 satellite to provide voice and data services to approximately 3,028 localities;

- Intelsat Satellite with 122 MHz of capacity in the C band on the IS-805 satellite and 648 MHz of capacity in the C band on the IS 10-02 satellite to transport voice and data signals from Manaus to Rio de Janeiro;

- SES New Skies with 108 MHz of capacity in the K band on the SES-4 satellite to provide voice and data services; and

- Intelsat Satellite with 103 MHz of capacity in the C band on the IS-905 satellite to transport voice and data signals from Macapá to Rio de Janeiro and Boa Vista to Rio de Janeiro.

In 2005, Oi's predecessor Brasil Telecom and Telemar started to operate satellite platforms operating in the Ku band that are comprised of a satellite transport solution with Digital Video Broadcast-Return Channel Satellite ("DVB-RCS") technology and a next generation network ("NGN") control solution.

DTH Network

Oi provides its DTH services through a satellite uplink located in Lurin, Peru, which receives, encodes and transmits television signals to satellite transponders. Oi leases these facilities and licenses the related technology from Telefónica. Oi leases transponders for the delivery of television signals to its subscribers from Telefónica. Oi has leased 216 MHz of capacity in the Ku band on the Amazonas 1 satellite and 36 MHz of capacity in the Ku band on the Amazonas 2 satellite to provide DTH services. Oi's customers lease satellite dishes and set-top boxes from Oi as part of their subscriptions to its *Oi TV* services.

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HFC Network

Oi provides subscription analog and digital television services and broadband internet access to the residential and commercial markets in the cities of Belo Horizonte, Poços de Caldas, Uberlândia and Barbacena using an HFC network. The analog television signal is distributed from integrated headend equipment owned by Cemig Telecom that is located in these cities. The digital television signal is distributed to the HFC network in Belo Horizonte from Oi's integrated headend equipment located in Alvorada in the city of Rio de Janeiro.

Network Maintenance

Most of Oi's maintenance, installation and network servicing are performed by third-party service providers. For example, Oi has contracts with some well-known providers such as A.R.M. Engenharia for the maintenance of its external plant and equipment, and Alcatel-Lucent, Nokia Siemens Networks and Telemont, for the maintenance of Oi's internal plant and equipment. Oi also performs some of its ordinary course maintenance with Oi's own team of maintenance technicians, which also coordinates the planning and execution of maintenance services performed by third parties.

In July 2009, Oi and Telemar entered into a services agreement with Nokia Siemens Networks for installation, operation, and corrective and preventive maintenance in connection with their fixed line telecommunications services, mobile telecommunications services, data transmission services (including broadband access services), satellite services, buildings, access ways, and towers, in the States of Rio de Janeiro, Minas Gerais, Espírito Santo, São Paulo, Bahia, Sergipe, Pernambuco, Alagoas, Paraíba, Rio Grande do Norte, Ceará, Piauí, Maranhão, Pará, Amapá, Amazonas and Roraima. The total estimated payments under this contract are R$2.5 billion during the five-year term of this contract.

In November 2009, Oi and Telemar entered into a services agreement with Alcatel-Lucent to perform the same services in the States of Rio Grande do Sul, Santa Catarina, Paraná, Mato Grosso do Sul, Mato Grosso, Goiás, Tocantins, Acre, Rondônia and the Federal District, as well as Pegasus data transmission network equipment in the States of Paraná, Santa Catarina, Rio Grande do Sul, Goiás and the Federal District. The total estimated payments under this contract are R$1.2 billion during the five-year term of this contract.

In January 2012, Oi entered into a services agreement with Telemont for installation, operation, and corrective and preventive maintenance in connection with Oi's external plant and associated equipment, public telephones, and fiber optic and data communication networks (including broadband access services) in the State of Rio de Janeiro. The total estimated payments under this contract are expected to be R$2.6 billion during the five-year term of this contract.

In January 2012, Oi entered into a services agreement with Serede Serviços de Rede S/A for installation, operation, and corrective and preventive maintenance in connection with Oi's external plant and associated equipment, public telephones and fiber optic in the State of Rio de Janeiro. The total estimated payments under this contract are R$1.4 billion during the five-year term of this contract.

In October 2012, Oi entered into a services agreement with Telemont, which replaced and superseded an agreement that Oi had entered into with Telemont in March 2010, for installation, operation, and corrective and preventive maintenance in connection with Oi's external plant and associated equipment, public telephones, and fiber optic and data communication networks (including broadband access services) in the States of Minas Gerais, Espírito Santo, the Federal District, Mato Grosso, Mato Grosso do Sul, Tocantins, Acre, Rondônia and Goiás. The total estimated payments under this contract are expected to be R$3.9 billion during the five-year term of this contract.

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In October 2012, Oi entered into a services agreement with A.R.M. Engenharia, which replaced and superseded an agreement that Oi had entered into with A.R.M. Engenharia in July 2010, for installation, operation, and corrective and preventive maintenance in connection with Oi's external plant and associated equipment, public telephones, and fiber optic and data communication networks (including broadband access services) in the States of Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe, Bahia, Amazonas, Roraima, Pará, Amapá, Paraná, Santa Catarina and Rio Grande do Sul. The total estimated payments under this contract are R$6.2 billion during the five-year term of this contract.

Strategic Partnership with Oi

Background and History

On July 28, 2010, we reached an agreement with Telefónica to sell our 50% interest in Brasilcel N.V., a joint venture that held our interest in Vivo, to Telefónica. The sale was concluded on September 27, 2010. We reflect Vivo in our statements of income and cash flows for periods prior to September 27, 2010 as a discontinued operation. As of December 31, 2012, none of the assets or liabilities of Vivo are reflected on our statement of financial position.

On July 28, 2010, we also entered into a letter of intent with AG Telecom Participações S.A. ("AG Telecom") and LF Tel S.A. ("LF Tel"), companies that are part of the controlling group of Brasil Telecom, to establish the main terms that would serve as a framework for the negotiation of our strategic partnership with Oi.

On January 25, 2011, Portugal Telecom and our subsidiary Bratel Brasil S.A. ("Bratel") entered into agreements with TmarPart, AG Telecom, Luxemburgo Participações S.A. (a subsidiary of AG Telecom, that has since merged with and into AG Telecom and is referred to, together with AG Telecom, as "AG"), Andrade Gutierrez Telecomunicações Ltda. and Pasa Participações S.A., La Fonte Telecom S.A. (now known as Jereissati Telecom S.A., or "Jereissati Telecom"), LF Tel and EDSP75 Participações S.A., BNDES Participações S.A. ("BNDESPar"), Fundação Atlântico de Seguridade Social ("FASS"), Caixa de Previdência dos Funcionários do Banco do Brasil ("PREVI"), Fundação Petrobrás de Seguridade Social ("PETROS") and Fundação dos Economiários Federais ("FUNCEF") to implement the strategic partnership with the Oi Group.

On March 28, 2011:

- Bratel acquired from BNDESPar, PREVI, PETROS and FUNCEF an aggregate of 261,631,051 common shares issued by TmarPart, representing 9.6% of TmarPart's total outstanding common shares;

- Bratel acquired from Andrade Gutierrez Telecomunicações Ltda. and La Fonte Telecom S.A. a 35% interest in each of Pasa Participações S.A. and EDSP75 Participações S.A., respectively, holding companies that own 100% of the share capital of AG Telecom and LF Tel;

- TmarPart increased its share capital through the issuance of 186,664,449 common shares, in which transaction (1) Bratel subscribed for an aggregate of 91,225,537 common shares issued by TmarPart, representing 3.1% of TmarPart's total outstanding common shares, (2) AG Telecom and its subsidiary Luxemburgo Participações S.A. subscribed for an aggregate of 36,784,491 common shares issued by TmarPart, representing 1.3% of TmarPart's total outstanding common shares, (3) LF Tel subscribed for an aggregate of 36,784,491 common shares issued by TmarPart, representing 1.3% of TmarPart's total outstanding common shares, and (4) FASS subscribed for an aggregate of 21,869,930 common shares issued by TmarPart, representing 0.7% of TmarPart's total outstanding common shares;

TNL increased its share capital through the issuance of 56,417,086 common shares at an issue price of R$38.5462 per share and of 28,409,175 preferred shares at an issue price of R$28.2634 per share. The aggregate proceeds received by TNL from this capital increase amounted to R$2,978 million. In this capital increase, TmarPart and its wholly-owned subsidiary Valverde Participações S.A. subscribed for 56,061,772 common shares issued by TNL, and Bratel acquired from TmarPart an aggregate of 20,752,270 of those common shares and 28,298,549 preferred shares issued by TNL. Following this capital increase, TmarPart owned, and owns as of the date hereof, 22.2% of TNL's outstanding share capital, including 56.4% of its voting share capital, and Bratel owned, and owns as of the date hereof, an aggregate 10.5% of TNL's outstanding share capital, or 11.3% of its voting share capital; and

Telemar increased its share capital through the issuance of 46,969,121 common shares at an issue price of R$63.7038 per share and 58,696,856 class A preferred shares at an issue price of R$50.7010 per share. The aggregate proceeds received by Telemar from such capital increase amounted to R$5,969 million, of which R$4,624 million represented the subscription price for the shares issued by Telemar subscribed for by TNL. In this capital increase, TNL subscribed for 46,743,149 common shares issued by Telemar and 32,475,534 class A preferred shares issued by Telemar, and Bratel acquired those 32,475,534 class A preferred shares from TNL. Following this capital increase, TNL owned, and owns as of the date hereof, 70.4% of Telemar's total share capital, including 98.0% of its voting share capital, and Bratel owned, and owns as of the date hereof, an aggregate of 9.4% of Telemar's total share capital.

Following the consummation of the transactions described above, we held a 25.3% economic interest in Telemar on a consolidated basis. We held this interest through (1) an indirect 35% interest in AG Telecom, (2) an indirect 35% interest in LF Tel, (3) a 12.1% direct interest in TmarPart, (4) a 10.5% direct interest in TNL and (5) a 9.4% direct interest in Telemar. Given our economic interest and our rights to participate in the management of Oi as described below, since April 1, 2011, we have proportionally consolidated 25.6% of TmarPart in our consolidated financial statements, which, in turn, fully consolidates TNL and Telemar.

Prior to the Corporate Reorganization of the Oi Group, described below, Telemar owned 100% of the outstanding shares of Coari. TNL owned 98.0% of the common shares and 47.9% of the preferred shares of Telemar, representing 70.4% of the total share capital of Telemar. TmarPart owned 21.8% of the total share capital of TNL (22.2% of the outstanding share capital, without counting treasury shares), including 55.5% of the total common shares of TNL, and directly owned 3.8% of the total share capital of Telemar, including 6.9% of the total preferred shares of Telemar. Coari, in turn, owned 161,990,002, or 79.6%, of Brasil Telecom's Common Shares, 128,675,049, or 32.2%, of Brasil Telecom's preferred shares and 290,665,051, or 48.2%, of Brasil Telecom's total share capital.

Reorganization of the Oi Group

On May 24, 2011, TmarPart publicly announced a proposed corporate reorganization (the "Corporate Reorganization") of the Oi Group. The Corporate Reorganization was effectively completed on February 27, 2012 and consisted of the following steps:

a split-off and share exchange under Brazilian law in which (1) Telemar transferred the shares of Coari that Telemar owned to Coari, (2) Coari assumed a portion of the liabilities of Telemar, (3) the common and preferred shares of Telemar (other than the shares of holders who exercised their withdrawal rights with respect to such shares) would be exchanged for newly issued common and preferred shares of Coari upon the termination of the period for exercise of withdrawal rights, and (4) Coari retained the Telemar shares exchanged for Coari shares, and as a result, Telemar became a wholly owned subsidiary of Coari;

- the merger of Coari into Brasil Telecom, resulting in Coari ceasing to exist and Telemar becoming a wholly owned subsidiary of Brasil Telecom; and
- the merger of TNL into Brasil Telecom, resulting in TNL ceasing to exist.

In connection with the Corporate Reorganization, the following events took place:

- On February 24, 2012, TmarPart exchanged all of the class A preferred shares of Telemar that it owned for common shares of TNL held by Jereissati Telecom, Andrade Gutierrez S.A. ("Andrade Gutierrez"), the parent of AG Telecom, and Bratel Brasil, each a shareholder of TmarPart, in order to ensure that upon the completion of the Corporate Reorganization, TmarPart retained the voting control of Brasil Telecom in order to comply with the legal and regulatory obligations of TmarPart to ANATEL;
- Bratel exchanged preferred shares of Telemar for common shares of TNL (under the same terms and conditions of the TmarPart exchange described above) held by Jereissati Telecom, Andrade Gutierrez, AG and LF, which they received as a result of exchanging their preferred shares of TNL for preferred shares and common shares of Oi according to the exchange ratios; and
- Brasil Telecom issued and distributed redeemable shares of Brasil Telecom to holders of Brasil Telecom shares prior to the mergers of Coari and TNL into Brasil Telecom and redeemed those shares for cash immediately following their issuance. In addition, Brasil Telecom was renamed Oi S.A.

As a result of these transactions, TmarPart became the direct controlling shareholder of Oi S.A. The final settlement of the Corporate Reorganization occurred on April 9, 2012.

The Corporate Reorganization was undertaken to:

- simplify the corporate structure of the Oi Group, which was extremely complex and included three publicly-held companies with seven different classes of publicly-traded shares, and simplify the corporate governance of the Oi Group by consolidating the shareholder bases of the Oi Group in one public company with two classes of shares traded in Brazil and abroad;
- reduce operational, administrative and financial costs following the consolidation of the general management of the Oi Group, the simplification of their capital structure, and the improvement of their ability to attract investments and access the capital markets;
- align the interests of the shareholders of the Oi Group;
- enhance the liquidity of the shares of Oi S.A. (formerly Brasil Telecom); and
- eliminate the costs of separate listings of the shares of TNL, Telemar and Oi S.A., as well as those costs arising from separately complying with the public disclosure requirements applicable to TNL, Telemar and Brasil Telecom.

Following the Corporate Reorganization, we hold a 23.25% economic interest in Oi S.A., including a direct interest of 15.54%.

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Corporate Structure

We set forth below a simplified corporate chart of Oi before and after the Corporate Reorganization:

The purpose of our strategic partnership with 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 our 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.

In connection with this strategic partnership, it was contemplated that the Oi Group would use part of the proceeds received from share capital increases to acquire up to 10% of the outstanding ordinary shares of Portugal Telecom. On April 28, 2011, TmarPart, TNL and Telemar announced that they had acquired 62,755,860 ordinary shares of Portugal Telecom, representing 7.0% of Portugal Telecom's outstanding ordinary shares. On May 29, 2012, TmarPart, TNL and Telemar announced that they held 89,651,205 ordinary shares, representing 10.0% of our outstanding ordinary shares, and they continued to hold those shares as of December 31, 2012.

Corporate Governance

In connection with the formation of our strategic partnership with Oi, we entered into various shareholders' agreements with Oi's current shareholders in order to regulate corporate governance practices within Oi, establish the rules, procedures and quorums for the approval of certain matters by

Oi's board of directors, board of executive officers and within Oi's shareholder structure, rights of first offer or first refusal in the sale of Oi's shares by its shareholders, tag-along rights and other provisions, and these rights allow us to play an active role in Oi's corporate governance. For example, our shareholders' agreements contemplate, among other things, a lock-up period for Portugal Telecom, Andrade Gutierrez Telecomunicações Ltda. and Jereissati Telecom of five years with respect to their ownership interests in AG Telecom, Pasa Participações S.A., LF Tel, EDSP75 Participações S.A. and TmarPart, a right of first refusal over a non-control sale of AG Telecom and LF Tel and over any sale of TmarPart, and a right of first offer and tag-along rights in case of a control sale of AG Telecom and LF Tel and (2) the need for our approval on certain corporate governance matters, including: (i) amendments to bylaws, (ii) mergers and acquisitions and shareholders agreements, (iii) dissolution, (iv) capital increases or reductions, (v) issuances of debt securities above a specified ratio and (vi) the annual budget and investments.

In connection with the strategic partnership with Oi, on April 28, 2011, at TNL's annual general shareholders meeting, Zeinal Bava, the Chief Executive Officer of Portugal Telecom, and Shakhaf Wine, an executive board member of Portugal Telecom, both nominated by Portugal Telecom, were elected as members of the board of directors of TNL, as we had announced on April 6, 2011. In addition, Mr. Bava was appointed a member of the board of directors of TmarPart, and Mr. Wine was appointed an alternate member of the board of directors of TmarPart.

After the Corporate Reorganization of Oi, Zeinal Bava and Shakhaf Wine were elected to serve on that board at the Oi S.A. shareholders meeting on April 30, 2012.

In addition, on April 6, 2011, Otávio Marques de Azevedo, then the Chairman of TmarPart and a member of the board of directors of TNL, and Pedro Jereissati, Chief Executive Officer, Investor Relations Officer and a member of the board of directors of TmarPart, were appointed to our board of directors and their appointment was ratified at Portugal Telecom's general meeting of shareholders held on May 6, 2011.

On October 25, 2012, Fernando Magalhães Portella, a member of the board of directors of Oi S.A., was appointed to our board of directors to replace Pedro Jereissati, who submitted his resignation on the same day. Otávio Marques de Azevedo continues to serve on our board, though he is no longer a member of the board of Oi S.A.

Our shareholder agreements in connection with our strategic partnership with Oi are described in more detail below.

Overview of TmarPart Shareholders' Agreements

On April 25, 2008, TmarPart's shareholders entered into two shareholders' agreements. The shareholders' agreement among AG Telecom, LF Tel, Asseca Participações S.A. ("Asseca"), BNDESPar, Fiago and FASS as parties, having TmarPart, PREVI, PETROS, FUNCEF and Andrade Gutierrez Investimentos em Telecomunicações S.A. as intervening parties, is referred to as the "Global Shareholders' Agreement." The shareholders' agreement among AG Telecom, LF Tel, Asseca and FASS as parties, having TmarPart and Andrade Gutierrez Investimentos em Telecomunicações S.A. as intervening parties, is referred as the "Control Group Shareholders' Agreement."

On June 20, 2008, Asseca assigned its 352,730,590 common shares of TmarPart to LF Tel and Andrade Gutierrez Investimentos em Telecomunicações S.A., which merged with and into AG Telecom (later Luxemburgo Participações S.A.). As a result, Asseca ceased to be a TmarPart shareholder and to have any rights under the Global Shareholders' Agreement or the Control Group Shareholders' Agreement.

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In July 2009, Fiago assigned TmarPart shares it held to PREVI, PETROS, FUNCEF and FASS. As a result of such transaction, Fiago ceased to be a TmarPart shareholder and to have any rights under the Global Shareholders' Agreement.

On January 25, 2011, TmarPart's shareholders amended the Global Shareholders' Agreement and the Control Group Shareholders' Agreement, both effective as of March 28, 2011, to reflect our acquisition, through Bratel, of voting shares of TmarPart and to modify certain clauses of the Global Shareholders' Agreement and the Control Group Shareholders' Agreement, including increasing the quorum requirements to hold pre-meetings and approve certain designated matters. AG, BNDESPar, PREVI, FASS, FUNCEF, PETROS, LF Tel and Bratel are parties to the amendment to the Global Shareholders' Agreement, while TmarPart and Portugal Telecom executed the amendment as intervening parties. AG Telecom, Luxemburgo, LF Tel and FASS are parties to the amendment to the Control Group Shareholders' Agreement, while TmarPart executed such an amendment as intervening party.

Global Shareholders' Agreement

The initial term of the Global Shareholders' Agreement expires on the later of April 25, 2048 or the expiration date of the last to expire of the concessions or authorizations held by TmarPart or its subsidiaries (including any renewals thereto). The term of the Global Shareholders' Agreement may be extended for successive periods of 10 years with the consent of each of the parties thereto.

The parties to the Global Shareholders' Agreement have agreed to the following provisions with respect to elections of members of the boards of directors and executive officers, and the voting of their shares of TmarPart, TNL, Telemar, Brasil Telecom and each of TmarPart's, TNL's or Telemar's material subsidiaries (*i.e.*, subsidiaries having annual net operating revenues equal to or in excess of R$100 million):

- AG, LF Tel, and FASS will together have the right to designate a majority of the members of the board of directors of TmarPart and of each of the material subsidiaries;

- each increment of 7% of the voting share capital of TmarPart held by each party to the Global Shareholders' Agreement will entitle that party to designate one member of the board of directors of TmarPart and each of the material subsidiaries and his or her alternate;

- so long as we hold at least 7% of the voting share capital of TmarPart, we will be entitled to designate one member and the respective alternate of the board of directors of TmarPart, such appointees to be designated from the directors and executive officers of Portugal Telecom;

- PREVI, PETROS, FUNCEF and BNDESPar are entitled to aggregate their shares to determine their eligibility to exercise the rights described above;

- Bratel, PREVI, PETROS, FUNCEF and BNDESPar each have the right to designate one member of the board of directors of any other subsidiary, provided that AG, LF Tel and FASS have designated members of such board of directors;

- AG, LF Tel, BNDESPar, FASS, PREVI, PETROS, FUNCEF and we, through Bratel, will together select the chief executive officers of each of the material subsidiaries pursuant to the rules outlined in the Global Shareholders' Agreement;

- the chief executive officer of TNL will select the members of TNL's board of executive officers;

- the chief executive officer of TNL, together with the chief executive officer of each of the other material subsidiaries, will select the other executive officers of such material subsidiary;

- BNDESPar, PREVI, PETROS and FUNCEF, jointly, have the right to designate one member to the fiscal council of each of the material subsidiaries;

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AG, Luxemburgo, LF Tel, BNDESPar, FASS, PREVI, FUNCEF, PETROS and we, through Bratel, will hold pre-meetings prior to shareholders' and board of directors meetings of the material subsidiaries and will vote our TmarPart shares and instruct our representatives on the boards of directors of the material subsidiaries to vote in accordance with the decisions made at pre-meetings; and

that approval of certain matters be subject to the supermajority vote of the shareholders (for instance, among other things, approval of changes to the bylaws of TmarPart or to the bylaws of any of its material subsidiaries, approval of donation policies, approval of investments of any kind not specifically foreseen in the budgets in excess of R$50 million and certain other matters are subject to a 75% majority; approval of, and amendments to, the annual budget of TmarPart and its material subsidiaries, capital reduction or increases, the issue of securities, proposals to pay or distribute dividends or interest on shareholders' equity in amounts below 25% of the net income, selection of auditors and certain other matters are subject to a 77% majority; sale or creation of any liens on the shares issued by the material subsidiaries, or the issue of convertible securities, the adoption of any procedure that would cause TmarPart to lose control of the material subsidiaries, any merger or spin-off transaction involving TmarPart or any of its material subsidiaries and certain other matters are subject to a 87.4% majority).

Under the Global Shareholders' Agreement, each of the shareholders party to it has agreed:

not to enter into other shareholders' agreements with respect to its TmarPart shares, other than (1) the Global Shareholders' Agreement, (2) the Control Group Shareholders' Agreement and (3) the shareholders' agreement entered into among Bratel, Andrade Gutierrez Telecomunicações Ltda. and Jereissati Telecom;

not to amend the Global Shareholders' Agreement, the Control Group Shareholders' Agreement or the shareholders' agreement entered into among Bratel, Andrade Gutierrez Telecomunicações Ltda. and Jereissati Telecom without the consent of all parties to the Global Shareholders' Agreement;

to grant a right of first refusal and tag-along rights to the other parties to the Global Shareholders' Agreement with respect to any sale of its TmarPart shares, except that FASS must grant the right of first refusal for its TmarPart shares to AG and LF Tel, (ii) any sale of TmarPart shares among PREVI, PETROS and FUNCEP is not subject to the right of first refusal and (iii) PREVI, PETROS and FUNCEF must grant the right of first refusal for their TmarPart shares to BNDESPar;

that the other parties to the Global Shareholders' Agreement have the right to sell, and Bratel has the obligation to buy, up to all of the other parties' shares of TmarPart in the event that Bratel acquires control of TmarPart;

to offer its TmarPart shares to the other parties to the Global Shareholders' Agreement in the event of a transfer of control of such shareholder, including, without limitation, in the event that Bratel acquires control of AG or LF Tel;

that the other shareholders have the right to purchase all of Bratel's TmarPart shares in the event of a change of control of Portugal Telecom; and

Oi will use part of the proceeds received from our investment in Oi to acquire up to 10% of the outstanding shares of Portugal Telecom. Based on the most recent information available to us, the Oi Group currently holds 10% of our outstanding shares.

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Control Group Shareholders' Agreement

The initial term of the Control Group Shareholders' Agreement expires on April 25, 2048 and may be extended for successive periods of 10 years with the consent of each of the parties thereto.

Under the Control Group Shareholders' Agreement, each of the parties has agreed:

- to hold pre-meetings between themselves prior to the pre-meetings to be held pursuant to the Global Shareholders' Agreement and to vote their TmarPart shares in accordance with the decisions made at such pre-meetings;

- that any TmarPart shares sold by a party to the Control Group Shareholders' Agreement to any other party to this agreement will remain subject to this agreement; and

- that if a party to the Control Group Shareholders' Agreement sells all or part of its TmarPart shares to another party or to a third party, the purchaser(s) and the selling party, as the case may be, will be considered one voting block for the purposes of the Control Group Shareholders' Agreement (even if the purchaser(s) is/are already a party to the agreement) and that such voting block will hold pre-meetings prior to the meetings of the parties to the Control Group Shareholders' Agreement.

PASA Participações S.A. and EDSP75 Participações S.A. Shareholders' Agreements

Part of the structure we used in order to obtain our interest in Oi was to acquire an indirect 35% interest in AG Telecom and in LF Tel, through a direct investment in PASA Participações S.A. and EDSP75 Participações S.A., respectively. We have a 35% direct economic interest in PASA Participações S.A., and the remaining 65% economic interest in the company is held by Andrade Gutierrez Telecomunicações Ltda. Likewise, we have a 35% direct economic interest in EDSP75 Participações S.A., and the remaining 65% economic interest in the company is held by Jereissati Telecom. AG Telecom is wholly owned by PASA Participações S.A., and LF Tel is wholly owned by EDSP75 Participações S.A.

In connection with our investments in PASA Participações S.A. and EDSP75 Participações S.A., on January 25, 2011, we entered into two shareholders' agreements, one with Andrade Gutierrez Telecomunicações Ltda. (in relation to PASA Participações S.A.) and another with Jereissati Telecom (in relation to EDSP75 Participações S.A.). The initial terms of these shareholders' agreements expire on April 25, 2048 but may be extended for successive periods of 10 years with the consent of each of the parties.

These shareholders' agreements serve the purpose of regulating corporate governance within PASA Participações S.A. and EDSP75 Participações S.A. and streamlining decision-making process between us, Andrade Gutierrez Telecomunicações Ltda. and Jereissati Telecom in connection with our investments in Oi. For instance, under these shareholders' agreements:

- pre-meetings are to be held between the shareholders to decide in advance the matters to be analyzed during pre-meetings to be held under the Global Shareholders' Agreement and the Control Group Shareholders' Agreement; and

- approval of certain matters are subject supermajority vote of the shareholders (*e.g*, approval of, and amendments to, the annual budget of PASA Participações S.A., EDSP75 Participações S.A., AG and LF Tel are subject to an 83% majority; the entering by PASA Participações S.A., EDSP75 Participações S.A., AG or LF Tel itno any loan agreements in excess of R$50 million, or the entering of any agreement imposing a pecuniary obligation on PASA Participações S.A., EDSP75 Participações S.A., AG or LF Tel in excess of R$50 million, or the granting of any guarantees by PASA Participações S.A., EDSP75 Participações S.A., AG or LF Tel in excess of R$50 million, are subject to a 90% majority; and any amendments to the Global Shareholders'

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Agreement or the issuance of preferred shares by PASA Participações S.A., EDSP75 Participações S.A., AG or LF Tel, the approval of any decision subject to supermajority vote under the Global Shareholders' Agreement (defined as a "material decision" under the PASA Participações S.A. and EDSP75 Participações S.A. shareholders' agreements), among other matters, are subject to the unanimous vote of the shareholders).

In addition, as long as we hold at least 17% of the voting and total share capital of each of PASA Participações S.A. and EDSP75 Participações S.A., we have the right to appoint one member to the board of executive officers of each of these companies. On the other hand, reduction in our interest in PASA Participações S.A. or EDSP75 Participações S.A. may change some of our rights under these agreements and in connection with the Global Shareholders' Agreement. For example, should our interest in PASA Participações S.A. or EDSP75 Participações S.A. be reduced to less than 20.5% of the voting share capital of either of these companies, approval of certain "material decisions," as defined in the preceding paragraph, subject to a 75% majority vote under the Global Shareholders' Agreement (for instance, approval of changes to the bylaws of TmarPart) would no longer require our consent.

These shareholders' agreements also contemplate:

- rights of first offer to the shareholders with respect to the transfer of the shares issued by PASA Participações S.A. and EDSP75 Participações S.A.;

- tag-along rights for our benefit in case of the sale of PASA Participações S.A. and EDSP75 Participações S.A. shares by Andrade Gutierrez Telecomunicações Ltda. or Jereissati Telecom, as the case may be;

- a general restriction on the sale of the shares issued by PASA Participações S.A. and EDSP75 Participações S.A. by Andrade Gutierrez Telecomunicações Ltda. or Jereissati Telecom, as the case may be, to our competitors; and

- a general right to PREVI, PETROS, FUNCEF and BNDESPAR, while they remain shareholders of TmarPart, or to any third parties which may acquire the shares held by these companies in TmarPart, to substitute Andrade Gutierrez Telecomunicações Ltda. or Jereissati Telecom in the exercise of their preemptive rights under the PASA Participações S.A. and EDSP75 Participações S.A. shareholders' agreements in case we decide to sell our shares in PASA Participações S.A. and/or EDSP75 Participações S.A.

BNDESPar, PREVI, PETROS and FUNCEF Shareholders' Agreement

On January 25, 2011, PREVI, PETROS, FUNCEF, BNDESPAR, Andrade Gutierrez Telecomunicações Ltda. and Jereissati Telecom entered into a voting bloc shareholders' agreement. The purpose of this shareholders' agreement is to regulate the exercise of voting rights with respect to, and general governance in connection with, PASA Participações S.A. and/or EDSP75 Participações S.A. in case of the sale of our interest in PASA Participações S.A. and/or EDSP75 Participações S.A. and the acquisition of such interest by any of PREVI, PETROS, FUNCEF or BNDESPAR, in which circumstance the purchaser, or purchasers, of our interest in PASA Participações S.A. and/or EDSP75 Participações S.A. will be deemed to be a single bloc and will succeed us in all our rights and obligations. We are not party to this shareholders' agreement, and no obligation or right is imposed or conferred upon us.

Other International Operations

Concurrently with our investment in Oi, we acquired an interest in Contax, which provides contact center services, IT services and BPO services in Brazil and other Latin American countries. In addition, we have significant interests in telecommunications companies in Angola, Cape Verde, Namibia and São Tomé and Principe in Africa and in Macau and East Timor in Asia. We describe these investments in more detail below.

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Our subsidiary Portugal Telecom Investimentos Internacionais Consultoria Internacional, S.A. manages all of our international businesses other than our investments in Oi and Contax.

Other Brazilian Operations

Brazilian Contact Center Operations

Concurrently with our investment in Oi, we acquired a 16.2% economic interest in CTX Participações S.A. ("CTX"), the controlling shareholder of Contax Participações S.A. ("Contax Participações") and Contax S.A. ("Contax"). Even before our investment in Contax, we provided call center services in Brazil through our subsidiary Dedic, S.A. ("Dedic"), and Dedic's subsidiary GPTI Tecnologias de Informação, S.A. ("GPTI") provided IT/IS services in Brazil. On June 30, 2011, we merged Dedic and GPTI into Contax, and our economic interest in Contax increased to 19.5%. On April 2, 2013, in connection with Contax's corporate reorganization, we increased our economic interest in Contax to 21.1%. We have proportionally consolidated the results of operations of Contax in our results of operations since April 1, 2011, and Contax's results of operations have included the results of operations of Dedic and GPTI since July 1, 2011. The impact of the proportional consolidation of Contax for the year ended December 31, 2012 and the nine months between April 1 and December 31, 2011 (including Dedic and GPTI from July 1, 2011) was €477.3 million (R$1,197.3 million) and €358.8 million (R$834.8 million), respectively.

Dedic and GPTI had consolidated revenues of R$311.5 million (€133.9 million) from January 1, 2011 through June 30, 2011, the period before they merged with Contax. Dedic's revenues were R$479.4 million in 2010 (€205.6 million) and R$402.3 million in 2009 (€145.2 million), and GPTI's operating revenues were R$133 million in 2010 (€56.9 million).

In April 2011, Contax acquired 100% of Allus Global BPO Center ("Allus") for R$245 million. Consequently, the results of Contax include the results of Allus as from May 1, 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 a global BPO (Business Process Outsourcing) provider, dedicated to supporting its clients throughout their customer relationship chain.

Strategic Partnership with Contax

AG and LF Tel, two of the significant shareholders of TmarPart, are also the controlling shareholders of CTX, the parent company of Contax Participações and Contax. In connection with the Oi transaction, we agreed to merge Dedic and GPTI with Contax in return for common and preferred shares of Contax. In this transaction, we acquired a 16.2% interest of CTX for consideration of R$116 million. Following the exchange of our interest in Dedic and GPTI for an additional economic interest in Contax, we raised our interest in CTX to 19.9% through the contribution of a portion of the Contax preferred shares we had through this exchange. Also in connection with this transaction, we received net cash of approximately R$162 million from the reimbursement by Contax of shareholder loans we had granted to Dedic prior to this transaction.

Following the merger of Dedic and GPTI with Contax, we held a 19.5% economic interest in Contax through a 44.4% direct and indirect interest in CTX, which held 34.0% of Contax, and a 4.3% direct economic interest in Contax. Our direct economic interest in Contax consisted of 7.0% of Contax's outstanding preferred shares.

On April 2, 2013, Contax undertook a corporate reorganization in connection with its migration to Level 2 Corporate Governance of the BM&FBOVESPA. In the corporate reorganization, CTX's shareholders, including Portugal Telecom, received a premium in shares of 25% of common shares held by them, and Contax absorbed CTX's total indebtedness. As a consequence of the corporate reorganization, we hold (1) a 21.1% economic interest in Contax through a 44.4% direct and indirect interest in CTX, which holds 27.5% of Contax, (2) a 35% direct stake in holdings AG and LF which each hold 3.9% in Contax and (3) a 6.2% direct economic interest in Contax.

In connection with our initial investment in CTX and Contax, on January 25, 2011, we entered into a shareholders' agreement with the other CTX shareholders, that is, AG Telecom, Luxemburgo, LF Tel and FASS through our subsidiary Portugal Telecom Brasil S.A., effective as of March 28, 2011 and amended on March 11, 2013 in connection with Contax's corporate reorganization (the "Contax and CTX Shareholders' Agreement"). AG Telecom, Luxemburgo, LF Tel, FASS and Portugal Telecom Brasil S.A. are parties to the Contax and CTX Shareholders' Agreement, while CTX, Portugal Telecom, Andrade Gutierrez Telecomunicações Ltda., PASA Participações S.A., La Fonte Telecom S.A. (now known as Jereissati Telecom S.A.) and EDSP75 Participações S.A. are intervening parties in the Contax and CTX Shareholders' Agreement.

Under the Contax and CTX Shareholders' Agreement, we have similar rights to those contained in the Global Shareholders' Agreement and the other shareholders' agreements described above under " *Brazilian Operations (Oi) Strategic Partnership with Oi*," and, accordingly:

- pre-meetings are to be held among the shareholders to decide in advance the matters to be voted during any shareholders' or board of directors' meetings and the decisions taken during such pre-meetings shall be binding upon the shareholders and their representatives; and

- approval of certain matters are subject to a supermajority vote of the shareholders (for instance, approval of amendments to CTX's bylaws, of the execution of any agreements with Telemar and certain other matters are subject to a 66.67% majority; approval of CTX's annual budget and the investment plans of CTX and its subsidiaries, among other matters, are subject to a 70% majority; approval of the sale of the shares issued by CTX's subsidiaries and of any merger, spin-off, or initial public offering involving CTX, among other matters, are subject to an 84% majority).

In addition, (i) as long as we hold at least 10% of CTX's voting share capital, we have the right to appoint two members to the board of directors of both CTX and Contax Participações; (ii) as long as we hold at least 5% of CTX's voting share capital, we have the right to appoint one member to the board of directors of both CTX and Contax Participações; (iii) as long as we hold at least 11% of CTX's voting share capital, we have the right to appoint one member to the board of executive officers of CTX. Also, under the Contax and CTX Shareholders' Agreement, we have the right to veto one among three of the nominees appointed by AG Telecom, Luxemburgo, LF Tel and FASS to the position of chief executive officer of Contax.

The Contax and CTX Shareholders' Agreement also contemplates preemptive rights to the shareholders with respect to the transfer of CTX's shares and tag-along rights in case of the sale of CTX's shares by its shareholders. More importantly, however, (i) the corporate control in any of CTX's shareholders may not be transferred without such shareholder first offering its CTX's shares to the other CTX shareholders in accordance with the procedures contained in the Contax and Shareholders' Agreement concerning the rights of first offer; and (ii) should we cease to be a TmarPart shareholder, our interest in CTX may be redeemed or exchanged in accordance with the procedures established in the Contax and CTX Shareholders' Agreement.

The first term of the Contax and CTX Shareholders' Agreement expires on March 11, 2053 or if and when Contax Participaçoes migrates to the highest level of BM&FBOVESPA's levels of corporate governance, the New Market (*Novo Mercado*), whichever happens first. The term of the Contax and CTX Shareholders' Agreement may be extended for successive periods of 10 years with the consent of each of the parties thereto.

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Assets in Africa and Asia

The table below provides the highlights of our main assets in Africa and Asia as of December 31, 2012.

	Portugal Telecom Direct Interest	Revenue in Local Currency (millions)(1)	Margin	Revenue in EUR (millions)(1)
Unitel, Angola(2)(4)	25.00%	2,043	58.1%	1,590
MTC, Namibia(3)(4)	34.00%	1,901	47.5%	180
Cabo Verde Telecom, Cape Verde(3)(4)	40.00%	8,336	49.4%	76
CST, S. Tome & Principe(3)(4)	51.00%	293,723	24.9%	12
CTM, Macau(2)	28.00%	4,922	27.6%	480
Timor Telecom, East Timor(3)	41.12%	75	55.8%	58

(1) Figures account for 100% of the company. We have management contracts with CVT, CST and Timor Telecom.

(2) Equity consolidation method.

(3) Full consolidation method.

(4) These interests are held by Africatel, which is 75% controlled by us.

Africatel Holding Company

We have several investments in Africa, including investments in Angola, Cape Verde Islands and Namibia. In 2007, we established a strategic partnership with Helios Investors LP ("Helios"), a private equity firm operating in sub-Saharan Africa. Under the terms of the agreement, Helios acquired a 22% interest in Africatel, the holding company formed to hold all of our interests in sub-Saharan Africa and whose main assets are Unitel, Cabo Verde Telecom, MTC and CST. In 2008, Helios increased its interest in Africatel to 25%. Our interest in the individual companies described below reflects the percentage of capital of those companies owned by Africatel.

Unitel, Angola

In 2000, we acquired 25% of the share capital of Unitel, a GSM mobile operator in Angola. Unitel's other shareholders are Sonangol, which holds 25%, and other local partners, which hold the remaining 50%. Unitel began operations in Luanda in 2001. Because of the 25% interest in our subsidiary Africatel held by Helios, we have an economic interest of 18.75% in Unitel.

As of December 31, 2012, Unitel had 8,980 thousand subscribers, of which 98.6% were holders of prepaid cards. During 2012, Unitel had 1,526 net additions, with subscriber growth occurring both in Luanda, the capital of Angola, and in other districts.

Services. Unitel provides services in the following customer segments:

- *Personal services*, which are mobile telecommunications services, such as voice, data and Internet-related multimedia services provided to personal (*i.e.*, individual) customers.

- *Enterprise services, including Corporate and SME/SoHo services*, which are services provided to corporate and medium and small business customers, to whom Unitel offers integrated data and business solutions.

Residential services, which include integrated networks inside the customers' homes, enabling the simultaneous connection of multiple devices, including fixed line telephones, PCs, tablets and smartphones.

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- *Wholesale and other services*, which primarily include wholesale telecommunications services.

During 2012, Unitel launched several initiatives, including successful marketing campaigns aimed at promoting voice usage and increasing penetration of the market for mobile broadband services. Unitel's marketing campaigns and offerings included:

- several smartphone campaigns, with specific pricing plans, including internet use;
- a wide range of handset choices for different categories of customers;
- wifi routers, dongles, PCs and tablets;
- voice stimulation campaigns, offering free calls during some hours of the day;
- recharge campaigns, offering incentives to customers who recharge their prepaid cards;
- expansion of voice and data roaming agreements;
- campaigns permitting customers to transfer recharges of prepaid cards among Unitel subscribers;
- the launch of 4G services in Luanda in December 2012; and
- the enlargement of Unitel's portfolio of enterprise services.

Unitel also launched several initiatives aimed at strengthening both its direct and indirect distribution channels, increasing both its capillarity and efficiency. Unitel also developed institutional advertising of its different services, focusing on its functionalities and advantages.

Network. During 2012, Unitel continued its investments to expand its fiber optic network, both in Luanda, in other large Angolan cities and between them. Unitel also made investments in its 2G and 3G networks in order to improve its coverage and capacity, aiming to address the telecommunications needs of a larger number of customers and to improve the quality of its services. At the end of the year, Unitel launched 4G services in Luanda.

Competition. Unitel is the market leader in Angolan mobile market. Movicel, the other mobile operator, also launched several marketing initiatives during 2012, including smartphone campaigns, new pricing plans for SMEs and campaigns to permit customers to transfer recharges among Movicel subscribers. We expect that a third mobile license may be awarded in the future.

Financial results. Unitel's total gross operating revenues were US$2,043.0 million in 2012 (€1,590.1 million), US$1,784.0 million in 2011 (€1,281.8 million) and US$1,502.0 million in 2010 (€1,132.8 million). Revenues increased in 2012 and 2011 primarily because of continuing growth in prepaid traffic.

Unitel's costs were US$1,067.8 million (€831.1 million) in 2012, US$985.6 million (€708.0 million) in 2011 and US$815.3 million (€614.9 million) in 2010. Unitel's income before taxes was US$964.5 million (€750.7 million) in 2012, US$867.0 million in 2011 (€622.8 million) and US$773.5 million in 2010 (€583.4 million). Unitel's costs generally rose in line with its revenues. Over time, as Unitel expands into more remote areas of Angola, its costs are expected to increase and lead to a decrease in its margins, but Unitel expects to continue to record strong margins in the near future. Through the end of 2012, Unitel was not subject to corporate income taxes in Angola, and, consequently, its net income equaled its income before taxes. In 2013, it is expected that Unitel will begin paying corporate income taxes.

Dividends. In 2012, we received dividends of €49.9 million from Unitel, compared to €125.9 million in 2011 and €44.1 million in 2010. The dividends we received in 2012 relate to Unitel's 2010 earnings, and the dividends we received in 2011 and 2010 relate to Unitel's 2009 earnings and a portion of its 2008 earnings, respectively.

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For more information about our investment in Unitel, see Notes 33, 47(h) and 48(a) to our audited consolidated financial statements.

Other African Investments

Cabo Verde Telecom, Cape Verde. Africatel owns 40% of the share capital of Cabo Verde Telecom. Cabo Verde Telecom provides fixed and mobile services in the Cabo Verde Islands.

As of December 31, 2012, Cabo Verde Telecom had 70.2 thousand fixed lines in service, which represents approximately 15.6 fixed main lines per 100 inhabitants. Cabo Verde Telecom had 322.4 thousand active mobile telephone cards as of December 31, 2012, of which 98.5% were prepaid customers.

Cabo Verde Telecom's total gross operating revenues were €75.6 million in 2012, €83.7 million in 2011 and €84.0 million in 2010. Revenues in 2012 were primarily impacted by the the international accounting rule IFRIC 12.

During 2012, CVT launched several commercial offers, both in mobile and fixed, aimed at promoting usage and customer loyalty, including: (1) new broadband offers based on 3G services; (2) Powa Swag youngesters pricing plan; (3) Grilo ao Segundo new all net pricing plan, and (4) international vouchers. Broadband and IPTV customers, represent 27.8% and 9.8% of the fixed line customer base, respectively.

MTC, Namibia. In 2006, we acquired 34% of the capital of MTC, a Namibian mobile operator. In connection with this transaction, we entered into an agreement with the other shareholders of MTC that allows us to set and control the financial and operating policies of this company. As of December 31, 2012, MTC had 2,146,8 thousand customers, of which 94.3% were customers under prepaid plans. MTC's revenues were 1,901 million Namibian dollars (€180.2 million) in 2012, 1,608.3 million Namibian dollars (€159.3 million) in 2011 and1,444.0 million Namibian dollars (€148.9 million) in 2010.

In 2012, MTC focused its marketing efforts and commercial activity on: (1) launching 4G services; (2) developing campaigns aimed at promoting usage, and (3) boosting growth of broadband customers, under the brand Netman. MTC's higher capital expenditures in 2012 reflected investments in the African submarine cable, optical fiber and 4G which should translate into future growth.

CST, São Tomé and Principe. Africatel owns 51.0% of the share capital of CST-Companhia Santomense de Telecomunicações, S.A.R.L. ("CST"), which provides fixed and mobile services in São Tomé and Principe.: As of December 31, 2012, CST had 122.2.0 thousand mobile customers. CST's revenues were €12.0 million in 2012, €11.9 million in 2011 and €12.7 million in 2010.

Asia

We have investments in Asia in CTM and in Timor Telecom.

CTM, Macau. We have a 28% interest in CTM, a provider of fixed and mobile telephone services in Macau. Macau, situated near Hong Kong on the coast of Guangzhou Province, China, was a territory administered by the Portuguese government until December 1999, when it was transferred to the People's Republic of China. The other shareholders of CTM are Cable & Wireless Communications Plc (CWC), whose 51% controlling stake is held through its wholly-owned subsidiary Sable Holding Limited ("Sable"), CITIC Telecom with 20% stake and Direcção dos Serviços de Correios e Telecomunicações de Macau with a 1% stake.

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As of December 31, 2012, CTM had 172.1 thousand fixed main lines in service. This figure represents approximately 29.6 fixed main lines per 100 inhabitants. CTM's mobile telephone services had 746.0 thousand customers as of December 31, 2011.

CTM's total gross operating revenues were 4,922.2 million Patacas (€479.5 million) in 2012, 3,978.9 million Patacas (€356.5 million) in 2011 and 2,760.2 million Patacas (€260.1 million) in 2010. Revenue growth in 2012 was mainly driven by an increase in equipment sales. Mobile service revenues increased by 10.0% in 2012, as compared to 2011, mainly impacted by growth in data revenues, which accounted 26.1% of mobile service revenues. In 2011, CTM launched several marketing campaigns aimed at increasing penetration of smartphones and wireless broadband.

In January 2013, we announced entering into a definitive agreement for the sale of our minority equity stake in CTM, representing 28% of CTM's share capital, to CITIC Telecom. Under this agreement, we expect to receive total proceeds of US$411.6 million, subject to certain adjustments, on a cash-free and debt-free basis and assuming a normal level of working capital. The transaction has been approved by our Board of Directors and is conditioned upon the satisfaction of certain conditions, including the successful completion of the transfer to CITIC Telecom of an equity stake representing 51% of the share capital of CTM held by Sable and the approval of both transactions by the Government of Macau and by the relevant governmental and regulatory authorities in the People's Republic of China.

CITIC Telecom and Portugal Telecom also entered into a strategic alliance agreement to capitalize on their expertise in the telecom sector and in the identification of ICT investment opportunities in order to create value for their respective shareholders. Pursuant to this strategic alliance agreement, CITC Telecom will select us as the CITIC Telecom Group?s strategic ICT service provider.

Timor Telecom, East Timor. We have a 41.12% interest in Timor Telecom, S.A. ("Timor Telecom"), a telecommunications provider for fixed and mobile services in East Timor. As of December 31, 2012, Timor Telecom had a total mobile customer base of 628.8 thousand and 3.3 thousand fixed lines.] Timor Telecom's revenues were US$74.6 million in 2012 (€58.1 million), US$66.4 million in 2011 (€47.7 million) and US$57.2 million in 2010 (€43.2 million). In 2012, data revenues accounted for 16.8% of mobile service revenues.

In 2012, Timor Telecom launched new pricing plans with more competitive tariffs and experienced positive results in usage levels and revenue generation. Timor Telecom also strengthened its distribution network in 2012.

Shared Services Companies

PT SI. PT Sistemas de Informação, S.A. ("PT SI") is the group unit responsible for data centers, information systems and information technology activities of our business units in Portugal. PT SI provides integrated information systems and information technology services to our business units in Portugal, as well as to our existing and new customers. We hold 100% of the share capital of PT SI.

PT Inovação. PT Inovação is our unit responsible for research and development activities. Our research and development programs focus on intelligent networks, network management systems, advanced services and systems and network integration and have led to the introduction of innovative products and services. PT Inovação's activities have been a driving force behind the development of new products and services, telecommunications infrastructure and information systems.

PT Contact. PT Contact is the group unit responsible for call center operations in Portugal. PT Contact takes advantage of economies of scale and process alignments to reduce costs in our call center operations.

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PT Pro. PT Pro aggregates all our back-office activities in Portugal. PT Pro takes advantage of economies of scale and process alignments throughout our group to reduce costs in back-office activities. The creation of PT Pro has also allowed for a reduction of the execution risk of our financial reporting function through standardization of processes and implementation of best practices.

PT Compras. PT Compras optimizes our purchasing function on an integrated basis, taking advantage of scale and specialization.

For a list of our significant subsidiaries, see Exhibit 8.1 to this annual report, which is incorporated herein by reference. For further details on our percentage interest in our subsidiaries and their business activities, see the exhibits to our audited consolidated financial statements.

Properties

Our principal properties consist of buildings and telecommunications installations. These include various sizes of exchanges, transmission equipment, cable networks, base stations for mobile networks, equipment for radio communications and a nationwide network of ducts. They are located throughout Portugal and internationally.

Following the transfer to the Portuguese Government of the pension funds described in "*Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources Post Retirement Benefits*," Portugal Telecom acquired several buildings previously owned by those funds. Portugal Telecom and its subsidiaries own several office buildings in Portugal. Our main proprietary office space is located at the following addresses:

Av. Fontes Pereira de Melo, 38/40, Lisboa, Portugal (61,534 square meters);

R. José Ferreira Pinto Basto, Aveiro, Portugal (36,030 square meters);

R. Tenente Valadim, 431/453, Porto, Portugal (21,400 square meters);

R. Afonso Costa, 4, Lisboa, Portugal (13,266 square meters);

R. General Humberto Delgado, 342/368, Coimbra, Portugal (13,321 square meters);

Largo do Carmo, Faro, Portugal (11,452 square meters);

R. Andrade Corvo, 10/14, Lisboa, Portugal (10,300 square meters);

R. Postiguinho Valadares, 12, Castelo Branco, Portugal (9,464 square meters);

Av. Carvalho Araújo, 629, Vila Real, Portugal (9,030 square meters);

Av. Infante D. Henrique/Praça Vasco da Gama, Ponta Delgada, Açores, Portugal (7,738 square meters);

Av. Doutor João Martins Azevedo, 21, Torres Novas, Portugal (7,112 square meters);

Av. de Zarco, Funchal, Portugal (7,025 square meters);

Praceta Nuno Rodrigues dos Santos, 9, Lisboa, Portugal (5,735 square meters);

Rua 9 de Julho, Beja, Portugal (5,331 square meters);

R. do Casal Velho, Santo Tirso, Portugal (4,809 square meters);

R. Menino Jesus, n° 1, Évora, Portygal (4,772 squere meters);

Rua Visconde Santarém 32, Lisboa, Portugal (4,601 square meters);

R. D. Estefânia 78/82, Lisboa, Portugal (4,441 square meters);

R. Maria Veleda, 1, Lisboa, Portugal (4,333 square meters);

Av. Fontes Pereira de Melo 32, Lisboa, Portugal (3,293 square meters);

Rua Conde Redondo 61, Lisboa, Portugal (2,783 square meters); and

Rua Passos Manuel, 2, Lisboa, Portugal (1,395 square meters).

We are not aware of any material environmental issues that may affect our use of these properties.

We have registered our important trademarks, such as "Portugal Telecom," "PT Comunicações," "Telepac," "Sapo," "*Meo*," "TMN" and their related logos, in Portugal. We have also applied for a European Community trademark for "Portugal Telecom" and our logo. We do not own any registered patents or copyrights which are material to our business as a whole.

For information regarding our current and historic principal capital expenditures and divestitures, see "*Item 5 Operating and Financial Review and Prospects Capital Investment and Research and Development.*"

Competition

We face substantial and increasing competition. The competitive conditions of each of our business segments are described below.

Competition on a Global Level

Globally, as telecommunications operators strive to cope with network investments, the sector is facing a significant increase in competition in mature markets in both fixed and mobile communications. In the wireline market, traditional telecommunications companies are threatened by both cable and mobile operators. Cable companies placing a significant bet on DOCSIS 3.0, a next-generation access technology that enables cable to compete with fiber solutions. In Europe alone, the number of DOCSIS 3.0 households is expected to grow 44% annually up to 2015. On the other hand, LTE is being rolled out around the world, and its high speed and low latency create an opportunity for mobile operators to compete in the residential arena.

In the mobile market, competition has also intensified, due largely to regulators pushing for an aggressive decrease in mobile termination rates, which in Europe are expected to reach €0.019 per minute in the short term. These levels create opportunities for aggressive offerings by operators using low-cost all-net bundles that dilute incumbent operators' network externalities. These offers are being launched in several countries with strong customer acceptance.

The broad telecommunications sector is expected to continue to expand at a global level, but an increasing market share is now occupied by adjacent sector players such as equipment manufacturers, internet service providers and media players. These players are taking advantage of improved connectivity and platform-agnostic technologies to offer over-the-top and cloud-based services. Telecommunications operators are expected to maintain traditional access services and billing relationships over which users access services from adjacent players such as well-known companies offering music, video, photos, apps and retail. These adjacent competitors are building strong global brands. For example, in the equipment manufacturers market, Apple and Samsung accounted for 50% of total global revenues, up from only 16% in 2007. The expansion of the competitive boundaries is creating additional pressure for telecommunications operators, but also creating significant opportunities. In fact, between 2011 and 2012 there have been more than 300 deals globally in which telecommunications operators acquired adjacent competitors, such as cloud providers, internet companies or software developers.

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Competition Facing Our Portuguese Operations

We face heavy competition from various telecommunications operators. In 2012, our primary competitors in Portugal included ZON (with Unitel International Holdings, B.V., with a qualified participation of 18.81%, and Kento Holding Limited, with a qualified participation of 10%, as the main shareholders, as well as certain Portuguese financial institutions), Sonaecom (which is 53.92% owned by Sonae, SGPS, S.A. and 20% owned by France Telecom, branded as *Optimus*), Vodafone Portugal (a Vodafone Group subsidiary), Oni Telecom InfoComunicações, S.A. (60.9% owned by Riverside Europe Telecom LLC fund and 34.6% owned by Gestmin SGPS), Cabovisão (previously 100% owned by Cogeco Cable, the fourth largest Canadian cable operator, which sold it to Altice, a European private equity group that owns Numericable, the leading cable operator in France, in early 2012), AR Telecom and Colt.

The competitive landscape is expected to change significantly in Portugal with the announcement in January 2013 of the merger of ZON, the largest cable operator, and Sonaecom, the third largest mobile operator, to create a new integrated telecommunications operator in Portugal, subject to regulatory approval and other closing conditions. This transaction is expected to further increase the focus on bundled offers and the evolution from triple-play to quadruple-play services as ZON and Optimus leverage their position as an integrated telecommunications operator. Quadruple-play services offered by the new company would compete with our M_4O service, the first quadruple-play service in Portugal launched in January 2013.

ZON's announced deal with Sonaecom continues its recent trend in expansion into other business segments. ZON is our primary competitor in the Pay-TV business in Portugal, and due to increasing competition in its core business, ZON has acquired several competitors and businesses in the past few years, such as the acquisition of the residential business of AR Telecom (which was approved by the Competition Authority in March 2012), and has expanded into other business segments, such as fixed voice, internet and voice and data mobile services.

The announced transaction between ZON and Sonaecom illustrates a broader trend in recent years in which operators that were previously more focused on one service have diversified their operations through the launch of bundled offers with a strong focus on triple-play services. This strategy has been followed by several players, namely *Meo* (our own brand), ZON, Cabovisão, Vodafone and Sonaecom. Among these players, both Portugal Telecom and ZON have a strong triple-play customer base (Portugal Telecom with 833 thousand customers in 2012, an increase of 22.6% from 2011, and ZON with 773 thousand customers, an increase of 9.0% from 2011). Of our fixed line customers, 32.0% have triple-play services, and 63.9% of ZON's cable TV customers have triple-play services, according to ZON's press release announcing its 2012 financial results. We compete in terms of content and price through the launch of bundle offers combining several services.

In the fixed voice market, Portugal had a penetration of 43.2 per 100 inhabitants in 2012 (compared to 42.5% in 2011), a positive evolution that is taking place mainly due to the bundle strategy being carried out in the residential segment, particularly through dual-, triple- and quadruple-play bundles.

According to ANACOM, we held an estimated 57.2% market share of access lines in (compared to 58.6% in 2011). The fixed voice market in Portugal is mainly a direct access market, which resulted from operators being more focused on direct access commercial offers and placing strong emphasis on customer migration from pre-selection configurations. Measures such as call-by-call selection (introduced in January 2000), carrier pre-selection (introduced in October 2000) and number portability (introduced in July 2001) did not have a significant impact on that dynamic. According to ANACOM, as of December 31, 2012, there were approximately 110 thousand clients in pre-selection, the lowest figures since 2001. Using the same source, we had an estimated 54.1% market share of total outgoing traffic in 2012, a decrease of 2.6 percentage points compared to 2011.

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By the end of 2012, fixed broadband Internet reached 2.3 million customers in Portugal, with market penetration at 22.6 per 100 inhabitants, up from 21.1 per 100 inhabitants in 2011, and still showing a significant upside potential. According to ANACOM, we are the top providers of these services, with 51.3% market share, an increase of 2.0 percentage points from 2011.

The Pay-TV market has a total of 3,122 thousand customers, according to ANACOM data, representing a 53.3% penetration of Portuguese households. ZON is the current market leader with a 50.2% market share, representing a decrease of 3.1 percentage points from 2011. Our brand, *Meo*, has gained market share, reaching 39.2% in 2012, representing an increase of 3.7 percentage points from 2011. Cabovisão's market share was 7.8% in 2012, a decrease of 0.9 percentage points from 2011, while the remaining players have not been able to achieve relevant market shares.

By the end of 2012, there were approximately 159.3 active mobile cards per 100 inhabitants in Portugal, making it one of the European countries with the highest adoption rate of mobile services. This level of penetration derives from a dynamic market, mostly based on prepaid services, where operators are focused on providing an extended product portfolio in order to address an extensive range of communication needs for their customers.

In the mobile market, TMN (our mobile operation) competes with Vodafone Portugal and Optimus, the two other mobile network operators licensed to provide mobile telephone services in Portugal. In 2007, CTT, the Portuguese postal company, launched "Phone-ix," an MVNO (Mobile Virtual Network Operator) supported by TMN's network, and in 2008, ZON launched an equivalent structure under the brand "ZON Mobile," a mobile virtual operation hosted by Vodafone Portugal's network. In 2012, an international MVNO, Lycamobile, was launched in Portugal, supported on Vodafone's network, focusing on offering low-cost international voice and data services targeting a niche market mainly composed of immigrant communities. In late 2012, another MVNO, Vectone, was announced to enter the market in 2013, supported on Optimus' network, but it has yet to be launched. Neither MVNO has, so far, been able to gain relevant market share.

Due to their shareholder structures, Vodafone Portugal and Sonaecom (Optimus) have access to substantial resources, cost synergies (*e.g.*, network and equipment costs) and best practices (*e.g.*, product development processes) to compete aggressively against TMN in the Portuguese mobile telephone market. In addition, by strengthening their position in the mobile business, these assets enable them to compete more directly and aggressively in the fixed line services.

According to figures from ANACOM, as of the end of 2012, TMN had a 43.5% market share in terms of active mobile cards in the Portuguese market, up 0.6 percentage points from 2011. Market share leadership is and will continue to be TMN's priority, as the main mobile competitors, Vodafone Portugal and Optimus, are expected to continue to market their services aggressively. All operators are expected to leverage new convergent fixed-mobile offers to reduce churn and secure their market shares in both the residential and personal markets.

With respect to mobile broadband service, according to ANACOM data, there were 978 thousand customers using dongles/modems by the end of 2012, down from 1,134 thousand customers at the end of 2011. This decrease is primarily explained by (1) the growth in fixed broadband Internet access, enabling wireless access at home through wifi routers, (2) the increased penetration of smartphones and tablets that enable email and internet access and (3) the challenging economic backdrop.

Residential Services

We face strong competition from fixed line operators as well as from mobile players. Currently, all mobile network operators have commercial offers that are a direct alternative to our fixed line telephone services, competing for the same customers. Residential services supported by mobile networks are offered by all mobile operators. In addition, these have also launched low-cost brands that are designed to reach the lower-end segment of the mobile market and have also had an effect on fixed line retail service.

More recently, operators have been offering unlimited voice communications to all national and up to 50 international fixed destinations, whenever the fixed voice service is purchased as part of a fixed service bundle. This competitive movement aimed to respond to the eroding revenues from international telephone service due to falling international call prices, extensive usage of lease lines by large users through which they connect to networks outside Portugal and aggressive competition from calling cards, rerouting of calls by other international operators and VoIP, which increasingly enables communications at lower prices than traditional public switched telephone networks. These factors put significant pressure on us to reduce international fixed line telephone prices.

We have committed to an ambitious FTTH roll-out strategy in the past few years, reaching approximately 1.6 million homes by the end of 2012. ZON and Cabovisão have leveraged their coaxial cable networks to upgrade to the DOCSIS 3.0 standard. Sonaecom and Vodafone have based their offers mainly on IPTV, relying on lines leased from PT and their own FTTH network, which is being rolled out. The two joined forces to share their fiber-based networks, reaching approximately 500,000 households in 2012, mainly in the Greater Lisbon and Greater Oporto regions. ANACOM is analyzing the creation of a wholesale fiber offer outside these two regions, which would enable our competitors to access any FTTH network rolled out by us outside the designated "competitive areas." We are currently considering the possibility of a further roll-out to an additional one million households to reach 2.6 million FTTH households and launching a wholesale offer for the other competitors.

Personal Services

Several years ago in 2008, an important development occurred in the Portuguese mobile market with the launch of aggressive on-net differentiated pricing plans, known as "tribal plans," led by Optimus (with "Tag") and followed by TMN (with *Moche*) and Vodafone Portugal ("Extreme" and "Extravaganza"). These tribal plans, targeting the youth segment through strong marketing campaigns, reached beyond this segment and became mass market plans with a strong relative presence in the personal mobile market.

In addition to the tribal plans, some postpaid, on-net oriented bundles of "voice+internet" were launched by the three major mobile operators, namely TMN (with *tmn unlimited*), Optimus (with "Smart") and Vodafone (with "Best"). The focus on on-net oriented flat rate plans and bundles of "voice+internet," which offer unlimited on-net voice calls, led to an increase in minutes of usage and an erosion of average revenue per minute.

In early 2011 TMN expanded its pricing plan portfolio with the launch of *e nunca mais acaba*, a prepaid flat-fee, on-net pricing plan that expands the tribal plan concept to all TMN customers, a move later followed by Vodafone (with "Vita 0") and Optimus (with "Zero").

In April 2012, TMN launched a tribal plan, *moche sub-25*, specifically designed for the youth segment, restricting new additions to those able to prove they are 25 years old or younger. This under-25 tribal plan has a different monthly fee and includes additional services that are appealing to this segment, such as music streaming, unlimited all-net SMS and an internet data allowance. This movement was followed by Optimus with the launch of "TAG sub-25." Vodafone chose not to launch an under-25 tribal plan, decreasing instead the monthly fee and adding internet data allowance to its mass market tribal plans. TMN and Optimus followed Vodafone's movement in their mass market tribal plans.

Mobile operators are also undertaking aggressive marketing efforts, often offering a subscription fee that allows access to cheaper communications during a limited period. Aggressive pricing structures and campaigns have stimulated usage at the expense of eroding retail revenues. TMN has recently launched marketing campaigns focused on its under-25 tribal plan, using its new tariff plan to better segment the market and target its efforts more efficiently.

All mobile operators launched 4G LTE commercial offers in early 2012, both in the form of smartphones and dongles, and they have been marketing them aggressively. Operators have also been focusing on extending LTE network coverage as quickly as possible, with TMN reaching 90% of the population by December 2012.

In the mobile broadband market, the competitive landscape has been challenging. Both in 3G and 4G tariff plans, Vodafone and Optimus have promoted their services aggressively through pricing campaigns under which they decrease the monthly fee during a certain period, as well as subsidize USB dongles.

In early 2012, TMN launched a multi-SIM offer that can be used both in 3G and 4G tariff plans. This multi-SIM offer allows both TMN mobile broadband and smartphone users to share their data tariff alowance with more than one device.

Mobile revenues have been under pressure not only from the competitive dynamics but also due to the regulatory framework. Mobile termination rates declined approximately 82% from €0.07 in 2008 to €0.0127 in 2012. Roaming revenues have also been a subject of regulation, as caps both for retail voice and data roaming services have been implemented. In 2012, the retail voice cap per minute originated and per minute received were €0.29 and €0.08, respectively, and the retail data cap was €0.70. These caps will decrease in the coming years. In 2013, the retail voice and data caps are expected to be €0.24 per minute originated, €0.07 per minute received and €0.45 per megabyte.

Enterprise Services

We face significant competition from several operators in the enterprise services market, namely ZON, Vodafone Portugal, Sonaecom, Oni Telecom, AR Telecom and Colt. These companies compete with us in providing data communications, voice services and internet services to business customers. Customers tend to have large volumes of traffic and complex virtual private network services with data, voice and video integration.

Our competitors may use satellite-based networks, public network operators' infrastructure, leased lines and their own infrastructure to provide telecommunications services to customers. These are all alternatives to our leased lines offer. As a result of competition, we have reduced our prices for leased lines and are focusing on value-added solutions based on Internet Protocol Virtual Private Networks ("IP VPN").

Our strong investment in our FTTH network, as well as our commitment to the investment in a top-European level data center, allow us to take advantage of the cloud services business opportunity. Cloud services are considered to be an attractive growth point in the telecommunications industry, and we intend to position ourselves ahead of the competition to provide such services, which will be an additional source of revenue as well as a retention and loyalty tool in our data and corporate customer category.

Other Services

We also face competition in our wholesale services. Fixed and mobile operators, other than TMN, are establishing direct international interconnections with mobile or wireline operators outside Portugal, enabling them to offer international telephone services without using our network. This is decreasing wholesale revenues generated from connecting mobile operators in Portugal to operators abroad.

The interconnection business faces more direct competition now that operators are focusing on installing and operating their own public wireline telephone networks, pushing for direct access offers.

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Some international operators are now providing wholesale services in Portugal, including international telephone services, network interconnection, data services, and broadband access to Portuguese ISPs.

Competition Facing Oi in Brazil

Oi's industry is highly competitive. The competitive environment is significantly affected by key trends, including technological and service convergence, market consolidation and combined service offerings by service providers. Oi faces intense competition in all the areas in which it operates from other mobile service and fixed line operators. Many of these competitors are part of large, national or multinational groups and have access to financing, new technologies and other benefits that are derived from being a part of such a group. Fixed line operators generally charge much lower tariffs than mobile service providers.

Local Fixed Line Services

In the local fixed line telecommunications services market in Brazil, competition has historically been focused on corporate customers. However, recently competitors have begun compete in the consumer market with bundles or services targeted to the needs of lower income customers. In addition, competition from other telecommunications services has been increasing, particularly from mobile telecommunications services, which has led to traffic migration from fixed line traffic to mobile traffic and the substitution of mobile services in place of fixed line services, encouraged by offers of aggressively priced packages from some mobile telecommunications services providers. Finally, the decrease in interconnection rates has discouraged the construction of new fixed line networks and has led to decreases in market prices for telecommunications services by enabling telecommunications services providers that use the local fixed line networks of incumbent fixed line providers to offer lower prices to their customers.

As of December 31, 2012, Oi was the leading provider of local fixed line services in Region I and Region II with 11.8 million fixed lines in service in Region I and 6.7 million fixed lines in service in Region II. Based on the most recent information available from ANATEL, as of May 31, 2012, Oi had an estimated market share of 71.2% of the total fixed lines in service in Region I and an estimated market share of 64.7% of the total fixed lines in service in Region II. Oi's principal competitors for fixed line services are (1) Embratel, which had an estimated market share of 18.2% of the total fixed lines in service in Region I and an estimated market share of 11.7% of the total fixed lines in service in Region II as of May 31, 2012, based on the most recent information available from ANATEL, and (2) GVT (an affiliate of Vivendi S.A.), which had an estimated market share of 5.6% of the total fixed lines in service in Region I and an estimated market share of 19.6% of the total fixed lines in service in Region II as of May 31, 2012, based on the most recent information available from ANATEL.

Embratel provides local fixed line services to residential customers through fixed devices that receive wireless signals from a single transmission tower located near the subscriber's residence and through the cable network owned by its subsidiary Net in the portions of Region I and Region II where Net provides cable television service. As a result, Net is able to offer cable television, broadband and telephone services as a bundle at a very competitive price. Oi expects competition from Embratel to increase in certain large cities, such as Rio de Janeiro, Belo Horizonte and Salvador, where it continues to expand its local fixed line network.

GVT has been increasing its competitive activities in Region I and Region II, expanding its fiber optic network in high-income residential areas and increasing its services to small- and medium-sized businesses. Oi expects competition from GVT to increase in certain large cities, such as Rio de Janeiro, Belo Horizonte and Salvador, and in some medium size cities with population in the range of 350,000 to 1,000,000, where GVT continues to expand its local fixed line network.

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Oi expects to continue to face competition from mobile services providers, which represent the main source of competition in the local fixed line service market. As of December 31, 2012, there were 132.2 million mobile subscribers (including Oi's mobile customers) in Region I, an 8.4% increase over December 31, 2011, and there were 66.5 million mobile subscribers (including Oi's mobile customers) in Region II, a 9.4% increase over December 31, 2011, based on information available from ANATEL. The increase in the number of mobile users, in addition to reduced mobile services rates, is expected to continue to adversely affect the number of fixed line subscribers and the volume of local fixed line traffic. In addition, because mobile providers offer promotions and service plans that permit subscribers to make calls within the mobile provider's network at rates that are less than those charged for calls from a fixed line telephone to a mobile telephone, Oi believes that it may be vulnerable to traffic migration as customers with both fixed line and mobile telephones use their mobile devices to make calls to other mobile subscribers.

Long-Distance Services

The long-distance services market in Brazil is highly competitive. As of May 31, 2012, based on the most recent information available from ANATEL, (1) of the total number of national long-distance minutes originated in Region I, Oi had a market share of 8.6%, ranking behind TIM with 57.9% and Embratel with 30.7%, (2) of the total number of national long-distance minutes originated in Region II, Oi had a market share of 18.3%, ranking behind TIM with 49.4% and Embratel with 26.6%, and (3) of the total number of national long-distance minutes originated in Region III, Oi had a market share of 11.1%, ranking behind TIM with 34.0%, Embratel with 28.9% and Telesp (a subsidiary of Telefónica) with 22.6%.

Oi's principal competitors for long-distance services are TIM and Embratel, which are currently offering long-distance services throughout Brazil at rates that are charged on a per-call, rather than per-minute, basis. As a result of its commencement of mobile services in Region III, Oi has also begun to compete with Telesp, which is the incumbent fixed line service provider in Region III.

Generally, Oi believes callers placing fixed line long-distance calls in Brazil tend to select the long-distance carrier affiliated with the provider of their fixed line service. Similarly, callers placing mobile long-distance calls in Brazil tend to select the long-distance carrier affiliated with the provider of their mobile or fixed line service. However, increased competition from long-distance service providers has resulted in pressure on the long-distance rates and adversely affected Oi's revenue from these services.

In addition, the offering of plans by other mobile services providers that include free minutes for calls to other subscribers of those mobile services providers may adversely impact Oi's revenues from mobile long-distance calls if Oi's mobile customers migrate to its competitors to remain within the network of the people to whom they plan to place long-distance calls. However, as a result of the increased use of SIM card-only strategies by other mobile service providers, there is a trend among Brazilian prepaid customers to purchase SIM cards from multiple mobile service providers to maximize the number of calls that they can make which are covered by these promotional offers.

New technologies that serve as an alternative to traditional long-distance telephone calls, such as VoIP, may start to capture part of Brazil's long-distance traffic. However, in contrast to what has occurred in other countries, such as the United States, Oi does not expect intense competition from VoIP providers in the near term due to the low level of broadband penetration in Brazil due to the population's relatively low per capita income and the expected adverse effect of the success of this technology on the long-distance call margins of Embratel, which is an affiliate of Net, the main service provider with the ability to offer alternatives through VoIP.

Mobile Services

The mobile telecommunications services market in Brazil is characterized by intense competition among providers of mobile telecommunications services. Oi competes primarily with the following mobile services providers, each of which provides services throughout Brazil:

- Telefónica, which is a subsidiary of Telefónica S.A., and which markets its personal services under the brand name "Vivo";
- TIM, which is a subsidiary of Telecom Italia S.p.A.; and
- Claro, which is a subsidiary of América Móvil.

In December 2010, Nextel Brazil acquired licenses to provide 3G services throughout Brazil. Nextel launched commercial services on its 3G network in December 2012. Nextel's entrance in the market could increase competition for mobile services as it expands its network.

As of December 31, 2012, based on information available from ANATEL, Oi had a market share of 18.8% of the total number of subscribers in Brazil, ranking behind Vivo with 29.1%, TIM with 26.9%, and Claro with 24.9%, and Oi captured 19.0% of all net additions of mobile subscribers in Brazil (calculated based on the number of mobile subscribers at the end of a period less the number of mobile subscribers at the beginning of that period) during 2012.

Competitive efforts in the Brazilian mobile telecommunications services market generally take the form of handset subsidies in the postpaid market and traffic subsidies in both the prepaid and postpaid market. The aggressiveness of promotions is generally driven by the desire of the provider offering the promotion to increase market share; however, these promotions generally are for a short duration as the pricing terms offered are not sustainable over the long term.

Data Transmission Services

Cable television providers that offer broadband services, particularly Net, represent Oi's principal competition in the data transmission services market in Brazil. Oi faces competition from these providers that offer integrated packages, consisting of Pay-TV services, broadband and voice telephone services to cable television subscribers who, in general, have more purchasing power than other consumers.

Oi's principal competitors in the commercial data transmission services market are Embratel, GVT and Telefónica. The commercial data transmission services market is significantly less regulated than the fixed line, long-distance and mobile services markets. Along with growth in traffic volume and increasing demand for broadband capacity, Oi expects significant price reductions in data transmission services as competitors expand their networks. In recent years, there has been a shift in competition towards value-added services provided over IP platforms and VPN services.

Pay-TV Services

In Brazil, the high quality programming of television broadcasters has resulted in aggregate ratings for these broadcasters of approximately 90% of viewers and has limited the perceived value of Pay-TV services. As a result, the Pay-TV market in Brazil has a lower penetration rates as compared to developed countries, and even to other Latin American countries, such as Argentina, Chile and Mexico. Penetration rates for Pay-TV services have grown from 8.0% of Brazilian households in 2005 to 28.2% in 2012. According to information available from ANATEL, the Brazilian Pay-TV services market grew by more than 27.0% in 2012.

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The primary providers of Pay-TV services in Region I and Region II in Brazil are SKY, which provides DTH services, and América Móvil, which provides DTH services through Embratel under the "Claro TV" brand and provides subscription television services using coaxial cable through Net. Oi commenced offering DTH subscription television services to the low-income residential market in the states of Rio de Janeiro, Minas Gerais, Rio Grande do Sul, Paraná and Santa Catarina. In 2010, Oi expanded this service to the Federal District and the states of Bahia, Sergipe, Pernambuco, Ceará, Paraíba, Rio Grande do Norte, Alagoas, Espírito Santo and Goiás. In 2011, Oi expanded this service to the remaining states of Region I and Region II.

In December 2012, Oi began to offer IP TV in the city of Rio de Janeiro. Oi plans to gradually expand its IP TV service to other cities.

Regulation

Portugal

As a telecommunications provider, we are subject to variety of regulations as well as general competition law and other laws. Such laws and regulations are promulgated and enforced to varying degrees by supranational regulators such as the European Union, the European Commission and national, state, regional and local authorities. This section describes the regulatory frameworks and key regulatory developments at the regional level and in the selected countries in which we operate.

Regulatory Institutions

European Commission. The European Commission ("EC") ensures that EU member states fully and correctly implement EU requirements in national law. The EC routinely monitors the status of EU member states in implementing EU directives. Most of the EU competition rules have the force of law in all EU member states and therefore apply to us in Portugal. The Directorate-General for Competition of the EC is responsible for considering potential claims that our business activities or Portuguese government regulations are inconsistent with the key provisions of the Treaty of Lisbon relating to competition in the EU. Among other things, the Treaty of Lisbon prohibits (1) agreements or coordinated action between competitors that may affect trade between EU member states and have as their objective or effect the prevention, restriction or distortion of competition within the EU and (2) any abuse of a market-dominant position within the EU that may affect trade between EU member states. The Directorate-General for Competition enforces these rules in cooperation with the national competition authorities. In addition, national courts have jurisdiction over violations of EU competition law.

ANACOM. The *Autoridade Nacional das Comunicações* ("ANACOM") is the Portuguese telecommunications regulator. It advises the Portuguese government on telecommunications policy and legislation and monitors compliance with concessions, licenses and permits granted to telecommunications providers in Portugal. The Portuguese government has delegated a significant number of those powers and functions to ANACOM in our concession agreement. The Portuguese government has substantially increased the autonomy of ANACOM and has allowed it to become a more effective and independent regulatory body. ANACOM acts on complaints against us by our competitors, our customers and other interested parties. It can impose fines on us if we do not meet our obligations under our concession, including our obligations to supply public switched wireline telephone services, leased lines and other services to our competitors on a timely basis. ANACOM has, from time to time, addressed complaints against us by our competitors. However, such complaints have been resolved in a manner that has not had a material adverse effect on our businesses or operations. ANACOM's decisions are subject to judicial review.

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Portuguese Competition Authority. Our activities are also overseen by the *Portuguese Competition Authority* (formerly the *Direcção Geral do Comércio e da Concorrência*), which is responsible for enforcement of Portuguese competition law. It is also responsible for considering complaints relating to our business practices or other business arrangements. Under Portuguese law, we and our subsidiaries are permitted to appeal any adverse decision of the Portuguese Competition Authority to the courts. Under the new competition law (Law No. 19/2012 of May 8, 2012), an appeal may not suspend the effects of a decision of the Portuguese Competition Authority pending a decision by the courts, except for decisions that impose structural measures.

ERC. The *Entidade Reguladora para a Comunicação Social* ("ERC") is the independent regulatory authority for the Portuguese media. ERC's primary responsibilities are the regulation and supervision of all entities that undertake media activities in Portugal. ERC is a legal entity endowed with administrative and financial autonomy. ERC oversees compliance with respect to fundamental rights such as freedom of the press, right to information, independence from political and economic power and freedom of speech. It is also responsible for monitoring compliance by all companies operating in the media sector, with standards for media and broadcast content, as well as for promoting the proper and effective functioning of the market where such companies operate. ERC's decisions may affect, among others, news agencies, periodicals, radio or television operators, and radio and television distribution operators.

EU Regulatory Framework and Relevant Markets

The European Union regulatory framework for electronic communications networks and services consists of five directives governing procedures, authorizations, access, universal service and data protection; one decision on the availability and use of radio spectrum; and a recommendation on relevant product and service markets within the electronic communications sector subject to "ex ante" regulation under a common regulatory framework for electronic communications networks and services. EU directives and recommendations, which adopt competition law principles such as market dominance for the designation of significant market power and the definitions of relevant product and geographic markets, which may be subject to "ex ante" regulation, have involved constant changes and refinements to this framework. The framework focuses on issues such as reinforcing consumer rights, encouraging competitive conditions among operators to increase consumer choice, promoting investment in new communications infrastructure (such as by freeing spectrum for the provision of broadband services) and ensuring network security and integrity. Under the current regulatory framework, obligations can be imposed on operators having significant market power in any of the one retail and six wholesale markets identified by the EC. Because we are active in all of these markets, these regulatory measures have and will continue to affect our businesses and operations.

Within the EU framework, ANACOM has identified and analyzed 19 retail and wholesale markets in Portugal. In a process it is required to undergo periodically, ANACOM has found Portugal Telecom to have significant market power in all but one of the analyzed markets, where ANACOM determined that no operator had significant market power (wholesale transit services). These markets include: (1) retail markets access to the public telephone network at a fixed location (residential and business), publicly available local and/or national telephone services provided at a fixed location (residential and business), publicly available international telephone services provided at a fixed location (residential and business), telephone services at a fixed location using non-geographic numbers, such as toll-free numbers and leased lines; and (2) wholesale markets call origination on the fixed telephone network provided at a fixed location, call termination on individual public telephone networks provided at a fixed location and wholesale unbundled access to local metallic loops, wholesale leased lines (trunk segments and terminating segments) and wholesale broadband access.

ANACOM has also conducted a market analysis to determine the regulatory obligations that should be imposed on operators with significant market power in the provision of wholesale (physical) network infrastructure access and wholesale broadband access. With respect to Wholesale Markets 4 and 5 (for the provision of wholesale (physical) network infrastructure access and wholesale broadband access), ANACOM has segmented the broadband market geographically between "C" (competitive) areas and "NC" (non competitive) areas. While Portugal Telecom's obligation to provide a bitstream reference offer (*Rede ADSL PT*) expired after a transitional period, we have decided to maintain the bitstream reference offer. See "*Areas of Recent Regulation and Updates Next Generation Access Networks*."

In addition to Portugal Telecom, all other fixed line operators in Portugal were determined to have significant market power in the call termination on individual public telephone networks provided at a fixed location wholesale market. Likewise, all mobile network operators were found to have significant market power in the call termination on individual mobile networks. ANACOM has found Portugal Telecom to have significant market power in the wholesale leased lines terminal market and segmented the transit segments between "C" and "NC" routes. In these wholesale markets, ANACOM included Ethernet connections and imposed the retail-minus rule over Ethernet solutions. In the "C" routes, Portugal Telecom has no significant market power. We expect that ANACOM will provide further analysis of the other relevant markets in the near future.

Our Concession and Existing Licenses and Authorizations

General

The EU prohibits any limitation on the number of new entrants in telecommunications markets, except as required to ensure efficient use of radio frequencies. Pursuant to this directive, which is part of the EU electronic communications framework, an operator must have a general authorization for the provision of electronic communications networks or services. A license can be required for the use of radio frequencies or numbering resources. The objective of this new authorization regime is to introduce more flexibility into the licensing framework.

Our concession is for the provision of universal service and for the operation of the terrestrial broadcasting network in Portugal, and it permits us to provide public switched fixed line telephone, packet switched data in X.25 mode, leased lines and telex and telegraphy services in Portugal. We also operate a DTT platform and provide mobile telephone services, data communications services and television distribution services under the licenses granted and authorizations issued to our subsidiaries by the relevant authorities (the Portuguese government and ANACOM). The subsidiaries holding the licenses and authorizations are subject to separate financial reporting and other requirements.

The Ministry of Finance is responsible for monitoring financial issues with respect to the concession. ANACOM is responsible for issuing regulations to implement this authorization regime. The Ministry of Economy is responsible for all other issues under the concession. ANACOM is authorized to monitor and assess penalties up to a maximum of €5 million if we fail to fulfill our obligations under the concession or other obligations imposed by law or stemming out of ANACOM's determinations. Disputes concerning the application and interpretation of the concession are dealt with by arbitration.

Our concession imposes universal service obligations on us. See "*Areas of Recent Regulation and Updates Universal Service Obligations*" below.

Our Fixed Line Concession

The Portuguese has government granted us a concession, currently held by our subsidiary, PT Comunicações, with an initial term expiring in 2025. The concession grants us the right to install, manage and operate the infrastructure that forms part of the basic telecommunications network and the terrestrial broadcasting network. The Portuguese government retains the ability to suspend or

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terminate our rights under the concession. In cases of serious non-fulfillment by us of our obligations under the concession, the Portuguese government may, on a provisional basis, take over the development and operation of services authorized under the concession. The concession may also be terminated in cases of "severe, continual or unremedied" failure to perform our obligations. We believe that we have the resources to fulfill all our obligations under the concession. In addition, the Portuguese government may revoke the concession upon at least one year's notice if it deems such action to be justified in the public interest. If this occurs, we would be entitled to compensation equaling our annual average net profits for the five years prior to notification of revocation multiplied by the number of years remaining before the concession expires. The concession provides that we are exempt from all taxes, fees and charges with respect to the usage of public rights-of-way for our telecommunications infrastructure. Nevertheless, we are subject to a rights-of-way regime in Portugal whereby each municipality may establish a fee, up to a maximum of 0.25% of each wireline services bill, to be paid by the customers of those wireline operators whose network infrastructures are located in each such municipality. Our exemption from municipal taxes is currently being challenged in court. See "*Item 8 Financial Information Legal Proceedings Claims for Municipal Taxes and Fees in Our Portuguese Telecommunications Business*."

DTT Services

For a summary of our usage rights for DTT, see "*Areas of Recent Regulation and Updates DTT Services*" below.

Our Fixed Line and Data Licenses

We also hold the following licenses: (1) a non-exclusive license to provide fixed line telephone services; (2) a non-exclusive license to be a "Public Telecommunications Networks" operator; and (3) all the licenses formerly held by Telepac, including a data communications license. Our data communications license authorizes us to provide X.25/X.32 synchronous services and X.28 asynchronous services and other switched and non-switched data communications services, including frame relay and virtual private networks for data communications. The license also authorizes us to provide value-added services such as electronic data interchange and videotext services. In addition, the license authorizes us to construct certain network infrastructure in connection with licensed services. With respect to packet switched data, the data communications license is valid for 30 years, unless our wireline concession is terminated earlier. Licenses have also been granted to other providers of data communications and Internet access services, including companies associated with major international telecommunications providers. However, companies are not required to have a license to provide data communications services and Internet access. Instead, it is sufficient to register their intended services with ANACOM under its service registration scheme. Since 1997, we have also held a license to provide data communications services using satellite infrastructure and a license to offer voice services to corporate networks and other closed groups of users.

TMN's Mobile Service License

Portuguese mobile telephone service licenses are valid for 15 years and are issued by ANACOM. These licenses authorize the use of radio spectrum and the installation of base stations, base station controllers and control switching centers and require the licensee to construct networks capable of reaching at least 75% of Portugal's population within a specified period of time. Charges for the provision of mobile telephone services are not subject to regulation.

Through TMN, we hold a renewable license to provide traditional and GSM digital mobile telephone services throughout Portugal. The authorization for the use of GSM radio spectrum is valid until March 16, 2022. We are required to comply with a number of mobile telephone service criteria. These include satisfying minimum quality standards regarding blocked call rates, network effectiveness

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and servicing time, and providing certain services. We are also required to provide ANACOM with information about our mobile telephone operations, including the number of customers, number and average duration of calls on a quarterly basis, and annual information about the development of infrastructure.

ANACOM also issues UMTS licenses, which are the European version of the globally accepted technical standards for "third-generation" mobile communications. The broadband capacity of the frequency spectrum allocated under the UMTS licenses enables operators to supply video and Internet content to mobile telephones at higher transmission speeds. On January 5, 2012, ANACOM issued a final report on an auction for the allocation of rights of use of frequencies in the 450, 800, 900, 1800 MHz and 2.1 and 2.6 GHz bands. Following that auction, on March 9, 2012, ANACOM issued the final renewable license to TMN, allowing the provision of electronic communications services based, among others, on LTE (Long Term Evolution) technology. This license is valid until March 2027, and it also unifies the previous GSM and UMTS licenses issued by ANACOM.

In February 2012, the World Radiocommunication Conference 2012 adopted Resolution No. 232 (or "WRC-12") on the allocation of the 700 MHz band to mobile services. This is the first assignment that allows a globally harmonized use. It is expected to have profound implications at the European level, particularly in television broadcasting and in mobile networks and services.

In March 2012, the European Parliament and the Council established the first multiannual radio spectrum policy. This first program is focused on identifying new spectrum bands for the provision of broadband electronic communications services and in establishing the criteria and methodology for creating an European Spectrum Inventory. The EC is currently preparing the first steps of implementation of this decision.

Areas of Recent Regulation and Updates

Number Portability and Carrier Selection

Number portability allows a subscriber at a specific location to change service providers without having to change telephone numbers. Under ANACOM regulations, we are required to allow number portability for both fixed line and mobile services. ANACOM requires call-by-call carrier selection to be offered by us for long distance and international calls. Call-by-call carrier selection enables customers to select the carrier of their calls by dialing a code connecting them to the selected carrier. All fixed line network operators with significant market power must offer carrier pre-selection. Carrier pre-selection allows customers to select the carrier that will be their default carrier. This removes the need for customers to dial any code to connect to their selected carrier when making calls. On September 13, 2012, ANACOM amended the existing number portability regulations to ensure fixed and mobile number portability within one working day, which reinforces subscribers' number portability rights.

DTT Services

PT Comunicações holds frequency usage rights for DTT associated with the transport of the signal of free-to-air television channels (the RTP, SIC and TVI broadcast channels), the so-called "*Multiplex A*" or "*Mux A*." PT Comunicações fulfilled all of its obligations with respect to the usage grant and successfully concluded the channel update process. The switch-off of the analog television network in Portugal occurred on April 26, 2012. PT Comunicações may be entitled to receive compensation or reimbursement, by means of a governmental ordinance, for certain DTT-related costs. Designed to ensure equal access to DTT, the DTT usage rights require PT Comunicações to subsidize the installation and purchase of DTT-related equipement for individuals with special needs (e.g., the elderly, low income groups, etc.).

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Wholesale Reference Offers (Unbundling the Local Loop)

The EC requires fixed line network operators found to have significant market power in the relevant wholesale market for physical network infrastructure access at a fixed location to make the local loops between their customers and the local switches on their networks available to competitors. This allows such competitors to connect their networks to the copper "local loop" and use it to provide their services directly to those customers without having to invest in the local loop or to rely upon the network operator's relationship with the customers. Under this regulation, we are required to maintain a reference offer for unbundled access to our local loops and related facilities and to meet reasonable requests for unbundled access to our local loops and related facilities under transparent, fair and non-discriminatory conditions. Prices charged must be cost-oriented. The conditions under which the local loop unbundling services are provided are set forth in a published reference offer for unbundled access to our local loops in accordance with terms established by ANACOM. This reference offer covers all of our main distribution framework buildings where technical and space conditions allow co-location. Co-location means providing space and technical facilities to competitors to the extent necessary to reasonably accommodate and connect the relevant equipment of the competitor.

On March 28, 2012, ANACOM set forth the procedures to be followed in evaluating the quality of service of regulated wholesale offers. This follows notification of the respective draft decision to the EC, to the Body of European Regulators for Electronic Communications ("BEREC") and to the national regulatory authorities of the other Member States of the European Union. This decision determined that PT Comunicações must amend several reference offers that establish deadlines for repairs (local loop unbundling, leased lines, Ethernet accesses, bitstream and wholesale line rental) within 30 business days after receiving notification of ANACOM's final decision.

Leased Lines Reference Offers and Ethernet Access Reference Offers

Our Leased Lines Reference Offer (*oferta de referência de circuitos alugados*) ("ORCA") sets forth the characteristics and the technical and commercial conditions associated with the provision of leased circuits by our subsidiary PT Comunicações in the wholesale markets. Our Ethernet Accesses Reference Offer (*oferta de referência de circuitos Ethernet*) ("ORCE") sets forth the characteristics and the technical and commercial conditions associated with the provision of Ethernet circuits by PT Comunicações in the wholesale markets.

Following a decision by ANACOM on leased line markets, the retail leased line market was deregulated, which meant that our prices in this market ceased to be subject to a 26% retail-minus rule. However, for the wholesale leased line markets, in which we were declared an operator with significant market power, ANACOM decided to make Ethernet circuits subject to a retail-minus rule (which remains undefined by ANACOM). On July 14, 2012, ANACOM approved a final decision amending our ORCA and ORCE, the draft decision of which has been provided to the EC (which has subsequently stated it had no comment to the action), BEREC and national regulatory authorities of other Member States of the European Union. We have challenged this decision before the courts, arguing that the decision was illegal in certain respects.

Wholesale Market for Voice Call Termination on Individual Mobile Networks

The regulation of the market for wholesale voice call termination establishes a price control obligation on wholesale voice call termination services. Following EC recommendations on the regulatory treatment of fixed and mobile termination rates in the EU, this price control results in a cost-oriented price cap determined by a pure Long-Range Average Incremental Cost ("LRIC") bottom-up cost model.

On April 30, 2012, ANACOM set the termination rates to be applied in the wholesale market for voice call termination on individual mobile networks. In accordance with ANACOM's decision, the cost model for mobile termination set the maximum prices to be applied by the three mobile operators considered to have significant market power at €1.27 per minute, to be billed per second from the first second and independent of the origin of the call.

Next Generation Access Networks

ANACOM provides a segmented approach on the regulation of Next Generation Access Networks ("NGA"), which addresses several issues, including market and technological issues, the impact of NGAs on existing networks, applicable development models, public policy considerations and regulatory models. In areas designated "C" (competitive) areas, the main obligation is access to ducts, and in areas designated "NC" (non-competitive) areas, the obligations are access to ducts, access to fiber and advanced bitstream, subject to conditions. On February 6, 2012, ANACOM approved a draft decision on the relevant Markets 4 and 5 to integrate the changes due to the development of NGAs. ANACOM's decision related to the definition of the markets of wholesale (physical) network infrastructure access ("Market 4") and wholesale broadband access ("Market 5"), evaluation of significant market power and the imposition, maintenance, modification or suppression of regulatory obligations. ANACOM proposes to maintain the national scope of Market 4 and the geographic segmentation in Market 5, which is divided into "NC" Areas and "C" Areas (the latter unregulated). According to this draft decision, we will continue to be considered to have significant market power in Markets 4 and 5.

According to the draft decision concerning access obligations in the market of wholesale (physical) network infrastructure access, in addition to the obligation of granting unbundled access to copper loops and subloops and to ducts and poles at the national level, ANACOM intends to impose a geographically differentiated obligation to grant virtual access to optical fiber (advanced bitstream). This obligation would not be imposed in 17 municipalities that are considered to have conditions for other operators to invest in fiber. In addition, we would also be required to demonstrate to ANACOM that the difference between our retail prices and the prices of the wholesale offers made available to other operators does not result in a margin squeeze. The final decision is still pending.

With respect to the roll-out of optic fiber networks, current Portuguese law establishes a legal framework for the construction of and access to infrastructure suitable for the accommodation of electronic communications networks and the construction of infrastructure for telecommunications in housing developments, urban settlements and concentrations of buildings. The law addresses access to the public domain, expropriation and the constitution of public easements, and amendments to existing law in 2009 introduced a new level of harmonization and transparency in procedures. In particular, the 2009 changes set forth several obligations in order to allow electronic communications operators to enjoy better conditions necessary for the installation and development of electronic communications networks.

The current legal framework also foresees the implementation of a Centralized Information System ("SIC") to be managed and operated by ANACOM and whose main objective is to make available information on infrastructure appropriate for the installation of electronic communications networks based on information provided by the Portuguese government, autonomous regions, municipalities, publicly held companies or concessionaires, other entities owning or using infrastructure in the public domain, autonomous regions or municipalities and electronic communications undertakings. Other elements, such as the terms upon which objects will be geographically defined through the combination of their administrative location and georeferencing, are also set forth.

Since PT Comunicações already has a reference offer under which it is required to provide a substantial amount of information to operators that wish to use its ducts and associated infrastructure, we are paying close attention to the implementation of the SIC, since we do not wish for the SIC to compound PT Comunicações's obligation to provide information regarding its ducts and associated infrastructure.

Under the second edition of the technical rules and norms for infrastructure of telecommunications in buildings ("ITED 2nd Edition"), the first electronic communications undertaking entering a building with fiber remains obligated to install fiber optic wiring in order to allow sharing with other operators. However, ITED 2nd Edition only sets forth the technical rules that apply to installing wiring and does address matters concerning cost sharing, relationships of operators with the buildings' owners or management and technical harmonization needed within the sharing of the infrastructure.

Between April 27, 2012 and July 20, 2012, a public consultation was held on the reduction of NGA roll-out costs, highlighting the need for more coordination, information and transparency between the different stakeholders. According to the EC, 80% on the investment costs in NGA networks relate to the deployment of civil infrastructure, as is the case of trenching and laying of ducts, and up to 30% of these costs are due to inefficiencies. The EC is of the opinion that the NRAs and the Member-States may intervene at this level, making infrastructures sharing mandatory, including those of the utility companies. The EC published the report on this public consultation on November 22, 2012 and proposed a draft regulation on March 26, 2013. Next, in accordance with standard EU legislative procedure, the European Parliament and the European Council will jointly consider whether to adopt the draft regulation. Adoption of this proposal is expected in the course of 2014.

On December 5, 2012, the EC sent its draft recommendation on NGA non-discrimination and costing methodologies to BEREC. The draft recommendation expands on the principles set out by Commissioner Kroes, in July 2012, that price orientation to costs could be more flexible in certain circumstances, in return of a tighter control of non-discrimination at the wholesale level. BEREC issued its opinion on this draft recommendation on March 2013, endorsing the objectives of the EC but criticizing and asking for amendments of some aspects of the draft recommendation. The EC is expected to take into account the opinion of BEREC and submit the project for approval by the Council of Ministers. The EC intends to adopt the final recommendation in mid-July 2013.

Cost Accounting System ("CAS")

PT Comunicações runs an activity-based, fully distributed historical cost model, first developed following the privatization of the company in 1995. The CAS is also a regulatory obligation imposed on us within the scope of our concession and relevant market regulations.

On February 29, 2012, PT Comunicações requested that ANACOM review the weighted average cost of capital ("WACC") to be used in its regulatory cost accounting model for the year 2011. The preliminary value of WACC was set at 11%, and PT Comunicações requested a change to 14.78%. ANACOM approved a final decision on the issue, establishing the WACC for 2011 in 11.7%. ANACOM has since assigned the audit responsibilities with respect to determining PT Comunicações's CAS for the last five years to an independent auditing firm. The audit is currently in process. In addition to the the current audit, ANACOM recently provided PT Comunicações a set of determinations and recommendations to improve the CAS. On January 28, 2013 ANACOM issued the final decision, ordering PT Comunicações to recalculate the CAS for 2007, implementing some corrections and revisions. This decision was later rectified, following explanations provided by PT Comunicações. PT Comunicações resubmitted the CAS results for 2007 on February 8, 2013.

Compensation for the Negative Operating of the Mandatory Services

Under our concession Agreement, PT Comunicações has the right to be directly compensated by the Portuguese State for the negative operating margins resulting from the mandatory provision of fixed telex service, fixed switched data transmission service, telegram service, broadcasting and distribution service of telecommunications broadcasting signals and maritime mobile service. On August 27, 2012, the General Inspection of Finance produced a report on compensation for these negative operating margins in 2006, which states that the calculation of the amount of compensation shall be determined by calculating the aggregate margin of the various mandatory services (and not for each service, as had been the practice thus far), to the detriment of PT Comunicações. PT Comunicações has challenged this decision.

Regulation on the Settlement and Collection of Regulatory Fees

According to the Administrative Rule 1473-B/2008 of December 17, 2008, all providers are subject to the payment of a regulatory fee for the provision of electronic communications networks and services, through which they cover the administrative regulatory costs of ANACOM.

On April 27, 2012, after computing the actual administrative costs and revising the value of provisions, ANACOM corrected the value of the fees owed to PT Comunicações in its capacity as a supplier of networks and electronic communications services in 2011. After these corrections, the applicable operators were reimbursed. On November 26, 2012, ANACOM settled the contributory percentage (applicable to all providers of electronic communications networks and services with annual revenues greater than 1.5 million euros) at 0.5538%, which was used to determine the 2012 regulatory fees owned by each provider.

Universal Service Obligations

Our concession imposes universal service obligations on us in Portugal. ANACOM divides universal services into three functions (1) connection to a public telecommunications network at a fixed location and the provision of public telephone services, (2) publicly available telephone offers and (3) comprehensive directory and directory inquiry services. These functions are further divided into three geographic regions: (1) North, (2) Center and (3) South and Islands. On October 12, 2012, the Ministries of Finance, Economy and Employment launched a tender offer to establish a designation for universal service providers for each of the three functions described above (referred to as "Tender 1," "Tender 2" and "Tender 3"), which included a compensation fund for universal service providers, as described below, and a related renegotiation of our concession. To select the company responsible for providing a comprehensive directory and a directory inquiry service, the criterion was the highest remuneration payable to the Portuguese State. The granting period for each of the services was set at five years. Pursuant to the qualifying report issued on February 2, 2013, PT Comunicações qualified for each of the Tender 1, Tender 2 and Tender 3 categories. The deadline for the submission of proposals for each of these tenders was March 15, 2013. PT Comunicações, ZON and Optimus presented bids for Tender 1, PT Comunicações presented the only bid for Tender 2 and no bids were presented for Tender 3. On April 18, 2013, ANACOM published a preliminary report regarding the bids for Tenders 1 and 2, as there was no bidder in Tender 3. In accordance with this report, PT Comunicações did not present the lowest bid in Tender 1 and, as such, will not likely continue to be the universal service provider of a connection to a public telecommunications network at a fixed location. However, PT Comunicações presented the lowest bid for Tender 2 and will likely continue to be the universal service provider of public payphones. In addition, even in the case where PT Comunicações is not selected as a universal services provider, we will be required to contribute to the compensation fund for universal services providers according to our share of the revenues of the national telecommunications sector.

On August, 23, 2012, Law 35/2012 was enacted, creating a compensation fund under the Electronic Communications Law intended to finance the net costs of universal service ("NCUS"). Further, if ANACOM determines that the provision of universal service obligations has become an "excessive burden," it may compensate us based on its own calculations of the costs associated with providing the universal service. On October 12, 2012, ANACOM issued its final decision on the substantiation of abnormally high access costs, under the methodology applicable to the calculation of the NCUS, determining that for this purpose, the costs of customers situated in the last third of customers with higher access costs should be considered. PT Comunicações's NCUS calculations have since been

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provided by ANACOM to an independent auditing firm for the period between 2007 to 2012. The auditing process is currently underway.

Consumers

On March 29, 2012, ANACOM set forth required procedures for subscribers to terminate contracts (in whole or in part) entered into by users and electronic communications undertakings in respect of the provision of publicly available electronic communications services. ANACOM determined that operators must implement certain measures, including requiring operators to amend their general terms/contracts and to make information available to the public in respect of standardized offers (within 90 business days from the date of the final decision). Pursuant to this decision, operators are required to make explicit the content of the termination declaration that can be submitted by a subscriber, the documents required to be submitted with the declaration form and the manner of submitting the termination request.

Network Security

On December 22, 2011, ANACOM approved a draft decision on the circumstances, format, and procedures applicable to reports regarding security breaches or loss of integrity with a significant impact on the functioning of electronic communications networks and services available to the public. This draft decision also sets forth the conditions under which ANACOM considers there to be a public interest in disclosing information regarding those events to the public. While there have been interactions between ANACOM, PT Comunicações and the Portuguese Association of Electronic Communications Operators (*Associação dos Operadores de Comunicações Electrónicas Apritel*) to address this issue, it remains pending.

Cloud Computing

Recently, the EC issued a review of cloud computing in Europe with the goal of enabling and facilitating its adoption throughout all sectors of the economy with a view to cutting ICT costs and boosting productivity, growth and jobs. The EC put forward a set of measures that, in its view, are key to promoting cloud computing and ensuring users' rights.

On December 12, 2012, the Directorate-General for Justice organized a workshop on cloud computing contracts, with the purpose of exploring stakeholders' experiences and views on cloud computing contracts with the EC. The EC and stakeholders discussed possible future developments of the market, issues relating to cloud computing contracts, based on existing practice, the economic impact of these issues in cloud computing contracts and the possible ways forward. The EC considered the workshop a first step to find precise feasible mandate for an expert group that will be formed to address cloud computing issues. It is expected that such group will issue guidance on fair and balanced contract terms, possible ways to increase trust of costumers and users and to introduce more legal certainty among providers, costumers and users, particularly in terms of security (with respect to the service and information stored) and privacy.

Cinema Law

On September 6, 2012, Law nr. 55/2012 established State action principles regarding the promotion, development and protection of cinema and cinematographic and audiovisual activities, referred to as the "Cinema Law." The law contemplates (1) an obligation to pay an annual fee of €3.50 for television services subscriptions, which will increase 10% annually up to a maximum of €5.00 and will be calculated based on the average number of subscriptions in the preceding calendar year (calculated in accordance with the information contained in quarterly reports published by ANACOM), (2) an obligation to participate in film and audiovisual production ensured through an annual investment in national cinematographic works, which amount will be annually set by statute, but not less than 1% of the revenues of video-on-demand services and (3) an obligation to create an area

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dedicated to national works where, upon the request of distributors and rights holders, all supported works will be available along with other national productions for sale or rent under conditions that confer the right to a percentage of not less than 50% of revenues to the owners of the rights.

Roaming

The EC regulates the roaming charges that may be charged in the wholesale market and the retail market in Europe. These regulations extend to data and SMS, or text messaging. On July 1, 2012, the previous roaming regulations were replaced by a new version, known as "Roaming III," which will expire on June 30, 2022. In addition to setting maximum voice roaming rates (subject to a glide path) that may be charged with respect to the wholesale market, retail market, data and SMS, Roaming III also features (1) extended transparency and consumer-protection measures ("bill-shock") that go beyond the EU territory, (2) a cap on retail data roaming communications, (3) the introduction of an obligation for mobile operators in the wholesale market to provide reasonable network access in order to allow roaming services and (4) the decoupling of roaming services from other services, while enabling a consumer to use the same number.

Pricing of Fixed Line Telephone Services

ANACOM has established a pricing regime for fixed line telephone services. This pricing regime creates the following regulatory obligations for the retail market for telephone services at a fixed location:

- Under the universal service obligation, the price cap applies, based on a basket composed of residential access and domestic calls is the Portuguese Consumer Price Index ("CPI") minus 2.75%.

- The price of fixed-to-mobile calls (residential and non-residential) is required to be cost-oriented, and a price control is in place in the form of a cap of €0.063 on the amount retained by the fixed operator with respect to fixed-mobile calls.

- The price of off-net fixed calls is also subject to a cap corresponding to the on-net prices, corrected for the existing asymmetry between the wholesale voice calls termination rates of Portugal Telecom and other operators.

- The tariffs for domestic payphone calls are required to correspond to a maximum of three times the tariff for a residential phone call.

- A requirement to grant a 50% discount on our monthly fee for retired people, a price accessibility obligation that was included under our universal service obligations.

In addition, general regulatory obligations of transparency, non-discrimination, cost orientation, cost accounting and account separation apply to access to the fixed line network and to the telephone services at a fixed location.

Interconnection

The Interconnection Framework. The EU Access and Interconnection Directive requires that interconnection services be made available in a non-discriminatory manner. The EU Access and Interconnection Directive encourages commercial negotiations among operators but requires national regulatory authorities to establish mechanisms for effective dispute resolution. According to the EU Access and Interconnection Directive, all telecommunications companies with significant market power in the call origination or termination markets must:

- make interconnection access to their networks available to other network operators;

- not discriminate between interconnection customers;

provide to those requesting interconnection the information and technical specifications necessary for them to interconnect their networks;

offer interconnection prices that are transparent and cost-oriented and do not discriminate between interconnection customers; and

maintain a separate accounting system for interconnection activities.

The EU Access and Interconnection Directive established the general conditions for access and interconnection among telecommunications operators in competitive markets. It guarantees the rights of new entrants to obtain interconnection from telecommunications operators with significant market power. ANACOM is entitled to review and modify our proposed interconnection rates and arrangements in our reference interconnection offer. ANACOM has established an overall interconnection framework based on cost and consistent with the EU legal framework for both wireline and mobile services.

Wireline Interconnection. ANACOM regulates call origination on fixed telephone networks provided at a fixed location and call termination on individual public telephone networks provided at a fixed location within the scope of market analysis and significant market power designations. ANACOM has declared the Portugal Telecom group to have significant market power in these markets. As a result, we are subject to price controls in these markets based on our costs and other factors and must publish a reference offer that includes these prices and quality of service standards.

Mobile Interconnection. All mobile operators are considered to have significant market power in call termination in mobile networks market. ANACOM has imposed price controls on interconnection rates for the termination of calls on mobile networks. These reductions have had, and are expected to continue to have, a significant impact on TMN's interconnection revenues and consequently its earnings.

On March 7, 2013, ANACOM published a draft decision regarding the revision of the relevant wholesale market for voice call termination on individual public telephone networks provided at a fixed location, proposing to set an average symmetrical fixed termination rate ("FTR") of €0.01091 from January 10, 2013 to January 7, 20, 2014, calculated as the average FTR of the countries that have already adopted the requirements of the EC decisions based on bottom-up pure LRIC cost models. A bottom-up LRIC cost model to regulate FTR, in line with the EC recommendation, is to be developed by ANACOM in the fourth quarter of 2013.

ANACOM has issued successive decisions that have reduced mobile termination rates over time. Most recently, in March 2012, ANACOM issued a final decision that reduced mobile termination rates progressively to €0.0127 by December 2012. The reductions in mobile termination rates have had and will continue to have a negative effect on our cash flows and revenues.

Pricing for Mobile Origination Rates

In January 2012, the Portuguese Competition Authority completed an analysis on mobile rates for originating calls, finding origination rates to be excessive and stating that mobile operators must reduce their rates to the level of their costs by July 2012 or face the possibility of being sanctioned. All three mobile network opeators decided to reduce its mobile originating rates between €0.07 and €0.0975 and no subsequent action from the Authority is expected.

Internet Access

As a result of past ANACOM decisions, we offer two access regimes to ISPs: (1) the Reference Offer for Internet Access, which includes two alternative pricing methods, namely a monthly flat rate and a per minute origination charge, and under which the connection of the ISP's infrastructure to our fixed line network is based on DSS1 signaling, and (2) the Reference Interconnection Offer, which includes a pricing method based on call origination, and under which the connection of the ISP's infrastructure to our fixed line network is based on Signaling System No. 7 (SS7) protocols. The ISPs determine which regime will apply to their arrangements to connect with our fixed line network.

Internet and Related Services

Various regulatory developments may affect our Internet business. A Data Protection Directive was adopted by the EC in 2006, imposing data-retention obligations on operators. The law implementing this directive requires Internet service providers and other electronic communications providers to preserve data for a specified period of time and imposes other obligations in this area.

Net Neutrality

Although there is no set definition of "net neutrality," Article 8(4)(g) of the EU Framework Directive requires national regulatory authorities to promote the interests of the citizens of the European Union by promoting the ability of end-users to access and distribute information or run applications and services of their choice.

In 2012, the EC and BEREC promoted several initiatives, including public consultations, guidelines on the scope of net neutrality and requests of information to the operators.

Reporting Obligations and Statistical Information

The regulatory framework requires PT Comunicações to submit periodic reports on the quality of service and comply with specified indicators. Penalties may occur if we do not achieve these metrics. On August 30, 2012, ANACOM approved a final decision that requires that mobile operators submit quarterly reports of statistical indicators with respect to machine-to-machine communications and mobile broadband. We must also provide white page directories and certain other facilities to certain specified categories of subscribers free of charge.

Regulatory Proceedings

We are regularly involved in regulatory inquiries and investigations involving our operations. In addition, ANACOM, the EC, the Portuguese Competition Authority and the ERC regularly make inquiries and conduct investigations concerning our compliance with applicable laws and regulations. These investigations are described in more detail in "*Item 8 Financial Information Legal Proceedings*."

Brazil

Overview

Oi's business, including the nature of the services it provides and the rates it charges, is subject to comprehensive regulation under the Brazilian General Telecommunications Law (*Lei Geral das Telecomunicações*) and a comprehensive regulatory framework for the provision of telecommunications services promulgated by ANATEL. Oi provides fixed line, domestic and international long-distance and mobile telecommunications services under concessions, authorizations and licenses that were granted by ANATEL and allow it to provide specified services in designated geographic areas, as well as set forth certain obligations with which it must comply.

ANATEL is a regulatory agency established pursuant to the General Telecommunications Law and the *Regulamento da Agência Nacional de Telecomunicações*. ANATEL oversees Oi's activities and enforces the General Telecommunications Law and the regulations promulgated thereunder. ANATEL is administratively independent and financially autonomous. ANATEL is required to report on its activities to the Brazilian Ministry of Communications. ANATEL has authority to propose and issue regulations that are legally binding on telecommunications services providers. ANATEL also has the authority to grant concessions and licenses for all telecommunications services, other than broadcasting services. Regulations and actions proposed by ANATEL are subject to a period of public comment, which may include public hearings. ANATEL's decisions may be challenged, administratively before the agency itself, or through the Brazilian judicial system.

Regulation of Fixed Line Services

General Policies for the Regulation of the Fixed Line Telecommunications Sector

Decree No. 4,733, which was intended to consolidate several changes in the regulation of Brazil's fixed line telecommunications sector, sets forth general declarations of policy regarding, among other things:

- universal access to telecommunications services;
- stimulation of employment and development of the Brazilian telecommunications sector;
- promotion of competition and adoption of rate readjustment policies that take into account Brazilian socioeconomic considerations; and
- the financial equilibrium of existing concession agreements.

This decree also defined certain changes that are reflected in the concession agreements entered into by providers of public regime services that became effective on January 1, 2006.

A number of bills affecting telecommunications policy have been submitted to the Brazilian Congress with an aim to make telecommunications services more accessible to Brazil's low-income population. These bills have proposed to eliminate the monthly subscription fee (*assinatura mensal*) that compensates telecommunications companies for extending and maintaining fixed line telecommunications services for their customers. If approved, Oi expects that this proposal will adversely affect the overall margin of telecommunications providers.

Rate Regulation

Public regime service providers must offer a basic service plan comprised of the following basic services: (1) installation, (2) monthly subscription, and (3) switched local minutes. Modifications of the rates charged for these basic services are determined by reference to a local rate basket that represents the weighted average of the rates for monthly subscriptions and switched local minutes. Rates for long-distance services originated and terminated on fixed lines vary in accordance with three basic criteria: (1) physical distance separating callers, (2) time of the day, and (3) day of the week on which the call is placed. Modifications of the rates charged for these long-distance services are determined by reference to a long-distance rate basket that represents the weighted average of the rates for long-distance calls. The rates for the provision of services through payphones and installation rates are treated separately. The rates for international long-distance services provided by Embratel, the incumbent international long-distance concessionaire, are regulated by ANATEL. However, the rates for international long-distance services charged by other long-distance service providers, all of whom provide these services under authorizations rather than concessions, are not subject to ANATEL regulation.

The concession agreements establish a price-cap mechanism for annual rate adjustments for basic service plans and domestic long-distance rates based on formulas set forth in each provider's concession agreement. The formula provides for two adjustments to the price cap based on the local rate basket, the long-distance rate basket and the use of a price index. The price cap is first revised upward to reflect increases in inflation, as measured by an index, then ANATEL applies a productivity discount factor, or Factor X, which reduces the impact of the rate readjustment provided by the index.

ANATEL calculates the sector's weighted average productivity rate. As of the date of this annual report, Factor X is equal to (1) 50% of the increase in the weighted average productivity rate of public regime providers, plus (2) 75% of a factor calculated by ANATEL that is designed to reflect cost optimization targets for the telecommunications industry as a whole. If the weighted average

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productivity rate is negative, ANATEL will not allow an annual adjustment in excess of the IST inflation index.

ANATEL has proposed new regulations under which it would modify the Factor X applicable to the determination of rate increases available to public concessionaires providing fixed line services. These regulations were submitted for public consultation in July 2011 and the public consultation period ended on September 1, 2011. Oi expects these new regulations, as they may be modified as a result of ANATEL's further analysis, to be adopted in 2013.

A provider may increase rates for individual services within the local rate basket or the long-distance rate basket by up to 5% more than the IST so long as the rates for other services in that rate basket are reduced to the extent necessary to ensure that the weighted average increase for the entire rate basket does not exceed the permitted annual rate adjustment.

A provider may also offer alternative plans in addition to the basic service plan. Alternative plans must be submitted for ANATEL's approval. The rates offered under the alternative plans may be adjusted annually based on the IST.

General Plan on Universal Service

The General Plan on Universal Service sets forth the principal network expansion and modernization obligations of the public regime providers, such as providing public telephones in localities with a population in excess of 100 and installing residential fixed lines within seven days of a request in localities with a population in excess of 300. In addition, public regime providers must comply with the Special Individual Access Class (*Acesso Individual Classe Especial*) rules, which are designed to require service for economically disadvantaged people. Under the Special Individual Access Class rules, a qualifying customer may subscribe to a service plan, limited to one fixed line per household, and pay lower monthly fees for service than under basic service plans.

Public regime providers are also subject to network expansion requirements under the General Plan on Universal Service, which are revised by ANATEL from time to time. No subsidies or other supplemental financings are anticipated to finance Oi's network expansion obligations. Oi's failure to meet the network expansion and modernization obligations established by the General Plan on Universal Service or in its concession agreements may result in fines and penalties of up to R$50 million, as well as potential revocation of its concessions.

On June 30, 2011, the General Plan on Universal Service was amended. Among other things, these amendments:

- expanded the obligations of local fixed line service providers to provide individual access to fixed line voice services to economically disadvantaged segments of the Brazilian population within their service areas through programs to be established and regulated by ANATEL;

- reduced the density requirements applicable to the obligations of local fixed line service providers to provide public telephones in urban areas within their service areas; and

- expanded the obligations to provide universal service in rural and remote areas of local and long-distance fixed line providers that obtain authorizations to use radio spectrum in the 450 MHz band, including increased obligations to provide individual and group access to fixed line voice services.

Service Restrictions

Pursuant to regulations in effect as of the date of this annual report, public regime providers are subject to certain restrictions on alliances, joint ventures and mergers and acquisitions with other public regime providers, including:

- a prohibition on holding more than 20% of the voting shares of more than one other provider of public regime services; and

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- a restriction on mergers between regional fixed line service providers.

ANATEL has adopted regulations eliminating the limitation on the number of authorizations to provide subscription television services. Law No. 12,485 creates a new legal framework for subscription television services in Brazil, replacing and unifying the previously existing regulatory provisions that governed various forms of subscription television services, such as cable television, Multichannel Multipoint Distribution Service ("MMDS") and DTH. The principal provisions of Law No. 12,485:

- allow fixed line telephone concessionaires, such as Oi, who previously were allowed to provide subscription television services using only MMDS and DTH technologies, to enter the cable television market in Brazil;
- remove existing restrictions on foreign capital investments in cable television providers;
- establish minimum quotas for domestic content programming on every television channel;
- limit the total and voting capital held by broadcast concessionaires and authorized providers, and in television programmers and producers, with headquarters in Brazil to 30%; and
- prohibit telecommunications services providers with collective interests from acquiring rights to disseminate images of events of national interest and from hiring domestic artistic talent.

The framework established by Law No. 12,485 is expected to increase the availability and lower the price of subscription television services in Brazil, through increased competition among providers, and improve the quality, speed and availability of broadband internet services as a result of the expected proliferation of fiber optic cables used to transmit cable television.

In March 2012, ANATEL adopted new regulations under which the authorizations to provide various existing subscription television services have been consolidated into authorizations to provide a newly defined service called Conditional Access Service. Under these regulations, authorizations to provide Conditional Access Service apply to private telecommunications services, the receipt of which are conditioned on payment by subscribers, for the distribution of audiovisual contents in the form of packages, individual channels and channels with required programming by means of any communications technology, processes, electronic means or protocols. An authorization granted by ANATEL to provide Conditional Access Service is valid for the entire Brazilian territory. However, the provider must indicate in its application for an authorization the localities that it will service. In December 2012, ANATEL granted Oi's request to convert its DTH authorization agreement into a Conditional Access Service authorization. Although Oi has not yet signed the Conditional Access Service authorization agreement, the act by which ANATEL granted Oi's request authorized the company to begin offering the services to be governed by that agreement, including IP TV.

General Plan on Quality Goals

Fixed line service providers operating under the public regime or the private regime must comply with the provisions of the General Plan on Quality Goals. All costs related to compliance with the quality goals established by the General Plan on Quality Goals must be borne exclusively by the service provider. The General Plan on Quality Goals establishes minimum quality standards with regard to:

- modernization of the network;
- responses to repair requests;
- responses to change-of-address requests;

rate of call completion;

operator availability;

availability of services to customers;

issuance of bills;

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- responses to mail received from customers; and
- quality of public telephones.

These quality standards are measured according to definitions and quality indicators established by ANATEL. Every month, fixed line service providers are required to report their compliance with quality goals to ANATEL. Additionally, they are obligated to provide ANATEL with an in-depth report and analysis on each quality goal that is not satisfied. ANATEL may also collect such data from fixed line service providers at any time without prior notice. Fixed line service providers that fail to meet quality goals established by ANATEL may be subject to warnings, fines, intervention by ANATEL, temporary suspensions of service or cancellation of their concessions and authorizations.

ANATEL measures the performance of fixed line service providers in each individual state in which they operate. As a result, the performance of fixed line service providers in any particular state may not meet one or more quality performance targets even if such service provider's overall performance is satisfactory. Therefore, fixed line service providers, including Oi, could be subject to fines or penalties as a result of the failure to meet the quality performance targets in one or more particular states.

Oi's failure to meet the quality of service obligations established by the General Plan on Quality Goals or in its concession agreements may result in fines and penalties of up to R$40 million.

General Plan on Competition Targets

The General Plan on Competition Targets, which became effective in November 2012, contemplates the creation of one entity to manage information about telecommunications networks, act as an intermediary in contracts between telecommunications providers and supervise the offering of wholesale data traffic services. The General Plan on Competition Targets also addresses a variety of other matters relating to both fixed line and mobile service providers, including criteria for the evaluation of telecommunications providers to determine which providers have significant market power, regulations applicable to the wholesale markets for trunk lines, backhaul, access to internet backbone and interconnection services, and regulations related to partial unbundling and/or full unbundling of the local fixed line networks of the public regime service providers.

The General Plan on Competition Targets imposes stricter restrictions on providers that are deemed to have significant market power in a particular geographic area, ranging from a neighborhood within a municipality to the entire national territory. In order to determine whether a provider has significant market power, ANATEL established criteria that consider:

- the provider's market share in particular mobile interconnection and personal services market;
- the economies of scope and scale available to the provider;
- the provider's dominance over infrastructure that is not economically viable to duplicate; and
- that provider's concurrent operations in the wholesale and retail markets.

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Infrastructure Sharing

Prior to the adoption of the General Plan on Competition Targets, ANATEL established rules for partial unbundling of the local fixed line networks of the public regime service providers, which Oi refers to as "line sharing," and which (1) limited the rates service providers can charge for line sharing, and (2) addressed related matters such as co-location space requirements. Co-location means that a service provider requesting unbundling may place its switching equipment in or near the local exchange of the service provider whose network the requesting service provider wishes to use and may connect to the network at this local exchange.

The General Plan on Competition Targets requires public regime service providers that have significant market power share their fixed line network infrastructure with other providers, including local fixed line access networks. Providers that are deemed to have significant market power must offer (1) full unbundling of copper wire or coaxial cable access networks, and (2) partial unbundling of broadband networks to accommodate bitstreams of up to 10 Mbps. The methodology by which the wholesale prices for these services will be determined will be established by ANATEL.

Providers with significant market power must also share their passive infrastructure, such as telecommunications towers, with other service providers at prices determined by bilateral negotiations between the providers.

Interconnection Regulations Applicable to Personal Services Providers

The General Plan on Competition Targets established regulations for the rates charged by mobile service providers to terminate calls on their mobile networks ("VU-M rate"). The General Plan on Competition Targets established a reference value for VU-M rates of providers that are deemed to hold significant market power and determined that beginning in 2016, VU-M rates will be determined on the basis of costs. Under the General Plan on Competition Targets:

- until February 2015, mobile service providers with significant market power will be able to charge service providers without significant market power for calls originating from or terminating on their network only if the outgoing traffic in a given direction of transmission is higher than 80% of the total traffic between such providers;

- between February 2015 and February 2016, mobile service providers with significant market power will be able to charge service providers without significant market power for calls originating from or terminating on their network only if the outgoing traffic in a given direction of transmission is higher than 60% of the total traffic between such providers; and

- beginning in February 2016, mobile service providers with significant market power will be able to charge service providers without significant market power for calls originating from or terminating on their network at all times.

Roaming

Under the General Plan on Competition Targets, a mobile service provider with significant market power must offer roaming services to other mobile providers without significant market power at the maximum rate that the mobile service provider with significant market offers such services to its retail customers.

Regulation of Mobile Services

In September 2000, ANATEL adopted regulations that established operating rules for providers under the personal mobile service (*Serviço Móvel Pessoal*) regime. The regulations permitted ANATEL to grant authorizations to provide mobile telecommunications services under the personal mobile

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service regime. For purposes of the personal mobile service regulations, Brazil is divided into three service regions covering the same geographic areas as the concessions for fixed line telecommunications services.

Under the personal mobile services regulations:

- Band A and Band B service providers can apply for an additional frequency range;
- each service provider may apply to provide domestic and international long-distance services originating from its service region;
- existing service providers, as well as new entrants into the Brazilian telecommunications market, may bid for new licenses in all frequency bands, other than Band A and Band B;
- personal mobile services providers are required to offer a basic service plan to their customers containing certain prescribed features;
- personal mobile services providers are required to establish interconnection rates for the use of one provider's network by another provider;
- the number of regions in which a personal mobile services provider may offer services is not limited; and
- a personal mobile services provider, or its controlling shareholders, may not hold more than one personal mobile services authorization covering any specific region.

Auction of Personal Mobile Services Spectrum

Prior to the establishment of the personal mobile services regime, ANATEL granted licenses to mobile services providers to operate in each region of Brazil using Bands A and B. Subsequently, ANATEL successfully auctioned authorizations and licenses to operators in Band D and Band E. ANATEL granted TNL PCS's initial authorization to provide personal mobile services in Region I and a license to operate in Band D. ANATEL granted Oi's initial authorization to provide personal mobile services in Region II and a license to operate in Band E. ANATEL conducted additional auctions of radio frequency licenses in 2004 and 2006, whereby Brasil Telecom Mobile acquired an additional license to operate in Region II.

In December 2007, ANATEL auctioned the remaining spectrum of Bands A, B, C, D and E to existing service providers as extension blocks and auctioned additional spectrum in Band M (1.8 GHz) and Band L (1.9 GHz). In these auctions, TNL PCS acquired (1) an authorization to provide personal mobile services in the State of São Paulo and licenses to operate using Band M throughout the State of São Paulo and Band E outside of the city of São Paulo, and (2) licenses to use additional spectrum in 12 states in Region I.

Auction of 3G Spectrum

In preparation for auctions of spectrum in Bands F, G, I and J (2.1 GHz), the use of which allows personal mobile services providers to offer 3G services to their customers, ANATEL issued regulations that divide the Brazilian territory into nine regions for purposes of operations using these frequency bands. In December 2007, ANATEL auctioned radio frequency licenses to operate on each of these frequency bands in each of the nine regions and the related licenses to use these frequency bands. In this auction, Brasil Telecom acquired the radio frequency licenses necessary to offer 3G services in two of the nine regions delineated by ANATEL for 3G services (corresponding to Region II under the personal mobile services regime) and TNL PCS acquired radio frequency licenses necessary to offer 3G services in six of the nine regions delineated by ANATEL for 3G services (corresponding to Region I and Region III under the personal mobile services regime, other than an area that consists of

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23 municipalities in the interior of the State of São Paulo that includes the city of Franca and surrounding areas).

Authorizations to Use 450 MHz Band and 2.5 GHz Band

Under Executive Decree 7,512, dated June 30, 2011, ANATEL granted authorizations to telecommunications providers to use radio spectrum in the 450 MHz band radio spectrum and the 2.5 GHz radio spectrum, the latter of which allows telecommunications providers to offer 4G services to their customers. Among other obligations, licensees of radio frequencies in the 450 MHz band radio spectrum must agree to provide individual and collective voice and data services in rural and remote areas, in accordance with the provisions of Executive Decree 7,512 and the General Plan on Universal Service. In June 2012, Oi acquired radio frequency licenses necessary to offer 4G services in 5,564 municipalities in Region I, Region II and Region III.

Personal Mobile Services Rate Regulation

Rates for personal mobile services are regulated by ANATEL. Personal mobile services providers are required to offer a basic service plan that consists of a monthly subscription, local calls and roaming. Basic service plans were approved by ANATEL for each of the personal mobile services providers following the grant of personal mobile services authorizations to each of these providers.

Following the effectiveness of the basic service plans, annual adjustments of the rates under these plans have been subject to a price-cap mechanism. Through 2005, rates were adjusted annually by no more than the rate of inflation, as measured by the IGP-DI. In 2006, ANATEL replaced the IGP-DI with the IST to calculate annual rate adjustments.

Personal mobile services providers are permitted to offer non-discriminatory alternative plans to the basic service plan. The rates charged under these plans (*e.g*., monthly subscription rates, charges for local calls and roaming charges) are subject to ANATEL approval prior to the time that these plans are first offered to mobile customers. Following the approval of these plans, the rates under these plans may be increased up to an annual adjustment that is approved by ANATEL and is no more than the rate of inflation, as measured by the IST.

Although subscribers of a plan cannot be forced to migrate to new plans, existing plans may be discontinued as long as all subscribers receive a notice to that effect and are allowed to migrate to new plans within six months of such notice. Discounts from the rates set in basic service plans and alternative service plans may be granted to customers without ANATEL approval.

In November 2012, ANATEL adopted revisions to the personal mobile services regulations that became effective in February 2013. Under these revised regulations, successive telephone calls originating from one telephone number to the same prior destination are considered one single call if the time elapsed between calls is equal to or less than 120 seconds, regardless of the duration of each individual call.

Obligations of Personal Mobile Services Providers

As a telecommunications services provider, Oi is subject to requirements concerning network expansion and quality of service, as established in applicable regulations and in its personal mobile services authorizations. If Oi fails to meet these obligations it may be fined, subject to a maximum penalty of R$50 million, until it is in full compliance with its obligations. While it is possible for an authorization to be revoked for non-compliance with these obligations, there is no precedent for such a revocation.

Quality of Service Obligations

Oi's personal mobile services authorizations impose obligations to meet quality of service standards relating to its network's ability to make and receive calls, call failure rates, capacity to handle peak periods, failed interconnection of calls and customer complaints. ANATEL defines these quality of service standards, and Oi must report information in connection with such standards to ANATEL.

Additional Obligations

ANATEL has adopted revisions to the personal mobile services regulations. These regulations impose additional obligations on personal mobile services providers, particularly in connection with customers' rights. These obligations require personal mobile services providers to:

- establish at least one customer service center in each registration area served that has more than 100,000 inhabitants;
- upgrade customer service centers to improve access by people with hearing disabilities;
- increase the term applicable to prepaid cards from 90 days to 180 days or more;
- deliver to prepaid customers a detailed report of service use upon request;
- reimburse unused prepaid credits;
- limit the duration of contracts with prepaid customers to 12 months;
- permit customers to change service plans without penalties; and
- unblock mobile handsets, allowing a customer who purchased a mobile handset from any personal mobile services provider to use it on the network of another personal mobile services provider.

Interconnection Regulations

Under the General Telecommunications Law, all telecommunications services providers are required, if technically feasible, to make their networks available for interconnection on a non-discriminatory basis whenever a request is made by another telecommunications services provider. Interconnection permits a call originated on the network of a requesting fixed line or personal mobile services provider's network to be terminated on the fixed line or personal mobile services network of the other provider. ANATEL initially adopted General Rules on Interconnection (*Regulamento Geral de Interconexão*) in 1998, which were amended and restated in July 2005.

Interconnection Regulations Applicable to Fixed Line Providers

Interconnection fees are charged at a flat rate per minute of use of a fixed line provider's network. Interconnection rates charged by a fixed line provider to terminate a call on its local network (the "TU-RL rate") or intercity network (the "TU-RIU rate") are subject to a price cap established by ANATEL. The price cap for interconnection rates varies from service provider to service provider based on the retail prices of each service provider.

Fixed line service providers must offer the same TU-RL and TU-RIU rates to all requesting providers on a non-discriminatory basis. The price caps on interconnection rates are adjusted annually by ANATEL at the same time that rates for local and long-distance rates are adjusted. Fixed line service providers are only required to pay interconnection fees to another fixed line service provider for traffic in the same local area in the event that the ratio of the outbound traffic generated by that provider (measured in minutes) to the inbound traffic terminated by that provider (measured in

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minutes) exceeds 75% or was less than 25%. This system is designated the "partial bill-and-keep" system.

In 2006, ANATEL established that (1) the TU-RL rates that fixed line service providers could charge each other to terminate a call on their respective networks was 50% of the rate included in their Basic Plan per Minute for a local fixed line call, and (2) the TU-RIU rates that fixed line service providers could charge each other to use a portion of their long-distance networks to complete long-distance calls was 30% of the applicable domestic fixed line-to-fixed line long-distance rates for calls of more than 300 km. In 2007, the TU-RL rates of the fixed line service providers were reduced to 40% of the rate included in their Basic Plan per Minute for a local fixed line call.

ANATEL announced that beginning in 2008, the method used to determine the TU-RL rates would be based on a cost methodology, known as long-run incremental costs (LRIC). However, in October 2007, ANATEL published an official letter delaying this change until the end of 2010. In September 2010, ANATEL commenced the bidding process to engage an international consultant to assist with the development of the long-run incremental cost methodology. ANATEL has indicated that it will provide a definitive timetable for the completion of the project in September 2013. Therefore, OI cannot predict when this new methodology will be adopted.

In May 2012, ANATEL adopted revisions to the regulations relating to TU-RL rates and TU-RIU rates that became effective in August 2012. Under the revised regulations (1) between August of 2012 and December of 2013, fixed line service providers will be able to charge other fixed line service providers for local fixed line calls originating on their local fixed line networks and terminating on the other provider's local fixed line networks only if the outgoing traffic in a given direction of transmission is higher than 75% of the total traffic between such providers, and (2) beginning in January 2014, fixed line service providers will no longer be able to charge other fixed line service providers for local fixed line calls originating on their local fixed line networks and terminating on the other provider's local fixed line networks.

In August 2012, the TU-RIU rates were reduced to 25% of the applicable domestic fixed line rates for calls with more than 300 km, and in January 2013, TU-RIU rates were reduced to 20% of the applicable domestic fixed line rates for such calls.

Interconnection Regulations Applicable to Personal Mobile Services Providers

Interconnection fees are charged at a flat rate per minute of use of a personal mobile services provider's network. The terms and conditions of interconnection agreements of all personal mobile services providers, including the VU-M rate (the rate charged by the operator of the network to terminate a call on its mobile network), commercial conditions and technical issues, are freely negotiated between mobile and fixed line telecommunications services providers, subject to compliance with regulations established by ANATEL relating to traffic capacity and interconnection infrastructure that must be made available to requesting providers, among other things.

Personal mobile services providers must offer the same VU-M rate to all requesting providers on a non-discriminatory basis. Interconnection agreements must be approved by ANATEL before they become effective, and they may be rejected if they are contrary to the principles of free competition and the applicable regulations. If the providers cannot agree upon the terms and conditions of interconnection agreements, ANATEL may determine terms and conditions by arbitration. Since no agreement with fixed line service providers could be reached regarding VU-M rates when Oi began offering personal mobile services, ANATEL set the initial VU-M rates. Personal mobile services providers negotiate annual rate increases for their VU-M charges with the fixed line telecommunications providers. If the providers cannot agree upon the terms and conditions of annual rate increases, ANATEL may determine the annual rate increases by arbitration.

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In November 2011, ANATEL adopted new regulations under which ANATEL was authorized to reduce the then-current VC-1, VC-2 and VC-3 rates by as much as 18% in 2011, 12% in 2012 and 10% in 2013, after giving effect to an inflation adjustment based on the IST measured from June 2009. In February 2012, ANATEL ordered Oi to reduce its VC-1, VC-2 and VC-3 rates by approximately 10%, although Oi is appealing the timing of the application of this rate reduction, as its VC-1 rate was increased in Region I by 1.54% in accordance with Oi's application for this increase in February 2012. In March 2013, ANATEL reduced Oi's VC-1 rates in Region I and Region II by approximately 18.6% and 8%, respectively; Oi will similarly appeal the timing of the application of the rate decrease in Region II. These regulations also provided procedures under which ANATEL adopted a maximum VU-M rate that is applicable in the event that providers cannot agree upon the VU-M applicable in their interconnection agreements.

Number Portability Regulations

Number portability is the ability of a customer to move to a new home or office or switch service providers while retaining the same fixed line or mobile telephone number. The General Regulation of Portability (*Regulamento Geral de Portabilidade*) established general rules regarding portability of fixed line and mobile telephone numbers. These regulations permit fixed line customers to retain their telephone numbers if they become customers of a different fixed line service provider in the same municipality or if they move to a new home or office in the same municipality. Personal mobile services customers are permitted to retain their telephone numbers if they change their service plan or if they become customers of a different personal mobile services provider within the same registration area. Each telecommunications provider has been required to contract a third-party management entity to manage all procedures relating to number portability. Service providers are permitted to charge a migrating customer that elects to retain its telephone number a one-time fee of no more than R$4.00. This amount is intended to compensate the customer's current provider for the costs associated with managing the portability process. The new provider may elect to absorb this fee on behalf of the customer.

Regulation of Data Transmission and Internet Services

Under Brazilian regulations, ISPs are deemed to be suppliers of value-added services and not telecommunications services providers. Value-added services are activities that add features to a telecommunications services supported by such value-added services. Telecommunications services providers are permitted to render value-added services through their own networks. In addition, ANATEL regulations require all telecommunications services providers and cable television operators to grant network access to any party interested in providing value-added services, including internet access, on a non-discriminatory basis, unless not technically feasible.

ANATEL has adopted regulations applicable to fixed line service providers with significant market power. Under these regulations, these providers are required to make the forms of agreements that they use for EILD and SLD services publicly available, including the applicable rates, and are only permitted to offer these services under these forms of agreement. Following publication of these forms of agreement, the rates under these agreements may be increased on an annual basis by no more than the rate of inflation, as measured by the IST. ANATEL also publishes reference rates for these services, and if a customer objects to the rates a provider charges for these services, the customer is entitled to seek a reduction in the applicable rate through arbitration before ANATEL.

Multimedia Communications Service Quality Management Regulations

In June 2011, the President of Brazil issued Executive Decree No. 7,512/11, which mandated ANATEL to take the necessary regulatory measures to establish quality standards for broadband internet services. In compliance with such decree, on October 31, 2011, ANATEL published a

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resolution approving the Multimedia Communications Service Quality Management Regulations (*Regulamentação de Gestão da Qualidade do Serviço de Comunicação Multimídia*), which identify network quality indicators and establish performance goals for multimedia communications service providers, including broadband internet service providers, with more than 50,000 subscribers. Such providers will be required to collect representative data using dedicated equipment installed at the site of each network connection and be subject to periodic measurements to ensure their compliance with these regulations, including:

- individual upload and download speeds of at least 20%, 30% and 40% of contracted speeds per measurement for at least 95% of all measurements, during the first year, second year and thereafter, respectively, following implementation of the regulations;

- average upload and download speeds of at least 60%, 70% and 80% of contracted speeds for all measurements during the first year, second year and thereafter, respectively, following implementation of the regulations; and

- individual round-trip latencies for fixed line connections of up to 80 milliseconds per measurement for at least 95% of the measurements.

To increase transparency, customers must be provided with specialized software at no cost to measure their own network quality, although such customer-generated measurements will not be included in official calculations. In addition to ensuring network quality standards, service providers must hire specialized companies to measure customer service and customer satisfaction indicators, including complaint resolution, customer service personnel competence, customer perceptions relating to billing and quality of technical support staff. Service providers must comply with the above-mentioned quality standards beginning on the thirteenth month following implementation of the regulations. Failure to meet such standards will subject non-compliant service providers to sanctions.

Concessions, Authorizations and Licenses

Under the General Telecommunications Law and ANATEL regulations, the right to provide telecommunications services is granted either through a concession under the public regime or an authorization under the private regime. A concession is granted for a fixed period of time following a public auction and is generally renewable only once. An authorization is granted for an indeterminate period of time and public auctions are held for some authorizations. These concessions and authorizations allow service providers to provide specific services in designated geographic areas, set forth certain obligations with which the service providers must comply and require equal treatment of customers by the service providers.

The three principal providers of fixed line telecommunications services in Brazil (Oi, Telesp and Embratel) provide these services under the public regime. In addition, CTBC and Sercomtel, which are secondary local fixed line telecommunications service providers, operate under the public regime. All of the other providers of fixed line telecommunications services and all providers of personal mobile services and data transmission services in Brazil operate under the private regime.

Providers of public regime services, such as Oi, are subject to more obligations and restrictions than providers of private regime services. Under Brazilian law, providers of public regime services are subject to certain requirements with respect to services such as quality of service, continuity and universality of service, network expansion and network modernization. Additionally, the rates that public regime service providers may charge customers are subject to ANATEL supervision.

With the goal of introducing competition in fixed line telephone services in Brazil, the federal government has granted four private-regime authorizations to permit fixed line service providers to compete with the incumbent fixed line concessionaires. The number of authorizations that the federal government may issue is unlimited. Providers of private regime services, although not generally subject to the requirements concerning continuity and universality of service and network modernization, are subject to certain network expansion and quality of service obligations set forth in their respective authorizations.

Oi operates under:

- a concession to provide local fixed line services in Region I (other than the 57 municipalities in the State of Minas Gerais that are excluded from the concession area of Region I) and a concession to provide local fixed line services in Region II (other than the nine municipalities in the States of Goiás, Mato Grosso do Sul and Paraná that are excluded from the concession area of Region II);

- a concession to provide domestic long-distance services in Region I (other than the 57 municipalities in the State of Minas Gerais that are excluded from the concession area of Region I) and a concession to provide domestic long-distance services in Region II (other than the nine municipalities in the States of Goiás, Mato Grosso do Sul and Paraná that are excluded from the concession area of Region II);

- authorizations to provide personal mobile services in Region I, Region II and Region III;

- radio frequency licenses to provide 3G mobile services in Region I, Region II and Region III (other than 23 municipalities in the interior of the State of São Paulo that include the city of Franca and surrounding areas);

- radio frequency licenses to provide 4G mobile services in Region I, Region II and Region III;

- authorizations to provide local fixed line services and domestic long-distance services in (1) the 57 municipalities in the State of Minas Gerais that are excluded from the concession area of Region I, (2) the nine municipalities in the States of Goiás, Mato Grosso do Sul and Paraná that are excluded from the concession area of Region II, and (3) Region III;

- authorizations to provide international long-distance services originating anywhere in Brazil;

- authorizations to provide Multimedia Communication Services (*Serviço de Comunicação Multimídia*) throughout Brazil; and

- an authorization to provide subscription television services throughout Brazil.

These concessions and authorizations allow Oi to provide specific services in designated geographic areas and set forth certain obligations with which Oi must comply.

Termination of a Concession

ANATEL may terminate the concession of any public regime telecommunications services provider upon the occurrence of any of the following:

- an extraordinary situation jeopardizing the public interest, in which case the Brazilian government may render the services set forth under the concession in lieu of the concessionaire, subject to congressional authorization and payment of adequate indemnification to the holder of the terminated concession;

termination by the provider (through an agreement with ANATEL or pursuant to legal proceedings) as a consequence of an act or omission of the Brazilian government that makes the rendering of the services excessively burdensome to the provider;

annulment of the concession due to a contractual term, which is deemed by subsequent law to be illegal;

material failure to comply with the provider's universalization targets;

- failure to meet insurance requirements set forth in the concession agreement;
- a split-up, spin-off, amalgamation, merger, capital reduction or transfer of the provider's control without ANATEL's authorization;
- the transfer of the concession without ANATEL's authorization;
- the dissolution or bankruptcy of the provider; or
- an extraordinary situation in which Brazilian government intervention, although legally permissible, is not undertaken, as such intervention would prove to be inconvenient, unnecessary or would result in an unfair benefit to the provider.

In the event a concession is terminated, ANATEL is authorized to administer the provider's properties and its employees in order to continue rendering services.

Fixed Line Services Concession Agreements

Oi has entered into concession agreements with ANATEL that govern its concessions to provide fixed line services in the Federal District and each of the states of Region I and Region II. Each of Oi's concession agreements:

- expires on December 31, 2025;
- sets forth the parameters that govern adjustments to fixed line services rates;
- requires compliance with the network expansion obligations set forth in the General Plan on Universal Service;
- requires compliance with certain quality of service obligations set forth in the concession agreements as well as the quality of service obligations set forth in the General Plan on Quality Goals;
- requires payment of biannual fees equal to 2.0% of Oi's net operating revenue derived from the provision of local fixed line services (excluding taxes and social contributions) during the immediately preceding year, while allowing Oi to apply the amount of such fees to finance the expanded service obligations created by the amended General Plan on Universal Service in lieu of making payment to ANATEL;
- allows Oi to offer subscription television services such as IP TV, over its fixed line networks;
- requires the implementation of electronic billing systems;
- sets forth the conditions under which ANATEL may access information from Oi;
- requires the payment of fines for systemic service interruptions; and

requires Oi to rescind its contracts if ANATEL determines they are contrary to any rules or regulations, economic order or public interest.

These concession agreements also required Oi to provide transmission lines connecting its fiber-optic internet backbones to municipalities in Oi's concession areas in which it did not provide internet service, which Oi refers to as "backhaul." Under these concession agreements, Oi was obligated to set up backhaul in 3,252 municipalities in Region I and Region II. The facilities that Oi constructed to meet these obligations are considered to be property that is part the concessions and will therefore revert to the Brazilian government on January 1, 2026.

These concession agreements provide that ANATEL may modify their terms in 2015 and 2020 and may revoke them prior to expiration under the circumstances described above. The modification right permits ANATEL to impose new terms and conditions in response to changes in technology, competition in the marketplace and domestic and international economic conditions. ANATEL is obligated to engage in public consultation in connection with each of these potential modifications.

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Domestic Long-Distance Services Concession Agreements

Oi has entered into concession agreements with ANATEL that govern its concessions to provide domestic long-distance services originating from the Federal District and each of the states of Region I and Region II. Each of Oi's concession agreements:

- expires on December 31, 2025;
- sets forth the parameters that govern adjustments to domestic long-distance services rates;
- requires compliance with certain quality of service obligations set forth in the concession agreements as well as the quality of service obligations set forth in the General Plan on Quality Goals;
- requires payment of biannual fees equal to 2.0% of Oi's net operating revenue that is derived from the provision of domestic long-distance services (excluding taxes and social contributions) during the immediately preceding year;
- requires the implementation of electronic billing systems;
- sets forth the conditions under which ANATEL may access information from Oi;
- requires the payment of fines for systemic service interruptions; and
- requires Oi to rescind its contracts if ANATEL determines they are contrary to any rules or regulations, economic order or public interest.

These concession agreements provide that ANATEL may further modify their terms in 2015 and 2020 and may revoke them prior to expiration under the circumstances described above. The modification right permits ANATEL to impose new terms and conditions in response to changes in technology, competition in the marketplace and domestic and international economic conditions. ANATEL is obligated to engage in public consultation in connection with each of these potential modifications.

Personal Mobile Services Authorization Agreements and Radio Frequency Spectrum Licenses

Oi has entered into authorization agreements with ANATEL that govern its authorization to provide personal mobile services in Region I, Region II and Region III. These authorizations permit Oi to provide personal mobile services for an indeterminate period of time, but do not provide Oi with the right to use specific radio frequency spectrum.

Oi holds nine licenses to use radio frequency spectrum to provide 2G services in specific geographic regions of Region II. These licenses grant permission to use the applicable radio spectrum for 15 years from the date of the authorization agreement under which they are granted and are renewable for 15-year terms. Upon renewal of any of these licenses and on every second anniversary of such renewal, Oi will be required to pay an amount equal to 2.0% of its prior year's net operating revenue from personal mobile services. The initial terms of Oi's radio frequency spectrum licenses expire between 2016 and 2022.

Oi's authorization agreements are subject to network scope and service performance obligations. Specifically, Oi is required to (1) service all municipalities in Region I and Region II with a population in excess of 100,000, and (2) service all municipalities in Region III with a population in excess of 200,000. In addition, by the fifth anniversary of the date of the authorization agreement for Region III, Oi will be required to service all municipalities in Region III with a population in excess of 100,000. A municipality is considered "serviced" when the covered service area contains at least 80% of the urban area in the municipality. Oi's failure to meet these targets may result in the imposition of penalties, in extreme circumstances, in termination of Oi's personal mobile services authorizations. As of the date of

this annual report, Oi has satisfied the network scope and service performance obligations set forth in the authorization agreements.

3G Radio Frequency Licenses

Oi holds five licenses to use radio frequency spectrum to provide 3G services in Region I, Region II and Region III. Each of these licenses grants permission to use the applicable radio spectrum for 15 years from the date of grant and is renewable for 15-year terms. Oi will be required to pay an amount equal to 2.0% of its prior year's net operating revenue from personal mobile services upon renewal of the license and on every second anniversary of the renewal. The initial terms of these licenses expire in 2023.

These radio frequency licenses include network scope obligations. Under these obligations, Oi is currently required to (1) provide service to 168 municipalities in Region II that did not have mobile services at the time these licenses were granted with either 2G or 3G mobile telecommunications services, and (2) provide 3G service to all state capitals in Region II, the Federal District and all municipalities with a population in excess of 200,000 inhabitants. In addition, Oi will be required to:

- provide 3G service to all of the municipalities covered by these licenses with a population in excess of 100,000 by the fifth anniversary of the date of these licenses;

- provide 3G service to 50% of all of the municipalities with a population between 30,000 and 100,000 by the fifth anniversary of the date of these licenses; and

- provide 3G service to 60% of the municipalities, including 242 specified municipalities, covered by these licenses with a population less than 30,000 by the eighth anniversary of the date of these licenses.

A municipality is considered "serviced" when the covered service area contains at least 80% of the urban area in the municipality. Oi's failure to meet these targets may result in the imposition of penalties, and in extreme circumstances, in the termination of the 3G frequency licenses. As of the date of this annual report, Oi has satisfied the network scope and service performance obligations set forth in the licenses.

4G Radio Frequency Licenses

Oi holds three licenses to use radio frequencies in 2.5 GHz sub-bands to provide 4G services in Region I, Region II and Region III. Each of these licenses grants permission to use the applicable radio spectrum for 15 years from the date of grant and is renewable for 15-year terms. Oi will be required to pay an amount equal to 2.0% of its prior year's net operating revenue from 4G services upon renewal of the license and on every second anniversary of the renewal. The initial terms of these licenses expire in 2027.

These radio frequency licenses include network scope obligations. Under these obligations, Oi will be required to:

- provide 4G service in all of the host municipalities of the 2013 FIFA Confederations Cup by April 30, 2013 and all of the host municipalities of the 2014 FIFA World Cup by December 31, 2013;

- provide 4G service in all state capitals, municipalities with a population in excess of 500,000 and the Federal District by May 31, 2014;

- provide 4G service to all of the municipalities covered by these licenses with a population in excess of 200,000 by December 31, 2015;

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- provide 4G service to all of the municipalities covered by these licenses with a population in excess of 100,000 by December 31, 2016;
- provide 4G service to all of the municipalities covered by these licenses with a population between 30,000 and 100,000 by December 31, 2017;
- provide 4G service to 30% of the municipalities covered by these licenses with a population less than 30,000 by December 31, 2017;
- provide 4G service to 60% of the municipalities covered by these licenses with a population less than 30,000 by December 31, 2018;
- provide 4G service to all of the municipalities covered by these licenses with a population less than 30,000 by December 31, 2019;
- provide voice services in the 450 MHz spectrum and data services at minimum upload speeds of 128 kbps and download speeds of 256 kbps and a minimum monthly allowance of 250 MB in 289 municipalities in the States of Goiás, Mato Grosso, Mato Grosso do Sul, Rio Grande do Sul and the Federal District by June 30, 2014, and in 384 such municipalities by December 31, 2015 and offer voice services in the 450 MHz spectrum and data services at minimum upload speeds of 256 kbps and download speeds of 1Mbps and a minimum monthly allowance of 500 MB in 962 such municipalities by December 31, 2017;
- provide unlimited data services at minimum upload speeds of 256 kbps and download speeds of 128 kbps to rural schools in 289 municipalities in the States of Goiás, Mato Grosso, Mato Grosso do Sul, Rio Grande do Sul and the Federal District by June 30, 2014, in 384 such municipalities by December 31, 2015 and in 962 such municipalities by December 31, 2017; and
- make Oi's fixed line network available to other telecommunications services providers to allow them to comply with their obligations under the General Plan on Universal Service in 289 municipalities in the States of Goiás, Mato Grosso, Mato Grosso do Sul, Rio Grande do Sul and the Federal District by June 30, 2014, in 384 such municipalities by September 30, 2014 and in 962 such municipalities by September 30, 2015.

In addition, the 4G radio frequency licenses impose minimum investment obligations in domestic technologies. At least 60% of the cost of all goods, services, equipment, telecommunications systems and data networks that Oi purchases to meet its 4G service obligations must developed in Brazil. This minimum requirement will increase to 65% between January 1, 2015 and December 31, 2016 and 70% between January 1, 2017 to December 31, 2022.

Oi's failure to meet these targets may result in the imposition of penalties, and in extreme circumstances, in termination of the 4G frequency licenses. As of the date of this annual report, Oi has satisfied the network scope and service performance obligations set forth in the licenses.

Fixed Line Services Authorization Agreements

Oi has entered into authorization agreements with ANATEL that govern authorizations to provide local fixed line services in and domestic long-distance services originating from (1) the 57 municipalities in the State of Minas Gerais that are excluded from the concession area of Region I, (2) the nine municipalities in the States of Goiás, Mato Grosso do Sul and Paraná that are excluded from the concession area of Region II, and (3) Region III. These authorizations do not have termination dates and require compliance with certain quality of service obligations set forth in the General Plan on Quality Goals.

Oi has also entered into authorization agreements that govern authorizations to provide international long-distance services originating from anywhere in Brazil. These authorizations do not

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have termination dates and require compliance with certain quality of service obligations set forth in the General Plan on Quality Goals.

Multimedia Communication Services Authorization Agreements

Oi holds Multimedia Communication Services authorizations, which superseded its prior Telecommunications Network Transportation Services (*Serviço de Rede de Transporte de Telecomunicações*) authorizations, permitting Oi to provide high-speed data service. The Multimedia Communication Services authorizations became effective in May 2003 and cover the same geographical areas as Oi's concession agreements. In April 2008, in connection with the amendments to Oi's fixed line services concessions, it agreed to provide internet service free of charge until December 31, 2025 to all urban schools in the areas of its concession agreements.

Pay-TV Authorization Agreement

In November 2008, Oi entered into an authorization agreement with ANATEL that governs its use of satellite technology to provide DTH satellite television services throughout Brazil. The authorization agreement permits Oi to provide DTH satellite television services for 15 years and is renewable for a 15-year term in exchange for a fee to be agreed upon.

Under this authorization, Oi is required to furnish equipment to certain public institutions, to make channels available for broadcasting by specified public institutions, and to comply with certain quality of service obligations set forth in applicable ANATEL regulations.

In December 2012, ANATEL granted Oi's request to convert its DTH authorization agreement into a Conditional Access Service authorization, allowing Oi to provide nationwide subscription television services through any technology, including satellite, wireline and coaxial cable. Although Oi has not yet signed the Conditional Access Service authorization agreement, the act by which ANATEL granted Oi's request authorized it to begin offering the services to be governed by such agreement, including IP TV. In accordance with the ANATEL resolution that approved the Conditional Access Service regime, Oi's Conditional Access Service authorization will prohibit it from creating television content or owning more than 30% of a company that creates content. Oi will also be required to carry a certain percentage of Brazilian programming, including open and public access channels.

Term of Commitment to Adhere to National Broadband Plan

On June 30, 2011, Oi entered into a Term of Commitment (*Termo de Compromisso*) with ANATEL and the Ministry of Communications to formalize its voluntary commitment to adhere to the terms of the National Broadband Plan, created in May 2010 by Executive Decree No. 7,175/10 with the goal of making broadband access available at low cost, regardless of technology, throughout Brazil. Pursuant to the Term of Commitment, Oi is required to offer (1) broadband services with minimum upload and download capabilities to retail customers in certain sectors of Region I and Region II for a maximum price of R$35 per month (or R$29.90 in ICMS-exempt states), plus fees, and (2) access to Oi's broadband infrastructure to certain wholesale customers, including small businesses and municipalities, in certain sectors of Region I and Region II for a maximum price of R$1,253 per 2 Mbps per month and a one-time installation fee, while observing all quality standards under ANATEL regulations. Both retail and wholesale services are subject to certain network capacity limits and only need to be provided upon demand. The services provided under the Term of Commitment may be implemented gradually. Oi is obligated to make services available to 100% of eligible retail and wholesale customers by December 31, 2014 and June 30, 2013, respectively. The Term of Commitment also requires that Oi:

- provide one public internet access point for the first 20,000 inhabitants and one additional access point for each subsequent 10,000 inhabitants, with a limit of six access points, at a speed of

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2 Mbps, in each municipality that has only satellite service, free of charge and upon demand of such municipality;

adequately advertise the services contemplated by the Term of Commitment and present to the Ministry of Communications semi-annual reports detailing its marketing efforts; and

use its best efforts to offer broadband services to retail customers at speeds of up to 5 Mbps, reaching the largest possible number of municipalities by 2015.

The Term of Commitment will expire on December 31, 2016.

Disclosure Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 added Section 13(r) to the Exchange Act. Section 13(r) requires an issuer to disclose in its annual or quarterly reports filed with the SEC whether the issuer or any of its affiliates has knowingly engaged in certain activities, transactions or dealings with the Government of Iran, relating to Iran or with designated natural persons or entities involved in terrorism or the proliferation of weapons of mass destruction during the period covered by the annual or quarterly report. Disclosure is required even when the activities were conducted outside the United States by non-U.S. entities and even when such activities were conducted in compliance with applicable law.

The following information is disclosed pursuant to Section 13(r).

We, through our subsidiary TMN and our jointly controlled entity Oi, have entered into roaming agreements with MTN Irancell. Pursuant to such roaming agreements, our customers are able to roam on the particular Iranian network (outbound roaming), and customers of such Iranian operators are able to roam on our relevant subsidiary's network (inbound roaming). For outbound roaming, we pay the relevant Iranian operator roaming fees for use of their network by our customers, and for inbound roaming the Iranian operator pays us roaming fees for use of our network by its customers.

In 2012, in connection with the above mentioned roaming agreements entered into with MTN Irancell, TMN recorded gross revenues of €1,200 and operating costs of €2,306, corresponding to a net loss after tax of €758, and Oi (whose results we proportionally consolidate due to our 25.6% interest in TmarPart) recorded gross revenues of €33 and operating costs of €647, corresponding to a net loss after tax of €405.

In addition to the above-mentioned transactions, TMN also incurred in expenses amounting to €537 in 2012 with the Mobile Company of Iran, corresponding to a net loss after tax of €368.

The purpose of all of these agreements is to provide our customers with coverage in areas where we do not own networks. For that purpose, we intend to continue maintaining these agreements.

We also provide telecommunications services in the ordinary course of business to the Embassy of Iran in Lisbon, Portugal. We recorded gross revenues and net profits of less than €10,000 from these services in 2012. As one of the primary providers of telecommunications services in Lisbon, Portugal, we intend to continue providing such services, as we do to the embassies of many other nations.

ITEM 4A UNRESOLVED STAFF COMMENTS

None.

ITEM 5 OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion in conjunction with our audited consolidated financial statements and the accompanying notes included elsewhere in this report. Our audited consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as adopted by the European Commission for use in the European Union. As of and for the years ended December 31, 2010, 2011 and 2012, there was no difference between IFRS, as adopted by the European Commission for use in the European Union, as applied by Portugal Telecom, and IFRS as issued by the International Accounting Standards Board.

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Overview

Our Segments and Customer Categories

Portugal Telecom, SGPS, S.A. is a group holding company. Our business operations are conducted by our subsidiaries and jointly controlled entities, which are classified for financial reporting purposes according to the manner in which our management views and manages our operations.

We operate in two reportable segments: (1) Telecommunications in Portugal and (2) Telecommunications in Brazil-Oi. We report revenues from the Portuguese telecommunications business in four customer categories: (i) residential, (ii) personal, (iii) enterprise and (iv) wholesale and other. We report revenues from the Brazilian telecommunications business in three customer categories: (i) residential, (ii) personal mobility, and (iii) enterprise (corporate and SMEs). In addition to the two reportable segments mentioned above, we have other businesses that do not rise to a threshold that would require disclosure as a reportable segment. Revenues from our Portuguese and international operations accounted for 42% and 58% of our consolidated revenues in 2012, respectively, reflecting primarily 41% and 46% of our consolidated revenues related to the Portuguese and Brazilian (Oi) telecommunications businesses, respectively, as well as 7% of our consolidated revenues related to the proportional consolidation of Contax and 4% of our consolidated revenues related to the Africatel businesses.

Telecommunications in Portugal. We generate revenues by providing services in the following customer categories:

Residential services, which include integrated networks inside the customer's home, enabling the simultaneous connection of multiple devices, including fixed line telephone, TV (including Internet Protocol Television and direct-to-home satellite Pay-TV services), game consoles, PCs, laptops, tablets and smartphones. We provide these services mainly through PT Comunicações.

Personal services, which are mobile telecommunications services, such as voice, data and Internet-related multi-media services provided to personal (*i.e.*, individual) customers through our subsidiary TMN.

Enterprise services, including Corporate and SME/SoHo services, which provide our corporate and medium and small business customers with data and business solutions, as well as IT/IS and business process outsourcing (BPO) services.

Wholesale and other services, which primarily include wholesale telecommunications services, public pay telephones, the production and distribution of telephone directories and other services in Portugal.

Telecommunications in Brazil Oi. After the completion of the corporate reorganization of Oi that occurred on April 9, 2012, we hold a 23.3% economic interest in Oi S.A., one of the largest telecommunications companies in Brazil, and we are parties to a series of shareholder agreements with other shareholders of Oi that allow us to jointly control Oi. We completed our investment in Oi on March 28, 2011 through the acquisition of a 25.6% effective interest in TmarPart, the parent company of Oi S.A., and the acquisition of a subsidiary of TmarPart that merged into Oi S.A. as part of the 2012 corporate reorganization. Although we hold a 23.3% economic interest in Oi S.A., we have proportionally consolidated 25.6% of the results of operations of TmarPart and its subsidiaries (including Oi S.A.) in our consolidated results of operations since April 1, 2011 due to our 25.6% effective interest in TmarPart. Oi generates revenues by providing services in the following customer categories:

Residential services, which include local fixed line services and domestic long-distance services, primarily in Region I and Region II of Brazil, data transmission services and usage of Oi's network to complete calls initiated by customers of other telecommunications services providers to Oi's fixed line network (fixed line interconnection services).

Personal services, which include mobile telecommunications services throughout Brazil (Region I, Region II and Region III) utilizing 2G and 3G technology, including voice and data transmission services, and usage of Oi's network to complete calls initiated by customers of other telecommunications services providers to Oi's moblie network (mobile interconnection services).

Enterprise services, which include fixed line telecommunications services, mobile telecommunications services, advanced voice services, such as 0800 (toll free) services, customized infrastructure and storage capacity and access to advanced data centers, in each case to corporate and medium and small businesses.

Other services, which include subscription television services, including cable and DTH television services, ISP services, operation of an iG internet portal (which Oi agreed to sell in 2012) and a mobile phone payment system and call center.

Other International Telecommunications Businesses. We also generate revenue from our other strategic partnerships in Brazil, Africa and Asia:

Contax, Brazil. Concurrently with our investment in Oi, we acquired a direct economic interest of 16.2% in CTX, the controlling shareholder of Contax Participações and Contax, a provider of corporate services (primarily contact services) in Brazil. Even before our investment in Contax, we provided call center and IT/IS services in Brazil through our subsidiaries Dedic and GPTI. On June 30, 2011, we exchanged our interest in Dedic and GPTI for an additional interest in Contax, as a result of which Dedic and GPTI became wholly owned subsidiaries of Contax and our economic interest in Contax increased from 14.1% to 19.5%. On April 2, 2013, in connection with Contax's corporate reorganization, we increased our economic interest in Contax to 21.1%. We have proportionally consolidated the results of operations of Contax in our results of operations since April 1, 2011, based on our direct and indirect interest in CTX (42.0% through June 30, 2011 and 44.4% as from July 1, 2011), and Contax's results of operations have included the results of operations of Dedic and GPTI since July 1, 2011.

MTC, Namíbia. We have a 34.0% direct interest in MTC (through our 75% owned subsidiary Africatel), which provides mobile telecommunications services in Namibia and which we fully consolidate in our consolidated financial statements.

Cabo Verde Telecom, Cape Verde. We have a 40.0% direct interest in Cabo Verde Telecom (through our 75% owned subsidiary Africatel), which provides fixed and mobile telecommunications services in the Cabo Verde Islands and which we fully consolidate in our consolidated financial statements.

CST, São Tomé and Príncipe. We have a 51.0% interest in CST (through our 75% owned subsidiary Africatel), which provides fixed and mobile telecommunications services in the São Tomé and Príncipe Islands and which we fully consolidate in our consolidated financial statements.

Timor Telecom, East Timor. We have a 54.01% direct interest in Timor Telecom (through our 76.14% owned subsidiary TPT Telecomunicações Públicas de Timor), which provides fixed and mobile telecommunications services in East Timor and which we fully consolidate in our consolidated financial statements.

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International Equity Investments. We also hold equity interests in strategic partnerships and investments in Africa and Asia:

Unitel, Angola. We have a 25.0% direct interest in Unitel (through our 75% owned subsidiary Africatel), which provides mobile telecommunications services in Angola and which we account for using the equity method.

CTM, Macau. As of December 31, 2012, we had a 28.0% economic interest in CTM, which provides fixed and mobile telecommunications services in Macau and which we account for using the equity method. In January 2013, we entered into a definitive agreement for the sale of our 28% equity stake in CTM to Citic Telecom International Holdings Limited. Under this agreement, we expect to receive total proceeds of US$411.6 million, subject to adjustments, on a cash-free and debt-free basis and assuming a normal level of working capital. The transaction has been approved by our Board of Directors and is conditioned upon the satisfaction of certain conditions, including the successful completion of the transfer to CITIC Telecom of an equity stake representing 51% of the share capital of CTM held by Sable and the approval of both transactions by the Government of Macau and by the relevant governmental and regulatory authorities in the People's Republic of China.

For more information on our segment reporting, see Note 7 to our audited consolidated financial statements.

Business Drivers and Measures

The businesses of each of our segments are affected by a number of significant industry trends. In operating our businesses and monitoring their performance, we also pay attention to a number of operational and other factors. We summarize some of these trends and factors for each of our business segments below.

Global Telecommunications Sector

Changing consumer habits. A surge of new devices and faster networks, coupled with the proliferation of new innovative players in the telecommunications, media and technology markets, are creating new needs and changing consumer habits. Consumers are demanding digital content, a full mobility experience and access to data everywhere. Content is increasingly digital, with usage time of online content growing faster than that of offline content, especially in gaming, video and music. Mobility has become the norm as consumers have more personal devices and spend an increasingly higher share of their online time using these devices, especially for data services. This new consumer demand for uninterrupted access to data and content across several devices is transforming the expectations we must meet to remain competitive, translating into a need to transform our business model. In response to these changes, telecommunications companies are becoming increasingly dependent on information technologies and searching for more efficient and effective solutions. We are endeavoring to address these new needs by delivering integrated solutions, encompassing communications, networks and information technologies, and by offering flexible, scalable and secure cloud services.

Increasing network investment. The increasing digitalization of consumers and companies is leading to a surge in usage of heavy data services. This surge is generating a "data tsunami" that is flooding communication networks around the globe, particularly in mobile networks, driven by the exponential growth of mobile video consumption. This new paradigm of network scarcity places a significant premium on network investment as operators strive to enhance customer experience for increasingly more demanding customers. The deployment of new access technologies and networks continues to be an overriding trend across the sector, with operators

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announcing plans, trials and investments in Next Generation Access Networks (NGAN), especially FTTH networks in the fixed business and 4G-LTE in the mobile business. Both technologies offer more speed, lower latencies and higher reliability. FTTH improves customer experience by providing higher and guaranteed speed, download and upload symmetry and lower latency. Moreover, fiber investment also supports an enhanced mobile network, with high-quality fiber connections for mobile base stations. Mobile 4G-LTE technology is also critical to the ability to offer a seamless connectivity experience everywhere, addressing the increasing need for mobility with a high quality connection. Both FTTH and 4G-LTE dramatically improve efficiency of data transmission, enabling significant cost reduction for operators.

Challenges in mature markets. As operators strive to cope with network investments, the sector is facing a significant increase in competition in mature markets, in both fixed and mobile communications. In the wireline market, traditional telecommunications companies are threatened by both cable and mobile operators. Cable providers are placing a significant bet on DOCSIS 3.0, a next-generation access technology that enables cable to compete with fiber solutions. In Europe alone, the number of DOCSIS 3.0 households is expected to grow rapidly in the medium term. In the mobile market, LTE is being rolled-out at a global level, and its high speed and low latency create an opportunity for mobile operators to compete in the residential arena. In addition, regulators are pushing an aggressive decrease in mobile termination rates, which in Europe are expected to reach €0.019 per minute in the short term. These levels open opportunities for aggressive offerings by new entrant operators, including low-cost all-net bundles that dilute incumbent operators' network externalities. Such offers are being launched in several countries with strong customer acceptance.

Continued growth in emerging markets. Emerging markets continue to appeal to telecommunications operators as they remain sources of scale and growth. Simultaneous growth in population and GDP per capita is driving the emergence of new consumers, translating into new demand and thus new potential for traditional telecommunications services providers. Generally, penetration of most services in emerging markets has yet to reach levels of mature markets. In general, emerging markets are accounting for a significant portion of the revenue growth in both fixed line and mobile service segments. This trend is expected to persist in the medium term.

Shifting competitive boundaries. The broader telecommunications sector is expected to continue to expand at a global level, but an increasingly large share is now occupied by adjacent sector players such as equipment manufacturers, internet service providers and media players. These players are taking advantage of improved connectivity and platform-agnostic technologies to offer over-the-top and cloud-based services. Telecommunications operators are expected to maintain traditional access services and a billing relationship through which users access a myriad of services from adjacent players, such as music, video, photos, apps and retail. These adjacent competitors are often able to build strong global brands. For example, in the equipment manufacturers market, Apple and Samsung accounted for 50% of total global revenues, up from only 16% in 2007. The expansion of the competitive boundaries is creating additional pressure for telecommunications operators.

Telecommunications in Portugal

Increasing Competitive Pressure. Our residential and enterprise businesses face increasingly strong competition from fixed line operators (including VoIP providers) as well as from mobile players. We face aggressive competition from ZON, Sonaecom, Vodafone and other corporate solutions operators in the Portuguese telecommunications sector. Our major competitors compete through their respective multi-play offers, which include traditional voice services as well as Pay-TV and broadband Internet services and, on the corporate side, complex telecom and IT/IS solutions. In addition, the competitive landscape is expected to change in the near term, with the announced consolidation of ZON with Sonaecom to create a new integrated telecommunications operator in Portugal. We anticipate this transaction will further increase the focus on bundled offers as a way to satisfy perceived consumer appetite for bundles that provide them with simplicity, convenience and economy.

Traffic Trends. In recent years, we have experienced a decrease in traffic on our fixed line network, primarily as a result of the trend among consumers to use mobile phones rather than fixed line service and increasing competition from mobile operators, other fixed line operators and, more recently, cable and VoIP providers. This decrease in traffic has negatively affected both our residential and wholesale revenues.

Changes in Revenue Mix. Our Pay-TV customers have increased since we introduced Pay-TV service in 2008. In addition, our ADSL residential accesses increased by 11.4% in 2012 due to our marketing of service packages that include Pay-TV and ADSL broadband services. The mix of the revenues of our residential business has therefore shifted significantly in recent years, with Pay-TV related revenues partially offsetting the continued pressure on the traditional voice business. In each of the last three years, for example, we achieved positive net additions of fixed lines, primarily due to strong performance of *Meo* double-play and triple-play offers. We expect that Pay-TV and broadband services will continue to be an important driver of our fixed line business, and the architecture and regulation of the developing fiber optic network in Portugal will be an important factor affecting our business and revenues.

Decreasing Fixed Line Calling Prices and Greater Focus on Pricing Plans. Retail calling prices, particularly for regional, national and international calls, have been decreasing steadily in recent years, which have negatively affected our residential revenues. One of our strategies in response to this trend has been to aggressively market a variety of pricing plans to promote customer loyalty in our competitive market. Our pricing plans tend to increase our revenues from fixed charges but contribute to a decrease in our traffic revenues, particularly with respect to the growing percentage of pricing plans that offer calls at a flat rate. We aggressively use pricing plans for both our residential and personal services.

Decreasing Interconnection Charges. In 2005, ANACOM declared all mobile operators, including TMN, to have significant market power in call termination in the mobile networks market. As a result, ANACOM imposed price controls on interconnection charges that have caused both fixed-to-mobile and mobile-to-mobile interconnection rates to decrease steadily. ANACOM has issued successive decisions that have reduced mobile termination rates over time. Most recently, in March 2012, ANACOM issued a final decision reducing mobile termination rates progressively to €0.0127 by December 2012. These reductions have had, and will continue to have, a significant adverse impact on TMN's revenues and results of operations.

Continuing Introduction of New Products. The fast development and availability of new access devices are leading to significant growth in Internet users and more frequent usage, leading to increased bandwidth consumption. Examples of this trend are smartphones, tablet PCs and Internet pads. In 2012, we continued to develop and introduce a diversified product offering in the mobile market, including touch-screen phones, smartphones and tablet PCs, making available to our customers data and value-added services and sophisticated applications. In January 2013, we announced the launch of a quadruple-play offer of converged fixed-mobile services by *Meo*, which includes TV, internet, fixed telephone and mobile telephone services. We describe several of our recently launched services in "*Item 4 Information on the Company Our Businesses Portuguese Operations.*"

Continuing Investments in our Network. Remaining competitive requires continuing investments to build out our third- and fourth-generation network and develop new services, and our capital

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expenditures on our network have increased in recent years. In December 2011, we completed the acquisition of a fourth-generation mobile license, under which TMN provides services using long term evolution ("LTE") technology, which represents an evolution from the GSM technology that allows for higher levels of bandwidth and speed.

Decreases in Wholesale Revenues. In our wholesale business, the decrease in regulated fixed-to-mobile interconnection charges has also affected our revenues because our wholesale wireline unit records revenue from international incoming calls through our network that terminate on the networks of mobile operators. Decreases in transit traffic (calls that use our network but neither originate nor terminate on our network) also have affected our wholesale revenues.

Telecommunications in Brazil Oi

Continuing Importance of the Brazilian Market to Our Results of Operations. Under the terms of our strategic partnership with Oi, we have a role in Oi's management, allowing us to share the control of its strategic financial and operating decisions. We proportionally consolidate the results of operations of Oi in our results of operations based on our 25.6% economic ownership interest in TmarPart, the controlling shareholder of Oi S.A. The results of operations of Oi and the dynamics of the Brazilian telecommunications markets are crucial to our financial condition and results of operations.

Effects of Fluctuations in Exchange Rates. Because we present our financial statements in Euros and must translate Oi's assets, liabilities, results of operations and cash flows from Reais into Euros as of and for each fiscal period, fluctuations in the Euro-Real exchange rate can significantly affect our statement of financial position, results of operations and cash flows. In addition, fluctuations in the exchange rate between the Real and the U.S. dollar have a significant effect on Oi's own results of operations. Substantially all of Oi's cost of services and operating expenses are incurred in Reais in Brazil. As a result, the appreciation or depreciation of the Real against the U.S. dollar has not had a material effect on Oi's operating margins. However, the costs of a substantial portion of the network equipment that Oi purchases for its capital expenditure projects is denominated in U.S. dollars or is U.S. dollar-linked. This network equipment is recorded on Oi's statement of financial position at its cost in Reais based on the applicable exchange rate on the date of the transfer of ownership. As a result, depreciation of the Real against the U.S. dollar results in this network equipment being more costly in Reais and leads to increased depreciation expenses. In addition, a significant portion of Oi's indebtedness is denominated in U.S. dollars. When the Real appreciates against the U.S. dollar, Oi's interest costs on its indebtedness denominated in U.S. dollars decline in Reais, which positively affects its results of operations in Reais, and the amount of Oi's indebtedness denominated in U.S. dollars declines in Reais. A depreciation of the Real against the U.S. dollar or the Euro has the converse effect.

Decreased Demand for Fixed Lines Services. Demand for local fixed line services (including Oi's public telephones) has reached a plateau in recent years, with the number of Oi customers terminating their fixed line services exceeding new activations. Oi has sought to combat the general trend of substitution of mobile services in place of local fixed line services by offering a variety of bundled plans that include mobile services, broadband services and *Oi TV* subscriptions. As a result of these service offerings, we expect that the rate of decline in the number of Oi's fixed lines in service will decrease.

Increased Competition in the Growing Mobile Services Market. While Oi's mobile services base has grown substantially in recent years, this market is extremely competitive. Competitive pressures have required Oi to introduce service plans under which the monthly and per-minute rates that

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they charge mobile customers are lowered, reducing its average revenue per customer. We expect Oi's overall mobile services business to continue to grow in terms of its customer base, traffic volumes and revenues from value-added services. However, due to market saturation, we expect future growth in Oi's mobile services business to occur at lower rates than historically achieved.

Effects of Expansion of Mobile Data Transmission Services. In recent years, Oi undertook extensive capital expenditure projects to install the network equipment necessary to expand its offerings of 2G and 3G services. Oi expects that these services will generate significant additions to its mobile customer base and lead to long-term increases in its revenues and operating income before financial income (expenses) and taxes. The marketing and promotion campaigns related to Oi's offerings of mobile data transmission services contributed to an increase in the selling expenses of its personal services segment and to an increase in the amount of discounts that Oi recorded against gross operating revenue.

Effects of Brazilian Regulatory Requirements. New and existing regulations applicable to the telecommunications industry set forth by ANATEL and the obligations included in Oi's concession contracts require Oi to make capital expenditures, affect the revenues that it generates and impose additional costs. If Oi fails to meet quality goals established by ANATEL under the General Plan on Quality Goals, fails to meet the network expansion and modernization targets established by ANATEL under the General Plan on Universal Service and its concession agreements, fails to comply with its obligations under its personal mobile services authorizations or fails to comply with its obligations under other ANATEL regulations, Oi may be subject to warnings, fines, intervention by ANATEL, temporary suspensions of service or cancellation of its concessions and authorizations.

Decreased Rate of GDP Growth in Brazil. While growth in Brazil's GDP stimulates demand for telecommunications services, that demand is relatively inelastic in periods of economic stagnation. Brazilian GDP grew by an estimated 0.9% in 2012, 2.7% in 2011 and 7.5% in 2010. While we believe that a decrease in the rate of growth of Brazil's GDP would not be material under foreseeable scenarios, a substantial and continued deterioration of economic conditions could have a material adverse effect on the number of Oi's subscribers and the volume of usage of its services and, as a result, our net operating revenue.

Effects of Level of Indebtedness. At December 31, 2012, Oi's total outstanding indebtedness on a consolidated basis was R$33,346 million. The level of Oi's indebtedness results in significant interest expenses that are reflected in its income statement. Financial expenses consist of interest expense, exchange variations of U.S. dollar- and other foreign currency-denominated debt, foreign exchange losses or gains. In 2012, Oi recorded total financial expenses of R$4,491 million on a consolidated basis, of which R$2,066 million consisted primarily of interest expenses on loans and debentures payable to third parties and R$2,077 million consisted of losses from monetary correction and exchange differences on third-party loans and financing.

All our businesses are subject to significant competition and operate in highly regulated environments. You should carefully review "*Item 4 Information on the Company Competition*" and " *Regulation*" for more information. In addition, you should be aware of the risks to which each of our businesses is subject. See "*Item 3 Key Information Risk Factors*."

Seasonality

Although our revenues and costs fluctuate from quarter to quarter, we do not experience large fluctuations due to seasonality. In Portugal we tend to have higher revenues in the fourth quarter due to promotional campaigns centered on the Christmas holiday. To a lesser degree, promotional campaigns at the time of the Easter and Mother's Day holidays also tend to increase our revenues in the second quarter. In addition, our revenues from our Portuguese operations tend to be lower during the Portuguese summer holidays during the third quarter.

Our telecommunications services in Brazil are generally not affected by major seasonal variations, except for the first quarter of the year, when economic activity is generally reduced in Brazil.

Discontinued Operations Vivo

On July 28, 2010, we reached an agreement with Telefónica to sell our 50% interest in Brasilcel N.V., a joint venture that held our interest in Vivo, to Telefónica. The sale was concluded on September 27, 2010. Until the sale, we provided mobile telecommunications services in Brazil through Vivo. Our consolidated statements of income and cash flows for the year ended December 31, 2010 present Vivo under the caption "Discontinued Operations," but Vivo is no longer included in our consolidated statement of financial position as of December 31, 2010 or in our consolidated statements of income and cash flows for any period thereafter.

Limitation on Comparability of Our Financial Statements

Due to several recent significant transactions, our results of operations and other financial information for the years 2010, 2011 and 2012 are not fully comparable.

Acquisition of ownership interest in Oi. On March 28, 2011, we acquired a significant economic interest in Oi. Since April 1, 2011, we have proportionally consolidated 25.6% of TmarPart in our consolidated financial statements, which, in turn, fully consolidates Oi S.A. and Telemar. Our results of operations for 2010 and the first three months of 2011 do not include the results of operations of Oi, and, therefore, our results of operations for the years ended December 31, 2010, 2011 and 2012 are not fully comparable.

Acquisition of ownership interest in Contax. At the time of our investment in Oi, we also acquired an interest in Contax. On June 30, 2011, we exchanged our previous investments in Dedic and GPTI for an additional interest in Contax, and as a result our economic interest in Contax increased. We have proportionally consolidated the results of operations of Contax in our results of operations since April 1, 2011, and Contax's results of operations have included the results of operations of Dedic and GPTI since July 1, 2011. For the year ended December 31, 2010 and for the period from January 1, 2011 through June 30, 2011, we fully consolidated the results of operations of Dedic in our results of operations. The Contax transaction therefore affects the comparability of our results of operations for the years ended December 31, 2011 and 2012 with our results of operations for earlier periods.

Sale of interest in Vivo. On September 27, 2010, we sold to Telefónica our 50% interest in Brasilcel N.V., a joint venture that held our interest in Vivo. We reflect Vivo in our statements of income and cash flows for periods prior to September 27, 2010 as a discontinued operation. This transaction does not affect the comparability of our results of operations from continuing operations but impacts net income from discontinued operations and, consequently, consolidated net income, which includes the earnings of Vivo up to September 27, 2010. The transaction also led to a significant gain net of related expenses recorded in 2010 in connection with the sale.

Sale of interest in UOL. On December 29, 2010, we reached an agreement for the sale to a Brazilian third party of our 28.78% interest in Universo Online S.A. ("UOL"), Brazil's largest internet provider by revenue, for R$356 million. UOL's total operating revenues were R$816.7 million in 2010 (€350.5 million). Our results of operations include the results of operations of UOL only for the year ended December 31, 2010, through the equity method of accounting.

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Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our audited consolidated financial statements, which have been prepared in accordance with IFRS. We summarize our significant accounting policies, judgments and estimates in Note 3 to our audited consolidated financial statements. Our reported financial position and results of operations are sensitive to accounting methods, assumptions and estimates that underlie preparation of the financial statements. We base our estimates on historical experience and on various other assumptions, the results of which form the basis for judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our audited consolidated financial statements.

Property, Plant and Equipment, and Intangible Assets

Accounting for property, plant and equipment, and intangible assets involves the use of estimates for determining the expected useful lives of those assets and the fair value at the acquisition date, in the case of assets acquired in a business combination. The determination of the fair values of assets, as well as of the useful lives of the assets is based on management's judgment.

The determination of impairments of property, plant and equipment, and intangible assets involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment analysis is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the telecommunications industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, discontinuation of services, current replacement costs, prices paid in comparable transactions and other changes in circumstances that indicate an impairment exists. The determination of recoverable amounts and fair values are typically based on discounted cash flow methodologies that incorporate reasonable market assumptions. The identification of impairment indicators, the estimation of future cash flows and the determination of fair values of assets (or groups of assets) require management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows, applicable discount rates, useful lives and residual values. As of December 31, 2012, we concluded that the carrying value of these assets did not exceed their recoverable amounts.

Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over our interest in the fair value of the identifiable assets and liabilities of a subsidiary at the date of acquisition. The assets and liabilities acquired are measured provisionally at the date on which control or joint control is acquired, and the resulting value is reviewed in a maximum period of one year from the date of acquisition. Until the fair value of the assets and liabilities has been definitively calculated, the difference between the cost of acquisition and the carrying amount of the company acquired is recognized provisionally as goodwill.

In accordance with IFRS, at the end of each reporting period, we review the goodwill of each cash-generating unit for impairment (*i.e.*, a reduction in its recoverable amount to below its carrying amount) and write it down if necessary. The recoverability analysis of goodwill is performed systematically at the end of each year or whenever it is considered necessary to perform such an analysis. The recoverable amount is the higher of the estimated selling price of the asset less the related selling costs or the value in use of the asset. Value in use is taken to be the present value of the estimated future cash flows. In calculating the recoverable amount of goodwill, we used the value in use approach for all cases, preparing the projections of future pre-tax cash flows on the basis of the budgets most recently approved by our Board of Directors. These budgets include the best available estimates of the income and costs of the cash-generating units using industry projections, past experience and future expectations. These projections cover the coming four years, and the flows for future years are estimated by applying reasonable growth rates.

In light of the fact that analyzing the impairment of our recorded goodwill requires a combination of various assumptions and variables, it is very difficult to analyze the sensitivity of the projections to changes in any isolated variable on its own, since a change in one variable may have an effect on one or more of the other variables used.

The goodwill impairment analysis that we conducted as of December 31, 2012 did not suggest that any such impairment was likely in a future period.

The determination of the recoverable amount of a cash-generating unit under IFRS for impairment testing purposes involves the use of estimates by management. Methods used to determine these amounts include discounted cash flow methodologies and models based on quoted stock market prices. Key assumptions on which management has based its determination of fair value include ARPU (monthly average revenue per user), subscriber acquisition and retention costs, churn rates, capital expenditures and market share. These estimates can have a material impact on fair value and the amount of any goodwill write-down.

Accrued Post Retirement Liability

As of December 31, 2012, we recorded an accrued post retirement liability amounting to €921.4 million to cover our net unfunded obligations regarding pension supplements, post retirement healthcare benefits and salaries for pre-retired and suspended employees. We estimate our obligations regarding post retirement benefits based on actuarial valuations prepared annually by our actuaries, which use the projected unit credit method and consider certain demographic and financial assumptions. The key financial assumptions affecting post retirement benefit costs are based, in part, on actuarial valuations, including discount rates used to calculate the amount of the post retirement benefit obligations. The discount rate reflects the weighted average timing of the estimated defined benefit payments. The discount rate premium is determined based on European corporate bonds with a high quality rating. The assumptions concerning the expected return on plan assets are determined on a uniform basis, considering long-term historical returns, asset allocation and future estimates of long-term investment returns. In the event that further changes in assumptions are required with respect to discount rates and expected returns on invested assets, the future amounts of our post retirement benefit costs may be materially affected. See Note 14 to our audited consolidated financial statements for a more detailed explanation of the assumptions used.

Provisions and Adjustments

Provisions are recorded when, at the end of the period, we have an obligation to a third party that is probable or certain to create an outflow of resources to the third party. This obligation may be legal, regulatory and contractual in nature. It may also be derived from our practice or from public commitments having created a legitimate expectation for such third parties that we will assume certain responsibilities. To estimate the expenditure that we are likely to bear to settle the obligation, our management takes into consideration all of the available information at the closing date for our audited consolidated financial statements. If no reliable estimate of the amount of the obligation can be made, no provision is recorded; information is then disclosed in the notes to the financial statements.

Contingencies liabilities represent obligations which are neither probable nor certain at the time of drawing up the financial statements, and obligations for which the cash outflow is not probable are not recorded. Information about them is disclosed in the notes to the audited consolidated financial statements.

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Because of the inherent uncertainties in the foregoing evaluation process, actual losses may be different from the original estimated amount provisioned at the closing date.

The allowance for doubtful accounts receivable is stated at the estimated amount necessary to cover potential risks in the collection of overdue accounts receivable balances. A determination of the amount of allowances required is made after careful analysis of the evolution of accounts receivable balances, and, in specific cases, our analysis is also based on our knowledge of the financial situation of our customers. The required allowances may change in the future due to changes in economic conditions and our knowledge of specific issues. Future possible changes in recorded allowances would impact our results of operations in the period that such changes are recorded.

Assessment of the Fair Value of Financial Instruments

We choose an appropriate valuation method for financial instruments not traded in an active market based on our knowledge of the market and of the asset. In this process, we apply the valuation methods commonly used by market practitioners and use assumptions based on market rates.

Assessment of the Fair Value of Certain Assets Using the Revaluation Model

In 2008, we adopted the revaluation model for measuring the carrying value of certain classes of assets, namely duct infrastructure and real estate assets. In accordance with our policy, we revise the revalued amount at least once every three years and, accordingly, we performed another reevaluation during the year ended December 31, 2011. These revaluations were effective as of December 31, 2011 and resulted in a net reduction of tangible assets amounting to approximately €131.4 million, of which approximately €126.2 million was recognized directly in our consolidated statement of comprehensive income and €5.3 million was recognized in our consolidated income statement. In order to determine the revalued amount of those assets, we used the replacement cost method for the ducts infrastructure and the market value for real estate assets, which required the use of certain assumptions related to construction costs for duct infrastructure and the use of specific indicators for the real estate market. See Notes 3(c) and 37.4 to our audited consolidated financial statements for a more detailed explanation of the assumptions used.

Deferred Taxes

We recognize and settle income taxes based on the results of operations determined in accordance with local corporate legislation, taking into consideration the provisions of the applicable tax law, which are different from the amounts calculated for IFRS purposes. In accordance with IAS 12, *Income Taxes*, we recognize deferred tax assets and liabilities based on the differences between the carrying amounts and the taxable bases of the assets and liabilities. We regularly assess the recoverability of deferred tax assets and recognize 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.

Recent IFRS Accounting Pronouncements

During the year ended December 31, 2012, the following standard adopted by the European Union became effective, although its adoption had no impact on our audited consolidated financial statements:

- Changes to IFRS 7 *Financial Instruments: Disclosures*.

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In addition, the following standards or revised standards issued by the International Accounting Standards Board ("IASB") have already been adopted by the European Union, but their application is only required in subsequent periods:

- Amendments to IFRS 7 *Financial Instruments: Disclosures*;
- Amendments to IAS 1 *Presentation of Financial Statements*;
- Amendments to IAS 19 *Employee Benefits*;
- Amendments to IFRS 1 *First-Time Adoption of IFRS*;
- Amendments to IAS 12 *Income Taxes*;
- Amendments to IAS 32 *Financial Instruments: Presentation*;
- IFRS 10 *Consolidated Financial Statements*;
- IFRS 11 *Joint Arrangements*;
- IFRS 12 *Disclosure of Interests in Other Entities*;
- Amendments to IAS 27 *Consolidated and Separate Financial Statements* and to IAS 28 *Investments in Associates*; and
- IFRS 13 *Fair Value Measurement*.

The following new standards or revised standards issued by the IASB have not yet been endorsed by the European Union, and their application is only required in subsequent periods:

- On October 31, 2012, the IASB issued amendments to IFRS 10, IFRS 12 and IAS 27;
- On June 30, 2012, the IASB issued amendments to IFRS 10, *Transition Guidance of Consolidated Financial Statements*, IFRS 11, *Joint Arrangements*, and IFRS 12, *Disclosure of Interests in Other Entities*;
- In March 2012, the IASB issued amendments to IFRS 1, *First Time Adoption of IFRS*;
- In December 2011, the IASB issued amendments to IFRS 7, *Financial Instruments: Disclosures*; and
- In November 2009, the IASB issued IFRS 9, *Financial Instruments*, subsequently amended in October 2010.

For a discussion on the main issues covered by these standards and their potential impact on our financial statements, see Note 4 to our audited consolidated financial statements.

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Results of Operations

Our results reflect the changing patterns in our business described above in " *Overview*." The following tables set forth the contribution to our consolidated operating revenues of each of our major business lines, as well as our major consolidated operating costs and expenses, for the years ended December 31, 2010, 2011 and 2012.

	Year Ended December 31,							
	2010		2011			2012		
	EUR Millions	% of Operating Revenues	EUR Millions	% of Operating Revenues	% Increase of Item	EUR Millions	% of Operating Revenues	% Increase of Item
Continuing Operations Operating revenues:								
Telecommunications in Portugal	**3,102.2**	**82.9%**	**2,868.7**	**46.7%**	**(7.5)%**	**2,676.9**	**40.6%**	**(6.7)%**
Services	2,918.7	78.0%	2,726.4	44.4%	(6.6)%	2,532.7	38.4%	(7.1)%
Sales	146.5	3.9%	115.1	1.9%	(21.4)%	107.4	1.6%	(6.7)%
Other	36.9	1.0%	27.1	0.4%	(26.5)%	36.8	0.6%	35.7%
Telecommunications in Brazil Oi			**2,409.2**	**39.2%**		**3,037.9**	**46.0%**	**26.1%**
Services			2,297.5	37.4%		2,817.1	42.7%	22.6%
Sales			12.0	0.2%		56.9	0.9%	373.2%
Other			99.7	1.6%		163.9	2.5%	64.4%
Other businesses	**640.1**	**17.1%**	**869.0**	**14.1%**	**35.8%**	**884.0**	**13.4%**	**1.7%**
Services	597.3	16.0%	835.4	13.6%	39.9%	844.2	12.8%	1.1%
Sales	19.1	0.5%	14.3	0.2%	(25.3)%	34.3	0.5%	140.2%
Other	23.7	0.6%	19.3	0.3%	(18.6)%	5.5	0.1%	(71.5)%
Total operating revenues	**3,742.3**	**100.0%**	**6,146.8**	**100.0%**	**64.3%**	**6,598.8**	**100%**	**7.4%**
Costs, expenses, losses and income:								
Wages and salaries	637.1	17.0%	1,020.5	16.6%	60.2%	1,102.4	16.7%	8.0%
Direct costs	547.6	14.6%	1,012.3	16.5%	84.9%	1,092.4	16.6%	7.9%
Costs of products sold	179.9	4.8%	169.9	2.8%	(5.6)%	183.1	2.8%	7.8%
Marketing and publicity	81.1	2.2%	131.1	2.1%	61.7%	124.4	1.9%	(5.1)%
Supplies, external services and other expenses	724.5	19.4%	1,281.4	20.8%	76.9%	1,475.2	22.4%	15.1%
Indirect taxes	45.4	1.2%	187.5	3.0%	312.7%	247.0	3.7%	31.8%
Provisions and adjustments	35.0	0.9%	156.3	2.5%	347.1%	105.6	1.6%	(32.4)%
Depreciation and amortization	758.6	20.3%	1,325.6	21.6%	74.7%	1,390.6	21.1%	4.9%
Post retirement benefits costs	38.2	1.0%	58.5	1.0%	53.2%	58.3	0.9%	(0.4)%
Curtailment costs	145.5	3.9%	36.4	0.6%	(75.0)%	2.1	0.0%	(94.3)%
Gains on disposals of fixed assets, net	(5.5)	(0.1)%	(9.2)	(0.1)%	65.8%	(32.7)	(0.5)%	256.2%
Other costs, net	141.2	3.8%	32.6	0.5%	76.9%	(8.7)	(0.1)%	(126.7)%
Income before financial results and taxes	**413.8**	**11.1%**	**744.0**	**12.1%**	**79.8%**	**859.2**	**13.0%**	**15.5%**
Net interest expenses	185.0	4.9%	297.1	4.8%	60.6%	498.8	7.6%	67.9%
Net foreign currency exchange losses	6.8	0.2%	18.1	0.3%	166.3%	2.2	0.0%	(87.6)%
Net losses (gains) on financial assets and other investments	(1.9)	(0.0)%	(0.6)	(0.0)%	(68.9)%	3.9	0.1%	(770.8)%
Equity in earnings of affiliated companies, net	(141.7)	(3.8)%	(209.2)	(3.4)%	47.6%	(209.7)	(3.2)%	0.2%
Net other financial losses	33.3	0.9%	107.4	1.7%	222.5%	90.6	1.4%	(15.6)%
Income before taxes	**332.2**	**8.9%**	**531.1**	**8.6%**	**59.9%**	**473.2**	**7.2%**	**(10.9)%**
Income taxes	77.5	2.1%	108.2	1.8%	39.6%	147.6	2.2%	36.4%
Net income from continuing operations	**254.6**	**6.8%**	**422.9**	**6.9%**	**66.1%**	**325.6**	**4.9%**	**(23.0)%**
Discontinued operations								
Net income from discontinued operations	5,565.4	148.7%			(100.0)%			

Net income	**5,820.1**	**155.5%**	**422.9**	**6.9%**	**(92.7)%**	**325.6**	**4.9%**	**(23.0)%**
Attributable to:								
Non-controlling interests	147.9	4.0%	83.8	1.4%	(43.3)%	95.3	1.4%	13.8%
Equity holders of the parent	**5,672.2**	**151.6%**	**339.1**	**5.5%**	**(94.0)%**	**230.3**	**3.5%**	**(32.1)%**

Year Ended December 31, 2012 Compared to Year Ended December 31, 2011

Operating Revenues

Our operating revenues increased to €6,598.8 million in 2012 from €6,146.8 million in 2011, an increase of 7.4%, reflecting primarily the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012, as the earnings of these businesses were proportionally consolidated as from April 1, 2011, partially offset by the contribution of Dedic/GPTI in the first half of 2011, as this business was fully consolidated up to June 30, 2011 and then integrated with Contax, which we proportionally consolidate, following the completion of the exchange of our interest in this business for an additional stake in Contax. Excluding the impact of these changes in the consolidation perimeter, totaling €801.9 million, and also the impact of the depreciation of the Brazilian Real against the Euro (€278.7 million), our consolidated operating revenues would have decreased by 1.2%, or €71.2 million, in 2012 as a result of revenue decline in the Portuguese telecommunications businesses (€191.5 million), partially offset by higher contributions from Oi (€82.6 million) and other international operations, namely MTC in Namibia (€20.7 million), Timor Telecom (€9.3 million) and Contax (€8.4 million).

Our revenues from our Portuguese telecommunications business in the year ended December 31, 2012 were negatively impacted by, among other things, (1) lower revenues in the Enterprise customer category, where we experienced pricing and consumption pressure, namely from government agency clients, and by the absence of projects for the large companies, (2) revenue declines in the Personal customer category, including the effects of lower mobile interconnection revenues, lower customer service revenues and lower sales and (3) lower revenues from wholesale and other businesses, including the impact of a decline in the telephone directories business. These effects were partially offset by an increase in revenues from the Residential customer category, mainly related to Pay-TV and broadband revenues, which are driven by the success of the *Meo* double- and triple-play offers.

We present below the revenue information for each of our business segments, which, as described above, are as follows: (1) Telecommunications in Portugal and (2) Telecommunications in Brazil Oi (reflecting our proportional consolidation as from April 1, 2011 of TmarPart, which, in turn, fully consolidates Oi S.A. and its subsidiaries).

The revenue information for each segment in the tables below differs from the contribution to our consolidated revenues for each such segment in the table above because it is presented on a stand-alone basis and includes revenues from services rendered to other Portugal Telecom group companies.

Telecommunications in Portugal. The table below sets forth operating revenues from our Portuguese telecommunications business in 2011 and 2012. As described in more detail in "*Item 4 Information on the Company Our Businesses Portuguese Operations*," our Portuguese telecommunications business includes revenues from the Residential, Personal, Enterprise and Wholesale customer categories.

	2011	2012	% Change
	(EUR Millions)		
Telecommunications in Portugal			
Residential	682.3	711.7	4.3%
Personal	768.4	688.1	(10.4)%
Enterprise	982.1	896.0	(8.8)%
Wholesale, other and eliminations	459.2	404.7	(11.9)%
Total	**2,892.0**	**2,700.5**	**(6.6)%**

In the Residential customer category, operating revenues increased by 4.3% to €711.7 million in 2012 from €682.3 million in 2011. Our residential revenues benefitted from the commercial success of *Meo*, whose double-play and triple-play services (voice, data and Pay-TV) have grown and have partially mitigated the recent revenue loss trend in the Portuguese telecommunications business. As result of

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Meo's success, the weight of non-voice services in the Residential customer category stood at 63.4% in 2012, an increase of 4.9 percentage points as compared to 58.5% in 2011.

In the Personal customer category, operating revenues decreased by 10.4% to €688.1 million in 2012 from €768.4 million in 2011, primarily due to: (1) lower customer revenues (€56.3 million), which reflected the effects of challenging economic conditions that have made customers more price-sensitive, greater competitive pressures, increased popularity of "tribal plans" yielding lower revenues per user, as well as the negative effect of lower revenues from mobile broadband due to the higher popularity of fixed broadband, (2) lower interconnection revenues (€19.8 million), partially as a result of the negative impact of lower mobile termination rates and (3) lower equipment sales (€3.7 million). Notwithstanding the economic environment and significant growth in fixed broadband due to triple-play bundled offers, data revenues accounted for 33.2% of service revenues, an increase of 2.4 percentage points over 2011, as a result of the solid performance of "*internetnotelemovel*" (Internet on the cell phone) data packages, which continued to show strong growth, the commercial success of our "*e nunca mais acaba*" plan and increased penetration of smartphones, which partially offset the pressure on mobile broadband revenues.

Operating revenues from the Enterprise customer category decreased by 8.8% to €896.0 million in 2012 from €982.1 million in 2011, negatively affected by the economic environment, namely by: (1) strong cost cutting initiatives by government agency clients and significant reduction in investments in new projects, (2) the cost reduction initiatives by large corporations and (3) economic challenges faced by small and medium businesses, which showed some resilience in 2011 but have since become more negatively affected by the economic and financing conditions in Portugal. Our 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, we continued to provide advanced one-stop-shop IT/IS solutions, focusing on business process outsourcing (BPO) and on the marketing of machine-to-machine solutions. These offers leverage our 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 eliminations among our Portuguese businesses, decreased by 11.9% to €404.7 million in 2012 from €459.2 million in 2011, impacted by lower revenues associated with: (1) the directories business, (2) leased lines and accesses, including lower prices resulting from adverse regulatory decisions and lower volumes as operators continue to build networks, (3) public pay phones and (4) termination of national and international traffic.

Telecommunications in Brazil Oi. The table below sets forth our operating revenues from our Brazilian telecommunications business in 2011 and 2012.

	2011	2012	% Change
Telecommunications in Brazil Oi			
Services	2,297.5	2,817.1	22.6%
Sales	12.0	56.9	374.2%
Other	102.6	168.0	63.7%
Total	**2,412.1**	**3,042.1**	**26.1%**

Operating revenues from our Brazilian telecommunications business increased by 26.1% to €3,042.1 in 2012 (R$7,630.8) from €2,412.1 million in 2011 (R$5,611.8 million). Oi's results have been proportionally consolidated as from April 1, 2011, reflecting the 25.6% direct and indirect interest that we have in TmarPart, which, in turn, fully consolidates the Oi Group, including Tele Norte Leste Participações (which merged into Oi S.A. in 2012), Telemar (which is now a subsidiary of Oi S.A.) and Brasil Telecom (which has been renamed Oi S.A.).

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Oi has reorganized its business units, shifting its focus from product to customer segments, and has defined three main customer segments and priorities: (1) Residential customers, where Oi aims to leverage the largest residential customer base in Brazil, (2) Personal Mobility customers, where Oi seeks to improve competitiveness to expand market share, particularly in postpaid and in mobile data and (3) Enterprise (corporate and SME) customers, where Oi is focused on maintaining its market share and and penetrating new markets.

The increase in Oi's revenues that were proportionally consolidated in our financial statements reflects the effect of the proportional consolidation in the first quarter of 2012 (€788.4 million). Excluding the impact of the proportional consolidation of Oi's revenues for the first quarter of 2012, Oi's revenues would have decreased 6.6% from €2,412.1 million in 2011 to €2,253.6 million in 2012, primarily due to the impact of the depreciation of the Brazilian Real against the Euro (€241.1 million) and a decrease in service revenues on a constant currency basis (€3.4 million), partially offset by higher sales and other revenues on a constant currency basis (€86.0 million). The decrease in service revenues reflects the following factors and offsetting factors:

- A decrease in Residential revenues, primarily due to (1) a decrease in the average number of lines in service due to competition and the general trend towards substituting mobile services in place of fixed line services, (2) the migration of fixed line customers from basic service plans to alternative plans that have higher monthly allowances of minutes, leading to a decrease in total billed minutes, and (3) the effect on rates of aggressive discounting campaigns undertaken in 2012 by our competitors. This decrease was partially offset by an increase in revenues from data transmission services.

- An increase in Personal Mobility revenues due to (1) higher revenues from monthly fees due to postpaid customer growth, partially offset by a decrease in the average monthly subscription fee, (2) increased traffic revenues underpinned by prepaid customer growth and the improved quality of prepaid customers and (3) higher SMS revenues and higher revenues from data and value-added services as Oi rolled out 3G services.

- An increase in Enterprise revenues explained by an increase in revenue from both mobile and fixed line data services, partially offset by a decrease in fixed line traffic.

Other Businesses. Operating revenues from our other operations contributed €884.0 million to consolidated operating revenues in 2012, an increase of 1.7% from €869.0 million in 2011. This performance was mainly due to (1) the impact of the proportional consolidation of Contax in the first quarter of 2012 (€148.0 million), partially offset by the contribution of Dedic/GPTI business in the first half of 2011 (€133.9 million), and (2) the increases of 20.4% and 13.0% at Timor Telecom and MTC, respectively.

Costs, Expenses, Losses and Income

As explained in more detail below, our costs increased in 2012, primarily due to the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012, as the earnings of these businesses were proportionally consolidated only as from April 1, 2011, partially offset by the contribution of Dedic/GPTI in the first half of 2011, as this business was fully consolidated up to June 30, 2011 and then integrated with Contax following the completion of the exchange of our interest in this business for an additional stake in Contax. Excluding the impact of these changes in the consolidation perimeter, totaling €561.6 million, consolidated operating costs would have decreased as a result of (1) a reduction in costs in our Portuguese telecommunications business, primarily as a result of strict cost controls, a strong focus on the profitability of operations and lower direct costs resulting from the decrease in operating revenues, and (2) a lower contribution from Oi, reflecting the impact of the depreciation of the Brazilian Real against the Euro, which more than offset higher third-party costs,

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wages and salaries and commercial costs. For more detail on these costs and expenses as they relate to each of our segments, see Note 7 to our audited consolidated financial statements.

Wages and Salaries. Wages and salaries, including employee benefits and social charges, increased by 8.0% to €1,102.4 million in 2012 from €1,020.5 million in 2011, primarily due to the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012, partially offset by the contribution of Dedic/GPTI in the first half of 2011. Adjusting for these effects, wages and salaries would have decreased by 0.3% or €2.4 million in 2012, reflecting lower contributions from (1) the telecommunications business in Portugal, mainly due to lower variable and overtime compensation, higher efficiency levels in certain internal processes and lower personnel costs as a result of the restructuring plan implemented in the fourth quarter of 2011, and (2) Contax, including the impact of the depreciation of the Brazilian Real against the Euro. These effects were partially offset by a higher contribution from Oi, reflecting increased staff levels and a reorganization to create new regional sales and marketing structures, as part of the strategy to improve regional operational performance, which more than offset the impact of the depreciation of the Brazilian Real against the Euro.

Direct Costs. Direct costs increased by 7.9% to €1,092.4 million in 2012 from €1,012.3 million in 2011, primarily due to the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012 (€176.8 million). Adjusting for this effect, direct costs would have decreased by 9.6% to €915.5 million in 2012, primarily due to: (1) a lower contribution from the Portuguese telecommunications business (€23.2 million), reflecting mainly lower traffic costs at TMN, due to the impact of the regulatory mobile termination rate cuts and lower roaming interconnection costs, and lower costs associated with the directories business (which declines were partially offset by higher costs associated with international traffic and higher programming costs due to continued customer growth and investment in our *Meo* content offering) and (2) a lower contribution from Oi (€62.9 million), primarily reflecting the impact of the depreciation of the Brazilian Real against the Euro (€50.0 million) and a reduction in interconnection costs due to lower VU-M interconnection rates.

Costs of Products Sold. Costs of products sold increased by 7.8% to €183.1 million in 2012 from €169.9 million in 2011, reflecting primarily (1) the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012 (€6.5 million) and, adjusting for this effect, (2) a higher contribution from Oi (€5.7 million), reflecting increased marketing activity, which translated into higher sales, and notwithstanding the impact of the depreciation of the Brazilian Real against the Euro. The increase at Oi was partially offset by a reduction in the Portuguese telecommunications businesses (€4.0 million), primarily reflecting lower sales in the Personal customer segment, lower subsidies and the lower average cost of handsets as a result of favorable contracts entered into with key suppliers.

Marketing and Publicity. Marketing and publicity costs decreased by 5.1% to €124.4 million in 2012 from €131.1 million in 2011. Adjusting for the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012 (€12.7 million), marketing and publicity costs would have decreased by 14.8% (€19.4 million) in 2012 to €111.8 million, primarily as a result of (1) a reduction in the Portuguese telecommunications businesses (€11.8 million), reflecting strict cost controls and the marketing investments already made in previous years and (2) a lower contribution from Oi (€8.8 million), including the impact of the depreciation of the Brazilian Real against the Euro (€3.9 million).

Supplies, External Services and Other Expenses. Supplies, external services and other expenses increased by 15.1% to €1,475.2 million in 2012 from €1,281.4 million in 2011. This increase is primarily explained by the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012, partially offset by the contribution of Dedic/GPTI in the first half of 2011. Excluding the impact of these changes in the consolidation perimeter, totaling €191.8 million, supplies, external services and other expenses would have remained broadly stable, with (1) the lower contribution from the Portuguese telecommunications businesses, reflecting primarily lower maintenance and repair expenses,

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support services and other third-party services, which benefited from the roll-out of our FTTH network and the extensive field force transformation program, being offset by (2) a higher contribution from Oi, primarily explained by increased sales and marketing activity, higher third-party costs and higher electricity and rental expenses, notwithstanding lower provisions for bad debt and contingencies and the impact of the depreciation of the Brazilian Real against the Euro.

Indirect Taxes. Indirect taxes increased by 31.8% to €247.0 million in 2012 from €187.5 million in 2011, primarily reflecting the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012, amounting to €52.5 million. Adjusting for this effect, indirect taxes would have increased by 3.8% (€7.1 million) in 2012 to €194.6 million, mainly due to a higher contribution from Oi (€4.0 million), reflecting higher FISTEL fees (a Brazilian federal tax on telecommunications companies) and other indirect taxes, and notwithstanding the impact of the depreciation of the Brazilian Real against the Euro.

Provisions and Adjustments. Provisions and adjustments decreased to €105.6 million in 2012 from €156.3 million in 2011, notwithstanding the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012 (€37.0 million). Adjusting for this effect, provisions would have decreased by €87.7 million, primarily due to a lower contribution from Oi (€91.8 million), primarily reflecting lower provisions for bad debt and for civil and labor contingencies and also the impact of the depreciation of the Brazilian Real against the Euro.

Depreciation and Amortization. Depreciation and amortization costs increased 4.9% to €1,390.6 million in 2012 from €1,325.6 million in 2011, primarily reflecting the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012 (€160.9 million), partially offset by the contribution of Dedic/GPTI in the first half of 2011. Adjusting for these effects and also the impact of the depreciation of the Brazilian Real against the Euro, depreciation and amortization cost would have decreased by 2.9% (€38.0 million) in 2012, primarily reflecting a lower contribution from the Portuguese telecommunications business (€22.0 million), namely due to the swap of TMN's 2G equipment for 4G-LTE-enabled equipment, which had led to accelerated depreciation of 2G equipment through June 30, 2011, and the impact of the revision of the useful lives of certain tangible assets undertaken in 2012.

Post Retirement Benefits. Post retirement benefits amounted to €58.3 million in 2012, compared to €58.5 million in 2011. This cost item does not include early termination costs related to our workforce reduction program, which are discussed under " *Curtailment Costs*" below.

Curtailment Costs. Curtailment costs decreased to €2.1 million in 2012, compared to €36.4 million in 2011, reflecting mainly the reorganization undertaken at the end of 2011.

Net Gains on Disposals of Fixed Assets. Net gains on disposals of fixed assets increased from €9.2 million in 2011 to €32.7 million in 2012, primarily reflecting capital gains recorded by Oi in the fourth quarter of 2012 in connection with the disposal of mobile towers.

Net Other Costs (Gains). Net other gains amounted to €8.7 million, as compared to net other losses of €32.6 million in 2011, primarily reflecting a gain recorded in 2012 with respect to the estimated net compensation for prior year costs supported by PT Comunicações under its universal service obligation pursuant to our concession agreement, partially offset by non-recurring provisions and adjustments recorded in 2012 and the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012.

Financial Income and Expenses

Net Interest Expenses. Net interest expenses increased by 67.9% to €498.8 million in 2012 from €297.1 million in 2011, including the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012, amounting to €66.3 million. Adjusting for this effect, net interest expenses would have amounted to €432.6 million in 2012, an increase of €135.5 million compared to 2011, reflecting: (1) an €51.4 million interest gain recorded in the first quarter of 2011 on the cash deposits in Brazilian Reais that were used to pay the strategic investments in Oi and Contax on March 28, 2011, (2) a higher contribution from Oi and Contax (€44.4 million), reflecting the impact of the increase in its average net debt, due to dividends and other amounts paid to non-controlling shareholders in connection with the completion of Oi's corporate restructuring, partially offset by the effect of the depreciation of the Brazilian Real against the Euro and (3) an interest gain of €32.6 million recorded in 2011 related to the outstanding receivable from Telefónica in connection with the disposal of Vivo.

Net Foreign Currency Exchange Losses. We had net foreign currency losses of €2.2 million in 2012, compared to €18.1 million in 2011, primarily reflecting higher foreign currency losses recorded in 2011 by our Portuguese operations and Oi, explained mainly by the impact of the depreciation of the U.S. dollar against the Euro on net assets denominated in U.S. dollars and by the impact of the depreciation of the U.S. dollar against the Brazilian Real on Oi's net debt denominated in U.S. dollars, respectively.

Net Losses(Gains) on Financial Assets and Other Investments. We recorded net losses on financial assets and other investments of €3.9 million in 2012, compared to net gains of €0.6 million in 2011. These gains primarily include the impact of the change in the fair value of certain free-standing interest rate derivatives and rents received from real estate, net of related depreciation costs.

Equity in Earnings of Affiliated Companies. Equity in earnings of affiliated companies amounted to €209.7 million in 2012, compared to €209.2 million in 2011. In 2011, this caption includes a gain of €37.6 million related to the completion of the disposal of our investment in UOL for a total amount of €155.5 million. Adjusting for this effect, equity accounting in earnings of affiliated companies would have increased to €209.7 million in 2012 from €171.7 million in 2011, as a result of increased earnings of Unitel and CTM.

Net Other Financial Expenses. Net other financial expenses decreased to €90.6 million in 2012, compared to €107.4 million in 2011, and include banking services, commissions, financial discounts and other financing costs. This decrease primarily reflects a lower contribution from Oi adjusting for the impact of its proportional consolidation in the first quarter of 2012, mainly due to lower financial taxes and banking services. This effect was partially offset by higher commission expenses in our Portuguese operations in connection with certain bonds issued and facilities established in 2011.

Income Taxes

Income taxes. Income taxes increased to €147.6 million in 2012, compared to €108.2 million in 2011, corresponding to effective tax rates of 31.2% and 20.4%, respectively. This increase is primarily explained by: (1) the impact of the increase in the maximum statutory tax rate applicable in Portugal from 29.0% to 31.5%, (2) higher non-taxable interest income and equity gains in 2011 and (3) lower gains resulting from adjustments to prior year income taxes. Adjusting for non-taxable interest income and equity gains and for adjustments to prior year income taxes, the effective tax rate would have increased from 25.3% in 2011 to 28.4% in 2012, primarily reflecting the increase in the maximum statutory tax rate applicable in Portugal as referred to above.

For the years 2011 and 2010, following a change in Portuguese tax legislation that occurred in the second quarter of 2010, we and our subsidiaries located in Portugal were subject to corporate income tax at a maximum aggregate tax rate of approximately 29.0%, corresponding to a base rate of 25%, which is increased (1) up to a maximum of 1.5% of taxable income through a municipal tax and (2) by a 2.5% state surcharge applicable to taxable income in excess of €2.0 million. For the years 2012 and 2013, following a change in Portuguese tax legislation in December 2011, we are subject to corporate income tax at a base rate of 25%, increased (1) up to a maximum of 1.5% of taxable income through a municipal tax and (2) by a state surcharge levied at a rate of 3.0% on taxable income between €1.5 million and €10.0 million (€7.5 million as from January 1, 2013, following a change in Portuguese tax legislation in December 2012) and at a rate 5.0% on taxable income in excess of €10.0 million (€ 7.5 million as from January 1, 2013), resulting in a maximum aggregate tax rate of approximately 31.5%.

Net Income (Before Non-Controlling Interests)

Net income (before non-controlling interests) decreased by 23.0% to €325.6 million in 2012 from €422.9 million in 2011 for the reasons described above.

Income before financial results and taxes from our Portuguese telecommunications business decreased to €493.9 million in 2012, compared to €498.4 million in 2011, primarily due to lower operating revenues, net of related direct costs and costs of products sold. These effects more than offset the impact of lower workforce reduction costs, costs of supplies and external services, depreciation and amortization expenses, wages and salaries and other costs.

Income before financial results and taxes from our Brazilian telecommunications business (Oi), which was proportionally consolidated as from April 1, 2011, increased to €342.8 million in 2012, compared to €229.5 million in 2011, reflecting primarily the impact of the proportional consolidation in the first quarter of 2012, amounting to €72.9 million, partially offset by the impact of the depreciation of the Brazilian Real against the Euro. Adjusting for these effects, income before financial results and taxes would have increased primarily due to (1) a reduction in provisions and adjustments, reflecting both lower provisions for contingencies and lower adjustments for bad debt, (2) increases in sales and other revenues and (3) capital gains recognized in 2012 in connection with the disposal of mobile towers. These effects were partially offset by (1) higher third-party expenses, (2) higher personnel costs as a result of increased staff levels and (3) a gain recorded in the third quarter of 2011 related to the recognition of a reimbursement to be received from the Sistel Social Security Foundation (*Fundação Sistel de Seguridade Social*, or "SISTEL"), the manager of certain of Oi's post retirement benefit plans, with respect to a surplus under one of those plans.

Net Income Attributable to Non-Controlling Interests

Net income attributable to non-controlling interests amounted to €95.3 million in 2012 and was related primarily to our Africatel businesses (€74.4 million) and Oi (€9.1 million). In 2011, net income attributable to non-controlling interests amounted to €83.8 million and was related primarily to our Africatel businesses (€64.6 million) and Oi (€11.7 million).

Net Income Attributable to Equity Holders of the Parent

For the reasons described above, our net income attributable to our equity holders decreased to €230.3 million in 2012 from €339.1 million in 2011.

Basic earnings per ordinary and "A" shares from total operations decreased to €0.27 in 2012 from €0.39 in 2011 on the basis of 856,659,954 and 864,161,921 average outstanding shares in 2012 and 2011, respectively.

Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

Operating Revenues

Our operating revenues increased to €6,146.8 million in 2011 from €3,742.3 million in 2010, an increase of 64.3% reflecting the proportional consolidation of Oi and Contax as from April 1, 2011 (€ 2,768.0 million), which includes Dedic and GPTI as from July 1, 2011, following the completion of the exchange of our pre-existing interest in Dedic and GPTI for an additional interest in Contax. Excluding the effect of the proportional consolidation of Oi and Contax, our consolidated operating revenues would have decreased by 9.7% to €3,379.7 million in 2011 as a result of revenue declines in our Portuguese telecommunications business and the decrease in the contribution from Dedic/GPTI, which was fully consolidated until June 30, 2011 and then integrated in Contax. The decrease in revenues in our Portuguese telecommunications business was partially offset by revenue growth in our other international operations, namely MTC in Namibia and Timor Telecom. Contributions to our consolidated operating revenues from our Portuguese telecommunications businesses decreased by 7.5% (€233.5 million), and the contribution from other businesses increased by 35.8% (€228.9 million) for the reasons explained below.

Our revenues from our Portuguese telecommunications business in the year ended December 31, 2011 were negatively impacted by, among other things, (1) revenue declines in the Personal customer category, including the effects of lower mobile interconnection revenues, lower customer service revenues and lower sales, (2) lower revenues in the Enterprise customer category, which suffered due to the economic environment and (3) lower revenues from wholesale and other businesses, including the impact of a decline in the telephone directories business. These effects were partially offset by an increase in revenues from the Residential customer category, mainly related to Pay-TV and broadband revenues, which are driven by the success of the *Meo* double- and triple-play offers.

We present below the revenue information for each of our business segments, which, as described above, are as follows: (1) Telecommunications in Portugal (replacing the former operating segments "Wireline in Portugal" and "Mobile in Portugal") and (2) Telecommunications in Brazil Oi (reflecting our proportional consolidation as from April 1, 2011 of TmarPart, which, in turn, fully consolidates Oi S.A. and its subsidiaries).

The revenue information for each segment in the tables below differs from the contribution to our consolidated revenues for each such segment in the table above because it is presented on a stand-alone basis and includes revenues from services rendered to other Portugal Telecom group companies.

Telecommunications in Portugal. The table below sets forth our operating revenues from our Portuguese telecommunications business in 2010 and 2011. As described in more detail in "*Item 4 Information on the Company Our Businesses Portuguese Operations*," our Portuguese telecommunications business includes revenues from the residential, personal, enterprise and wholesale customer categories.

	2010	**2011**	**% Change**
	(EUR Millions)		
Telecommunications in Portugal			
Residential	647.0	682.3	5.4%
Personal	865.0	768.4	(11.2)%
Enterprise	1,079.6	982.1	(9.0)%
Wholesale, other and eliminations	532.8	459.2	(13.8)%
Total	**3,124.5**	**2,892.0**	**(7.4)%**

In the Residential customer category, operating revenues increased by 5.4% to €682.3 million in 2011 from €647.0 million in 2010. Our residential revenues benefitted from the commercial success of *Meo*, whose double-play and triple-play services (voice, data and Pay-TV) have grown and have partially mitigated the recent revenue loss trend in the Portuguese telecommunications business. As result of *Meo*'s success, the weight of non-voice services in the Residential customer category stood at 58.1% in 2011, up by 7.2 percentage points compared to 2010.

In the Personal customer category, operating revenues decreased by 11.2% to €768.4 million in 2011 from €865.0 million in 2010, primarily due to (1) lower customer revenues (€54.9 million), which reflected the effects of challenging economic conditions that have made customers more price-sensitive, greater competitive pressures, increased popularity of "tribal plans" yielding lower revenues per user, as well as the negative effect of lower revenues from mobile broadband due to the higher popularity of fixed broadband, (2) lower interconnection revenues (€ 28.9 million), partially as a result of the negative impact of lower mobile termination rates and (3) lower equipment sales (€12.3 million). Notwithstanding the economic environment and significant growth in fixed broadband due to triple-play bundled offers, data revenues accounted for 30.9% of service revenues, an increase of 1.7 percentage points over 2010, as a result of the solid performance of "*internetnotelemovel*" (Internet on the cell phone) data packages, which continued to show strong growth, the commercial success of our "*e nunca mais acaba*" plan and increased penetration of smartphones, which partially offset the pressure on mobile broadband revenues.

Operating revenues from the Enterprise customer category decreased by 9.0% to €982.1 million in 2011 from €1,079.6 million in 2010, negatively affected by the economic environment and consequent cost cutting efforts by companies, as well as the effect of one-off projects with the Portuguese government agencies that took place in 2010. Our 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, we continued to provide advanced one-stop-shop IT/IS solutions, focusing on business process outsourcing (BPO) and on the marketing of machine-to-machine solutions. These offers leverage on our 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 13.8% to €459.2 million in 2011 from €532.8 million in 2010, impacted by (1) lower revenues from directories (€20.4 million), (2) lower wholesale revenues (€ 24.7 million), mainly due to lower unbundled local loop (ULL) revenues and lower capacity sales and (3) lower revenues from public pay telephones (€4.0 million). The impact of regulation on wholesale revenues was approximately €3.0 million in 2011.

Telecommunications in Brazil Oi. The table below sets forth our operating revenues from our Brazilian telecommunications business in 2011.

	2011
Telecommunications in Brazil Oi	
Services	2,297.5
Sales	12.0
Other	102.6
Total	**2,412.1**

Operating revenues from our Brazilian telecommunications business stood at €2,412.1 million, equivalent to R$5,611.8 million. Oi's results are proportionally consolidated as from April 1, 2011, reflecting the 25.6% direct and indirect interest that we have in TmarPart, which, in turn, fully consolidates Oi S.A. and Telemar.

Other Businesses. Operating revenues from our other operations contributed €869.0 million to our consolidated operating revenues in 2011, an increase of 35.8% from €640.1 million in 2010. This performance was mainly due to (1) the impact of the proportional consolidation of Contax as from April 1, 2011 (€358.8 million), including Dedic/GPTI as from July 1, 2011 and (2) the increases of 10.6% and 7.0% at Timor Telecom and MTC, respectively. These effects were partially offset by a lower contribution from Dedic/GPTI, which was fully consolidated until June 30, 2011 and then integrated into Contax.

Costs, Expenses, Losses and Income

As explained in more detail below, our costs increased in 2011, primarily due to the impact of the proportional consolidation of Oi and Contax as from April 1, 2011. Adjusting for this effect, consolidated operating costs would have decreased reflecting (1) a reduction in costs in our Portuguese telecommunications business, primarily as a result of strict cost controls, a 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 June 30, 2011 and then integrated into Contax. For more detail on these costs and expenses as they relate to each of our segments, see Note 7 to our audited consolidated financial statements.

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Wages and Salaries. Wages and salaries, including employee benefits and social charges, increased by 60.2% to €1,020.5 million in 2011 from €637.1 million in 2010, primarily due to the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€ 505.4 million), including the Dedic/GPTI business as from July 1, 2011. Adjusting for this effect, wages and salaries would have decreased by 19.2% to €515.1 million in 2011, reflecting lower contributions from (1) Dedic/GPTI, as this business was fully consolidated until June 30, 2011 and then integrated into Contax and (2) the telecommunications business in Portugal, primarily reflecting lower variable and overtime compensation, higher efficiency levels in certain internal processes and lower personnel costs as a result of a restructuring plan implemented at the end of 2010.

Direct Costs. Direct costs increased by 84.9% to €1,012.3 million in 2011 from €547.6 million in 2010, primarily due to the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€521.3 million). Adjusting for this effect, direct costs would have decreased by 10.3% to €491.0 million in 2011, primarily due to lower contributions from the Portuguese telecommunications business as a result of a decrease in interconnection costs, mainly due to lower mobile termination rates, and lower costs related to the telephone directories business as a result of the decline in that business. These effects were partially offset by an increase in programming costs resulting from the continued growth in Pay-TV customers, despite a decline in programming costs per customer as Pay-TV is reaching critical mass.

Costs of Products Sold. Costs of products sold decreased by 5.6% to €169.9 million in 2011 from €179.9 million in 2010, reflecting primarily a lower contribution from the Portuguese telecommunications business (€37.9 million) in line with the decrease in sales and a rationalization of TMN's handset portfolio. This decrease more than offset the impact of the proportional consolidation of Oi and Contax as from April 1, 2011, amounting to €31.8 million.

Marketing and Publicity. Marketing and publicity costs increased by 61.7% to €131.1 million in 2011 from €81.1 million in 2010, reflecting primarily the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€48.5 million). Adjusting for this effect, marketing and publicity costs would have increased by 1.9% to €82.7 million in 2011, primarily explained by an increase at the Portuguese telecommunications business, reflecting the continued marketing of *Meo* and the new tariff plans aimed at the Personal customer category.

Supplies, External Services and Other Expenses. Supplies, external services and other expenses increased by 76.9% to €1,281.4 million in 2011 from €724.5 million in 2010. This increase is primarily explained by the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€597.4 million), partially offset by (1) a reduction in the Portuguese telecommunications business (€31.6 million), which reflected our continuing operational and cost discipline, and (2) the lower contribution from Dedic/GPTI, which was fully consolidated until June 30, 2011 and then integrated into Contax (€20.9 million).

Indirect Taxes. Indirect taxes increased by 3.0% to €187.5 million in 2011 from €45.4 million in 2010, reflecting primarily the impact of the proportional consolidation of Oi and Contax as from April 1, 2011, amounting to €146.2 million, which primarily includes spectrum fees (€52.6 million), indirect taxes related to the "Fust" fund (a fund to improve the general access to telecommunications services in Brazil) and the "Funttel" fund (the Brazilian National Telecommunications Fund), totaling €28.9 million, value-added tax expenses (€12.8 million), concession fees (€9.0 million) and other municipal, federal and state taxes in Brazil.

Provisions and Adjustments. Provisions and adjustments increased to €156.3 million in 2011 from €35.0 million in 2010, largely due to the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€135.0 million). Excluding this effect, provisions and adjustments would have decreased by 39.2% to €21.2 million, reflecting primarily a reduction in the Portuguese telecommunications business resulting from a lower level of doubtful receivables and lower provisions for legal actions.

Depreciation and Amortization. Depreciation and amortization costs increased by 74.7% to €1,325.6 million in 2011 from €758.6 million in 2010, reflecting primarily the impact of the proportional consolidation of Oi and Contax (€544.9 million), which includes the amortization of intangible assets recognized as a result of the purchase price allocation of the investments in Oi and Contax, amounting to €47.3 million in 2011. Adjusting for the proportional consolidation of Oi and Contax, depreciation and amortization cost would have increased by 2.9% to €780.6 million in 2011, reflecting a higher contribution from the Portuguese telecommunications business (€21.5 million) as a result of the FTTH rollout and Pay-TV growth, partially offset by the impact of a swap of TMN's 2G equipment for LTE (4G-enabled) equipment.

Post Retirement Benefits. Charges for post retirement benefits increased 53.2% to €58.5 million in 2011, compared to €38.2 million in 2010. The increase in this caption is primarily explained by a prior year service gain recorded in 2010, amounting to €31.2 million, resulting from changes introduced in the pension formula by Portuguese Law 3-B/2010 that led to a reduction in benefits granted to employees. Adjusting for this effect, post retirement benefit costs would have decreased by € 10.9 million, primarily due to the positive impact of the transfer of regulatory unfunded pension obligations to the Portuguese State (€16.0 million), which was completed in December 2010, partially offset by the impact of the proportional consolidation of Oi as from April 1, 2011 (€4.5 million). This cost item does not include early termination costs related to our workforce reduction program, which are discussed under " *Curtailment Costs*" below.

Curtailment Costs. Curtailment costs decreased to €36.4 million in 2011, compared to €145.5 million in 2010, primarily due to the reduction in employees undertaken by the end of 2010.

Other Costs. Other costs decreased to €32.6 million in 2011 from €141.2 million in 2010, primarily reflecting certain non-recurring items recorded in 2010, including (1) the recognition of provisions and adjustments in order to adjust certain receivables and inventories to their recoverable amounts and to reflect estimated losses with legal actions and (2) expenses incurred related to the Oi acquisition process.

Financial Income and Expenses

Net Interest Expenses. Net interest expenses increased by 60.6% to €297.1 million in 2011 from €185.0 million in 2010, primarily as a result of the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€175.2 million). Adjusting for this effect, net interest expenses would have decreased by €63.2 million to €121.9 million in 2011, mainly as a result of (1) a €51.4 million interest gain in the first quarter of 2011 on the cash deposits in Brazilian Reais that were used to pay for the strategic investments in Oi and Contax on March 28, 2011 and (2) the reduction in the average cost of debt of our Portuguese telecommunications busines, which was 3.3% in 2011, compared to 4.4% in 2010. These effects more than offset the impact of the increase in our average net debt, reflecting (1) the proportional consolidation of indebtedness of Oi and Contax beginning on April 1, 2011 (€3,727.6 million), (2) the dividends paid in June 2011 (€1,118.0 million) and (3) the debt related to the transfer of unfunded pension obligations to the Portuguese State completed in December 2010 (€1,021.7 million), which more than offset the impact of the first and second installments received from Telefónica in 2010 (€ 5,500 million) and the last installment received in October 2011 (€ 2,000 million) in connection with the Vivo transaction.

Net Foreign Currency Exchange Losses. We had net foreign currency losses of €18.1 million in 2011, compared to €6.8 million in 2010, primarily as a result of the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€15.8 million), the losses of which relate mainly to the impact of the depreciation of the Brazilian Real against the U.S. dollar on Oi's gross debt denominated in U.S. dollars that is not hedged through currency swaps. Adjusting for this effect, net foreign currency losses would have amounted to €2.3 million in 2011, as compared to €6.8 million in 2010 and are primarily explained by the impact of the depreciation of the U.S. dollar against the Euro on net assets denominated in U.S. dollars, primarily related to dividends receivable from Unitel.

Net Gains on Financial Assets and Other Investments. We recorded net gains on financial assets and other investments of €0.6 million in 2011, compared to €1.9 million in 2010. These gains primarily include the impact of the change in the fair value of certain free-standing interest rate derivatives and rents received from real estate, net of related depreciation costs.

Equity in Earnings of Affiliated Companies. Equity in earnings of affiliated companies increased to €209.2 million in 2011, compared to €141.7 million in 2010. In 2011, this caption includes a gain of €37.6 million related to the completion of the disposal of our investment in UOL for a total amount of €155.5 million, while in 2010, this caption includes one-time charges totalling €35.9 million to adjust the carrying values of certain of our investments to the corresponding estimated recoverable amounts (primarily in UOL in order to adjust its carrying value to the recoverable amount obtained upon the disposal of this investment, which was completed in January 2011). Adjusting for these effects and also for our share in UOL's earnings in 2010 (€14.3 million), equity accounting in earnings of affiliated companies would have amounted to €171.6 million in 2011 and € 164.0 million in 2010, as a result of increased earnings of Unitel and CTM.

Net Other Financial Expenses. Net other financial expenses increased to €107.4 million in 2011, compared to €33.3 million in 2010, and include banking services, commissions, financial discounts and other financing costs. This increase primarily reflects (1) the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€ 52.5 million) and (2) certain financial taxes incurred in Brazil in connection with the transfer of funds for the investment in Oi (€13.6 million).

Income Taxes

Income taxes increased to €108.2 million in 2011, compared to € 77.5 million in 2010, corresponding to effective tax rates of 20.4% and 23.3%, respectively. This increase is primarily explained by a gain of € 59.0 million recorded in 2010 related to a corporate restructuring of our African assets held by our subsidiary Africatel, which resulted in lower taxable profits, and by the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€7.4 million). Adjusting for (1) the above-mentioned one-off tax gain recorded in 2010, (2) the impact of lower non-deductible interest expenses, (3) certain non-current losses recorded in 2010 and (4) adjustments to prior year income taxes, the effective tax rate would have been 24.4% in 2011, compared to 25.6% in 2010.

As from January 1, 2010, following a change in Portuguese tax legislation that occurred in the second quarter of 2010, we and our subsidiaries located in Portugal are subject to corporate income tax at a maximum aggregate tax rate of approximately 29.0%, corresponding to a base rate of 25%, which is increased (1) up to a maximum of 1.5% of taxable income through a municipal tax and (2) by a 2.5% state surcharge applicable to taxable income in excess of €2.0 million. Prior to this change, the 2.5% state surcharge did not exist and, consequently, the maximum aggregate income tax rate was approximately 26.5%. For the years 2012 and 2013, following a change in Portuguese tax legislation occurred in December 2011, we will be subject to corporate income tax at a base rate of 25%, increased (1) up to a maximum of 1.5% of taxable income through a municipal tax and (2) by a state surcharge levied at a rate of 3.0% on taxable income between €1.5 million and €10.0 million and at a rate 5.0% on taxable income in excess of €10.0 million, resulting in a maximum aggregate tax rate of approximately 31.5%.

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Income from Continuing Operations (Before Discontinued Operations and Non-Controlling Interests)

Income from continued operations (before discontinued operations and non-controlling interests) increased by 66.1% to €422.9 million in 2011 from €254.6 million in 2010 for the reasons described above.

Income before financial results and taxes from our Portuguese telecommunications business increased to €498.4 million in 2011, compared to €415.1 million in 2010, primarily due to lower workforce reduction costs, supplies and external services, wages and salaries and other costs. These effects more than offset the impact of the reductions in operating revenues, net of related direct costs and costs of products sold, and higher depreciation and amortization and post retirement benefits costs.

Income before financial results and taxes from our Brazilian telecommunications business Oi, which was proportionally consolidated as from April 1, 2011, amounted to €229.5 million.

Income from Discontinued Operations

Income from our discontinued operation, which related to Vivo, amounted to €5,565.4 million in 2010. We completed the sale of Vivo on September 27, 2010 and had no income from Vivo after that date.

Net Income Attributable to Non-Controlling Interests

Net income attributable to non-controlling interests amounted to € 83.8 million in 2011 and was related primarily to our Africatel businesses (€64.6 million) and Oi (€11.7 million). In 2010, net income attributable to non-controlling interests amounted to €147.9 million and was related primarily to Vivo (€61.3 million) and our Africatel businesses (€76.1 million).

Net Income Attributable to Equity Holders of the Parent

For the reasons described above, our net income attributable to our equity holders decreased to €339.1 million in 2011 from €5,672.2 million in 2010.

Basic earnings per ordinary and "A" shares from total operations decreased to €0.39 in 2011 from €6.48 in 2010 on the basis of 864,161,921 and 875,872,500 average outstanding shares issued in 2011 and 2010 respectively.

Liquidity and Capital Resources

Overview

Our principal capital requirements relate to:

- funding our operations;
- capital expenditures on our network infrastructure, information systems and other investments, as well as acquisitions of interests in other telecommunications companies (see "*Capital Investment and Research and Development*" and "*Contractual Obligations and Off-Balance Sheet Arrangements*" below);
- repayments and refinancing of our indebtedness (see "*Indebtedness*" below);
- shareholder remuneration in the form of dividend payments; and
- funding of post retirement benefits (see "*Post Retirement Benefits*" below).

Our principal sources of funding for these capital requirements are cash generated from our operations and equity and debt financing. Our cash and cash equivalents and short-term investments decreased to €3,387.3 million as of December 31, 2012, compared to €5,668.1 million as of December 31, 2011. We believe that our cash balances, together with the cash that we expect to

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generate from our operations and available liquidity under our credit facilities and lines of credit, are currently sufficient to meet our present funding needs.

Cash Flows

The table below sets forth a breakdown of our cash flows for the years ended December 31, 2010, 2011 and 2012. For a discussion of the cash flow of our Vivo discontinued operations, see Note 32.2 to our audited consolidated financial statements for the year ended December 31, 2012.

	2010	**2011**	**2012**
		(EUR Millions)	
Cash flow from operating activities	1,506.9	1,775.2	1,574.1
Continuing operations	903.8	1,775.2	1,574.1
Discontinued operations	603.0		
Cash flow from (used in) investing activities	4,072.4	(1,009.2)	(1,267.3)
Continuing operations	(1,301.2)	(3,009.2)	(1,267.3)
Discontinued operations	5,373.6	2,000.0	
Cash flow from (used in) financing activities	(1,929.1)	(540.3)	(2,646.7)
Continuing operations	(1,571.2)	(540.3)	(2,646.7)
Discontinued operations	(357.9)		
Total	**3,650.2**	**225.6**	**(2,339.9)**

Cash Flow from Operating Activities

Cash flows from operating activities include collections from clients, payments to suppliers, payments to personnel, payments relating to income and indirect taxes and payments related to post retirement benefits. Our cash flows from operating activities result primarily from operations conducted by our subsidiaries and jointly controlled entities and not by Portugal Telecom. None of our subsidiaries and jointly controlled entities is subject to economic or legal restrictions on transferring funds to us in the form of cash dividends, loans or advances that would materially affect our ability to meet our cash obligations.

Net cash flow from operating activities decreased by 11.3% to €1,574.1 million in 2012 from €1,775.2 million in 2011. Excluding the impact of the proportional consolidation of Oi and Contax in the first quarter of 2012 (€86.2 million), consolidated operating cash flow would have amounted to €1,487.9 million in 2012, a decline of €287.3 million, primarily due to lower collections from customers (€574.5 million), reflecting the decline in revenues from the Portuguese telecommunications business, and the impact of the depreciation of the Brazilian Real against the Euro (€361.8 million). These effects were partially offset by (1) a reduction in payments to employees (€133.5 million), reflecting a lower contribution from the Portuguese telecommunications business and the impact of the depreciation of the Brazilian Real against the Euro (€51.2 million), (2) lower payments relating to income taxes (€32.9 million) and (3) lower payments related to indirect taxes and other operating activities (€98.4 million), including the impact of the depreciation of the Brazilian Real against the Euro (€114.5 million).

Net cash flow from operating activities related to continuing operations increased by 96.4% to €1,775.2 million in 2011 from €903.8 million in 2010. This increase primarily reflects the impact of the proportional consolidation of Oi and Contax as from April 1, 2011, totaling €585.7 million. Adjusting for this effect, net cash flow from operating activities would have increased by €285.8 million to €1,189.6 million in 2011, reflecting (1) lower payments to suppliers (€373.2 million), as a result of a one-off reduction in the payment cycle to certain suppliers undertaken at the end of 2010 using a portion of the cash we received from the Vivo transaction, (2) a reduction in payments to employees (€109.1 million), primarily due to a lower contribution from Dedic/GPTI business, which was fully consolidated until June 30, 2011 and then integrated into Contax, and (3) lower payments related to post retirement benefits (€37.4 million). These effects were partially offset by (1) lower collections from customers (€195.9 million), which reflect the decline in revenues from the Portuguese telecommunications business and the lower contribution from the Dedic/GPTI business, and (2) an increase in payments relating to income taxes (€38.7 million).

Cash Flow from (Used in) Investing Activities

Cash flows from investing activities include proceeds from disposals of investments in affiliated companies and property, plant and equipment, as well as interest and related income on cash equivalents and short-term investments. Cash flows used in investing activities primarily include investments in short-term financial applications, capital expenditures on tangible and intangible assets and investments in other companies.

Net cash used in investing activities related to continuing operations decreased to €1,267.3 million in 2012 from €3,009.2 million in 2011. This decrease primarily reflects the acquisition of the investments in Oi and Contax in March 2011 (€2,223.7 million, adjusted for their cash position as of March 31, 2011) and the acquisition by Contax of Allus Global BPO Center (€41.9 million, adjusted for Allus's cash position as of the acquisition date). These effects were partially offset by: (1) the proceeds obtained in 2011 from the disposal of our investment in UOL (€155.5 million), (2) the decrease in cash receipts from interest and related income (€122.4 million), mainly due to interest income received in the first quarter of 2011 on the cash deposits in Brazilian Reais that were used to pay for the strategic investments in Oi and Contax, (3) the decrease in cash payments for the acquisition of tangible and intangible assets (€293.1 million), primarily due to lower capital expenditures and also the impact of the depreciation of the Real against the Euro and (4) lower dividends received (€70.9 million), primarily due to our interest in Unitel.

Net cash used in investing activities related to continuing operations increased to €3,009.2 million in 2011 from €1,301.2 million in 2010. This increase primarily reflects the impact of the proportional consolidation of Oi and Contax and the acquisition by Contax of Allus Global BPO Center described above. These effects were partially offset by (1) the proceeds obtained in 2011 from the disposal of our investment in UOL (€155.5 million), (2) the increase in cash receipts from interest and related income (€254.0 million), primarily due to the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€70.7 million) and interest income received in the first quarter of 2011 on the cash deposits in Brazilian Reais that were used to pay for the strategic investments in Oi and Contax and (3) higher dividends received (€93.1 million), mainly related to our interest in Unitel.

Cash Flows from (Used In) Financing Activities

Cash flows used in financing activities include repayments of debt, payments of interest on debt and payments of dividends to shareholders. Cash flows from financing activities primarily consist of borrowings.

Net cash used in financing activities increased to €2,646.7 million in 2012 from €540.3 million in 2011, mainly due to: (1) an increase in net cash payments from loans obtained (€2,368.5 million), reflecting net cash payments of €913.2 million in 2012, including mainly the €1,300.0 million Eurobond repaid in March 2012 and payments of outstanding amounts due under the transfer of unfunded pension obligations (€454.3 million) and commercial paper programs (€378.0 million), net of the €400 million and €750 million bonds issued in July and October 2012, as compared to net cash receipts of €1,455.2 million in 2011, primarily including the €600.0 million Eurobond issued in January 2011 and the €750.0 million facility obtained in March 2011, (2) the amounts paid by Oi to non-controlling shareholders in connection with the completion of its corporate simplification process (€296.1 million) and (3) higher payments resulting from interest and related expenses (€104.5 million). These effects were partially offset by lower dividends paid (€563.2 million), primarily reflecting the reduction in dividends paid to our shareholders (€561.2 million), which in 2011 included an extraordinary dividend totaling €559.0 million.

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Net cash used in financing activities decreased to €540.3 million in 2011 from €1,571.2 million in 2010, mainly due to (1) an increase in net cash receipts from loans obtained (€1,255.9 million), primarily including the €600.0 million Eurobond issued in January 2011 and the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€248.9 million), and (2) a decrease in dividends paid (€245.9 million), primarily reflecting the reduction in dividends paid to our shareholders (€261.5 million). These effects were partially offset by (1) higher cash payments resulting from interest and related expenses (€335.1 million), primarily including the impact of the proportional consolidation of Oi and Contax as from April 1, 2011 (€256.1 million) and (2) the acquisition of treasury shares in 2011 (€86.8 million), reflecting the proportional consolidation of our interest in purchases of Portugal Telecom shares by Oi, as explained below.

Cash payments from loans obtained, net of cash receipts from loans repaid, primarily relate to commercial paper and other bank loans and amounted to €913.2 million in 2012. As described in more detail in Note 38 to our audited consolidated financial statements for the year ended December 31, 2012, net cash payments from loans obtained in 2012 primarily included (1) the repayment of the €1,300.0 million Eurobond issued by PT Finance in March 2005, (2) the payment of the last installment due to the Portuguese State in connection with the transfer of unfunded pension liabilities, amounting to €454.3 million, (3) the reduction of €378.2 million in the amounts due under commercial paper programs, (4) the repayment of debentures amounting to R$1,500 million issued by TNL in May 2011 (€153.2 million proportionally consolidated), (5) the €20.6 million payment under equity swap contracts on our own shares and (6) the repayment of several other financings entered into in previous years by the Oi Group, in accordance with the existing repayment schedule. These effects were partially offset by the €400.0 million and €750.0 million bonds issued by Portugal Telecom and PT Finance in July and October 2012, respectively, and by the senior notes (US$1,500 million) and debentures (R$2,000 million) issued by Oi (€484.0 million proportionally consolidated).

Cash receipts from loans obtained, net of cash payments from loans repaid amounted to €1,455.2 million in 2011. Net cash receipts from loans obtained in 2011 primarily included (1) the €600.0 million Eurobond issued by PT Finance in February 2011, (2) an increase of €466.0 million in the outstanding amount under commercial paper programs, (3) an amount of €750.0 million drawn under a credit facility obtained in March 2011 and (4) bonds issued by Brasil Telecom and TNL totaling €710.3 million. These effects were partially offset by (1) repayments by TNL of certain financings that were outstanding as of March 31, 2011 (€385.4 million), (2) the payment of €450.0 million to the Portuguese State in December 2011 related to the transfer of unfunded pension obligations completed in December 2010 and (3) a payment under equity swap contracts on our own shares amounting to €84.3 million.

In 2010, cash receipts from loans obtained, net of cash payments from loans repaid, amounted to €199.3 million, primarily due to two loans obtained from the EIB totaling €200.0 million.

In 2012, 2011 and 2010, dividends paid by Portugal Telecom and its subsidiaries and jointly controlled companies amounted to €642.9 million, €1,206.1 million and €1,452.0 million, respectively. During 2012, Portugal Telecom itself paid dividends of €184.8 million on January 4, 2012, which represented an advance dividend with respect to 2011 profits of €0.215 per share, and €371.9 million in May 2012, which represented an ordinary dividend of €0.435 per share, for total ordinary dividends per share paid in 2012 of €0.65 per share. In June 2011, Portugal Telecom paid dividends of €1.3 per share, totaling €1,118.0 million, including an ordinary dividend of €0.65 per share relating to the year 2010 and an extraordinary dividend of €0.65 per share (relating to the total extraordinary dividend of €1.65 proposed following the disposal of our investment in Brasilcel, of which €1 per share had already been paid in December 2010). In 2010, Portugal Telecom paid dividends of €0.575 per share in May 2010, totaling €503.6 million, which represented an ordinary dividend relating to the year 2009, and dividends of €879.9 million in December 2010, which represented the portion of the extraordinary dividend of €1 per share described above. The remainder of the dividends we paid in 2012, 2011 and 2010 represented dividends paid by Oi, Contax and certain of our other international investments. See Note 47(m) to our audited consolidated financial statements.

In 2011, under the strategic partnership entered into between Portugal Telecom and Oi, Telemar acquired 64,557,566 of our own shares, representing 7.2% of our share capital, including €61.5 million related to shares acquired before the end of March 2011 and €86.8 million related to shares acquired in the second quarter of 2011. The €86.8 million amount was proportionally consolidated in our consolidated statement of cash flows. In 2012, Telemar acquired 25,093,639 shares of our own shares for a total amount of €99.8 million, of which €23.2 million were proportionally consolidated in our statement of cash flows as an acquisition of treasury shares. Following these acquisitions, Telemar now holds 89,651,205 ordinary shares of Portugal Telecom, representing 10.0% of total issued shares.

For more detailed explanations of the changes in certain line items of our cash flow statement, see Note 47 to our audited consolidated financial statements.

Indebtedness

Our total consolidated indebtedness decreased by 9.6% to €11,098.5 million at the end of 2012, compared to €12,281.0 million as of December 31, 2011, reflecting (1) the repayments of loans obtained as described above under " *Cash Flows Cash Flows from (Used In) Financing Activities*" and (2) the impact of the depreciation of the Brazilian Real against the Euro. These effects were partially offset by the €400.0 million and €750.0 million bonds issued by Portugal Telecom and PT Finance in July and October 2012, respectively.

Our cash and cash equivalents decreased to €2,507.1 million as of December 31, 2012 from €4,930.0 million as of December 31, 2011, primarily explained by (1) net cash used in financing activities of €2,646.7 million in 2012, primarily reflecting net cash repayments of loans, and (2) net cash used in investing activities of €1,267.3 million in 2012, primarily reflecting the payments resulting from the acquisition of tangible and intangible assets. These effects were partially offset by net cash receipts from operating activities of €1,574.1 million in 2012, as explained above.

Our short-term investments increased to €880.2 million as of December 31, 2012 from €738.1 million as of December 31, 2011, reflecting payments, net of cash receipts, resulting from short-term financial applications, amounting to €140.0 million in 2011.

Of the total indebtedness outstanding as of December 31, 2012, 84.6% was medium- and long-term debt, compared to 73.2% as of December 31, 2011.

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The composition of our consolidated indebtedness as of December 31, 2011 and 2012 was as follows:

	As of December 31,			
	2011		2012	
Debt	Short-term	Long-term	Short-term	Long-term
Indebtedness				
Exchangeable bonds		723.4		732.9
Bonds	1,562.0	5,381.4	1,079.7	5,800.3
Bank loans				
External loans	413.1	2,735.4	337.1	2,548.9
Domestic loans	0.4		2.8	108.8
Liability related to equity swaps on treasury shares	93.8		73.2	
Commercial Paper	554.0		175.8	
Leasings	27.0	35.6	24.3	24.0
Derivative financial instruments	(2.2)	(4.2)	(31.3)	(7.7)
Other financings	643.6	117.8	51.3	178.6
Total indebtedness	**3,291.6**	**8,989.4**	**1,712.8**	**9,385.8**
Cash and cash equivalents	4,930.0		2,507.1	
Short-term investments	738.1		880.2	
Net Indebtedness	**6,612.8**		**7,711.2**	

Maturity

Of the total indebtedness outstanding as of December 31, 2012, €1,712.8 million is due before the end of December 2013. The remaining €9,385.8 million is medium- and long-term debt. As of December 31, 2012, the average maturity of our total indebtedness, net of cash and cash equivalents and short-term investments, was 5.6 years.

Interest Rates

As of December 31, 2012, 62.9% of our total indebtedness was at fixed rates, an increase from 61.1% as of December 31, 2011. Excluding the impact of the proportional consolidation of Oi and Contax as of December 31, 2012, 81.8% of our total indebtedness was at fixed rates, primarily as a result of the fixed-rate bonds issued by PT Finance in 2005, 2007, 2009, 2011 and 2012.

Credit Ratings

Our credit ratings are currently as follows:

Rating Agency	Credit Rating	Outlook	Last Change
Moody's	Ba2	Negative	April 13, 2012
Standard & Poor's	BB	Negative	February 11, 2013
Fitch Ratings	BBB	Negative	April 5, 2011

The actions taken by the rating agencies with respect to our credit ratings since January 1, 2011 are summarized below:

On June 3, 2011, S&P announced its review of our credit rating, downgrading our long-term rating from BBB to BBB-, with negative outlook, and the short-term rating from A-2 to A-3.

On June 7, 2011, Moody's announced its review of our credit rating, downgrading our long-term rating from Baa2 to Baa3.

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On July 29, 2011, Moody's announced that it confirmed our Baa3 issuer rating and the ratings of our wholly owned subsidiary PT International Finance B.V. ("PTIF") with negative outlook, completing a ratings review process initiated on June 7, 2011.

On December 23, 2011, Moody's announced its review of our credit rating and the ratings of PTIF, downgrading the long-term rating from Baa3 to Ba1.

On January 21, 2012, S&P announced its review of our credit rating, downgrading our long-term rating from BBB- to BB+, with negative outlook, and our short-term rating from A-3 to B.

On April 13, 2012, Moody's announced its review of our credit ratings and those of PTIF, downgrading the long-term ratings from Ba1 to Ba2, with negative outlook.

On February 11, 2013, S&P announced its review of our credit ratings, downgrading our long-term rating from BB+ to BB, with negative outlook, and maintaining our short-term rating at B.

Certain of our debt instruments contain provisions that are triggered by changes in our credit ratings. See " *Covenants Credit Ratings*" below.

Debt Instruments

Set forth below is a brief description of certain of our debt instruments.

Bonds Portugal Telecom and Subsidiaries. We have established a Euro Medium Term Note program ("EMTN") providing for the issuance of bonds. The EMTN program allows for bonds to be issued in a range of currencies and forms, including fixed and floating rates, zero coupon and index-linked. As of December 31, 2012, the total size of this program was €7.5 billion. As of December 31, 2012, we had outstanding bonds of €4,734.0 million. During 2012, we issued the following bonds under this program:

On July 26, 2012, we issued €400 million of fixed rate notes in a local offering in Portugal at an annual interest rate 6.25%, maturing in 2016.

On October 27, 2012, we issued a €750 million Eurobond through our wholly owned subsidiary PT International Finance BV, with a maturity of 5.5 years at an interest rate of 5.875% per annum.

For additional information on the bonds we have issued under the EMTN program, including the principal amount, price, maturity and interest rate for each series of bonds, see Note 38.2 to our audited consolidated financial statements.

Bonds Oi Group and its Affiliates and Contax. Following the acquisition and proportional consolidation of the investments in Oi and Contax, the bonds we record in our statement of financial position include issuances by Oi S.A., Contax Participações and their subsidiaries and controlling shareholders. As of December 31, 2012, our proportional share of the liabilities under bonds issued by these Brazilian entities was €2,164.0 million. During 2012, the following new issuances were undertaken:

In February 2012, Oi S.A. issued US$1,500.0 million of 5.75% Senior Notes due 2022 (of which we proportionally consolidated an amount equal to €290.5 million as of December 31, 2012) in an international private placement.

In March 2012, Oi S.A. issued a total of R$2,000.0 million of debentures in two series (of which we proportinally consolidated an amount equal to €189.5 million as of December 31, 2012) in a local Brazilian offering. The debentures mature on dates from 2017 through 2020.

In April 2012, TmarPart issued R$500.0 million of debentures (of which we proportionally consolidated an amount equal to €47.4 million as of December 31, 2012) in a local Brazilian offering. The debentures mature on dates from 2017 through 2019.

For additional information on the bonds issued by Oi, Contax and their affiliates, including the principal amount, price, maturity and interest of each series of bonds, see Note 38.2 to our audited consolidated financial statements.

Exchangeable Bonds. On August 28, 2007, we issued €750 million of bonds due 2014, exchangeable into fully paid ordinary shares of Portugal Telecom. The exchangeable bonds carry a coupon of 4.125% per annum, and the exchange price is currently €8.91 per ordinary share, in accordance with the terms and conditions of the bonds. For additional information on these exchangeable bonds, see Note 38.1 to our audited consolidated financial statements. On May 23, 2012, we announced a modification to the exchange price and the threshold amount, in accordance with the terms and conditions of the bonds. Effective May 22, 2012, the exchange price is €8.91 per ordinary share and the threshold amount is €0.4414. Thus, each holder of €50,000 in principal amount of bonds will be entitled to receive 5,611 shares.

Standby Credit Facilities Portugal Telecom and Subsidiaries. As of December 31, 2012, we had committed standby credit facilities totaling €950.0 million, of which €750.0 million was drawn as of December 31, 2012. Of the €950.0 million amount, €50.0 million expires in January 2013, €100.0 million expires in January 2015 and €800.0 million expires in June 2016. With respect to the €800.0 million credit facility, we initially obtained this facility in 2011 in the amount of €900.0 million and increased the commitments thereunder to €1,200.0 million. In 2012, we renegotiated the facility, extending its maturity to June 2016 and reducing the amount to €800.0 million. For additional information on these standby credit facilities, see Note 38.3 to our audited consolidated financial statements.

Standby Credit Facilities Oi. The Oi Group has also entered into standby credit facilities, under which no amount was drawn as of December 31, 2012: (1) a standby facility entered into in December 2012 with commitments of R$1,500 million, (2) a financing agreement entered into in July 2012 with commitments of US$200 million and (3) a standby facility entered into in November 2011 with commitments of US$1,000 million. For additional information about these standby credit facilities, see Note 38.3 to our audited consolidated financial statements.

EIB Loans. We had several amortizing loans from the EIB in the aggregate amount of €602 million as of December 31, 2012. These include (1) loans in the aggregate amount of €365.9 million, bearing an average fixed interest rate of 3.1% per annum and maturing on various dates from 2013 to 2019, (2) loans in the aggregate amount of €164.3 million, bearing fixed interest rates revisable on pre-agreed dates, with an average rate of 3.4% per annum as of December 31, 2012, and maturing on various dates from 2017 to 2021 and (3) loans in the aggregate amount of €71.4 million whose floating interest rates have been swapped for fixed rate obligations at an average interest rate of 3.2% and maturing on various dates from 2013 to 2014.

Export Credit Facility. In 2011, we entered into an export credit facility, including a €80.0 million committed tranche agreed in 2011 and a €100.0 million committed tranche agreed in January 2013. As of December 31, 2012, €61 million had been drawn under this facility.

Bank loans for our Brazilian Telecommunications Business Oi. As of December 31, 2012, the Oi Group had a number of outstanding bank loans, including those described below. For additional information on these bank loans, see Note 38.3 to our audited consolidated financial statements.

Financing agreements entered into by the Oi Group with the Brazilian national development bank (*Banco Nacional de Desenvolvimento Econômico e Social*, or "BNDES") in December 2012 for the purpose of financing investments between 2012 and 2014, totalling R$5,417 million. As of December 31, 2012, the outstanding amount was R$2,000 million, and Portugal Telecom's proportionally consolidated portion was €190 million.

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Financing agreements entered into with the BNDES by several of the companies of the Oi Group for the purpose of financing investments between 2009 and 2011, totaling R$4,403 million. Interest is payable monthly from January 2012 to May 2018, and principal amortizes monthly until final maturity in December 2018. The outstanding amount due as of December 31, 2012 was R$2,618 million, and Portugal Telecom's proportionally consolidated portion was €248 million.

A loan of R$4,300 million obtained in May 2008 by Telemar from Banco do Brasil for the purpose of acquiring an equity interest in Brasil Telecom (now Oi S.A.), with interest payable semi-annually. The remaining principal amount is payable in four annual installments beginning in May 2015. The outstanding amount due as of December 31, 2012 was R$3,071 million, and Portugal Telecom's proportionally consolidated portion was €291 million as of December 31, 2012.

A credit facility entered into by Telemar in November 2006 with BNDES to finance the expansion and technological upgrading of its fixed line network. Interest and principal are payable monthly through June 2014. The outstanding amount due as of December 31, 2012 was R$456 million, and Portugal Telecom's proportionally consolidated portion was €43 million as of December 31, 2012.

A credit facility entered into by Brasil Telecom in November 2006 with BNDES, amounting to R$2,004 million (actual loans of R$2,055 million). Interest and principal are payable monthly through May 2014. The outstanding amount due as of December 31, 2012 was R$399 million, and Portugal Telecom's proportionally consolidated portion was €38 million as of December 31, 2012.

Liability Related to Equity Swaps on Treasury Shares. As of December 31, 2012, we had equity swap contracts over 20,640,000 of our own shares, which were recognized as an effective acquisition of treasury shares, requiring us to recognize a corresponding financial liability for the related acquisition cost in the amount of €178.1 million. In December 2011 and 2012, we settled €84.3 million and €20.6 million, respectively, of the outstanding amount previously due, and, consequently, the liability as of December 31, 2011 and 2012 was reduced to €93.8 million and €73.2 million, respectively. For additional information on our liability related to these equity swaps, see Note 38.4 to our audited consolidated financial statements.

Commercial Paper. We have entered into several commercial paper programs, under which we had issued an aggregate amount of €176 million as of December 31, 2012, maturing in January 2013. Under these programs, we had available an underwritten amount of €200 million as of December 31, 2012. In January 2013, we entered into a new commercial paper program for a total amount of €400 million, including an underwritten amount of €200 million. For additional information on our commercial paper programs, see Note 38.5 to our audited consolidated financial statements.

Financing Relating to the Transfer of Unfunded Pension Obligations and Other Financings. Following the transfer of certain unfunded pension obligations to the Portuguese State for a total amount of €1,021.7 million, completed in December 2010, we paid €100.0 million in December 2010, €17.4 million and €450.0 million in January and December 2011, respectively, and the remaining €454.3 million in December 2012. This €454.3 million amount is reflected in the "Other financings" line of the consolidated indebtedness table above as of December 31, 2011. For more information on the other financings reflected in that line, see Note 38.8 to our audited consolidated financial statements.

Recent Financings by Oi.

In February 2013, Export Development Canada disbursed US$90 million under an export credit facility entered into with Telemar under which Export Development Canada agreed to disburse loans in the aggregate principal amount of up to US$200 million. Loans under this facility will bear interest at the rate of 2.25%, payable semi-annually in arrears through maturity. The principal amount of these loans will be payable in semi-annual installments commencing in May 2014.

In March 2013, Oi entered into an export credit facility agreement with the Office National Du Ducroire/Nationale Delcrederedienst ("ONDD"), the Belgium national export credit agency, under which ONDD agreed to disburse loans in two tranches in the aggregate principal amount of US$257 million. The proceeds of this export credit facility will be used to fund equipment purchases from Alcatel-Lucent. Loans under this export credit facility will bear interest at a rate of six-month Libor plus 1.50% per annum. As of the date of this annual report, no disbursements have been made under this export credit facility.

In March 2013, Oi issued non-convertible debentures in the Brazilian market in the aggregate principal amount of R$1,500 million. These debentures bear interest at the CDI rate plus 0.75% per annum, which will be payable annually through maturity in March 2019. The principal amount of these debentures will be payable at maturity. Oi has used and will use the net proceeds of this offering for its working capital requirements, to amortize its existing indebtedness and to fund capital expenditures.

Covenants

Our debt instruments contain certain covenants, as well as customary default and cross-acceleration provisions. As of December 31, 2012, the main covenants are as follows:

Change in Control. The exchangeable bonds, the credit facilities amounting to €1,180 million and the loans obtained from EIB totaling €602 million as of December 31, 2012 provide for redemption at the option of the bondholders (in the case of the exchangeable bonds) or mandatory prepayment in the case of any change in control of Portugal Telecom. According to the terms and conditions of these debt instruments, a change of control would occur if any person or group of persons acting in concert acquires or controls more than 50% of voting rights, whether obtained by ownership of share capital, the holding of voting rights or pursuant to the terms of a shareholders' agreement. In certain cases, gaining the power to appoint or remove all, or the majority, of the directors or other equivalent officers of the company or to give directions with respect to the operating and financial policies of the company with which the directors or equivalent officers of the company are obliged to comply are also considered a change of control.

Change of Control with Ratings Trigger. The Eurobonds amounting to €1,000 million and €750 million issued in 2009, the €600 million Eurobond issued in 2011 and the €750 million Eurobond issued in 2012 provide for redemption at the option of the bondholders in the event of any change of control of Portugal Telecom, as described above, if simultaneously a rating downgrade to sub-investment grade occurs (in case the securities are investment grade securities) or a rating downgrade occurs (in case the securities are sub-investment grade securities) during the Change of Control Period, as defined under the terms and conditions of these notes.

Credit Ratings. Certain loan agreements with the EIB, totaling €82 million as of December 31, 2012, state that we may be asked to present a guarantee acceptable to the EIB if, at any time, the long-term credit rating assigned by the rating agencies to Portugal Telecom is reduced from the rating assigned by the time the clause was included (BBB- by S&P, Baa2 by Moody's and

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BBB by Fitch). On December 23, 2011, Moody's announced the downgrade of Portugal Telecom's long-term rating from Baa3 to Ba1. On February 16, 2012, S&P announced its review of the credit rating attributed to Portugal Telecom, downgrading the long-term rating from BBB- to BB+, and the short-term rating from A-3 to B. Following these developments, Portugal Telecom agreed with the EIB to open a cash deposit account amounting to a portion of the amount due under the loan agreements that include the credit rating covenant, pledged in favor of the EIB. The amount deposited in this account, which amounted to €42 million as of December 31, 2012, will be reduced as loans are repaid. Portugal Telecom and the EIB have also agreed that further upgrades or downgrades of the credit rating assigned to Portugal Telecom will lead to, respectively, decreases or increases in the amount deposited, with no other consequence, which is applicable to the downgrade announced by S&P on February 11, 2013, from BB+ to BB, with negative outlook. See " *Credit Ratings*" above.

Control and Limitations on Disposals of Subsidiaries. As of December 31, 2012, certain credit facilities in the aggregate amount of €980 million provide that we must, directly or indirectly, maintain majority ownership and control of each material subsidiary. Material subsidiaries are those companies whose total assets are equal to or exceed 10% of total consolidated assets or whose total revenues are also equal or exceed 10% of total consolidated revenues.

Dispositions of Assets. Credit facilities totaling €150 million and the EIB loans totaling €602 million as of December 31, 2012 include certain restrictions regarding the disposition of assets by Portugal Telecom.

Financial Ratios. Certain credit facilities totaling €1,180 million require that the ratio of Consolidated Net Debt to EBITDA (EBITDA = income before financial results and taxes + depreciation and amortization + net post retirement benefits costs + curtailment and settlement costs + losses (gains) on disposals of fixed assets + other costs, net) may not exceed certain values, which vary depending on the loan agreements. Consolidated Net Debt is defined as total short and medium and long-term debt minus cash and cash equivalents and short-term investments. EBITDA is defined as income before financial results and taxes plus depreciation and amortization expenses, post retirement benefits costs, curtailment costs, net losses on disposals of fixed assets and net other costs. The Consolidated Net Debt to EBITDA ratio amounted to 3.3 and 2.6 in 2012 and 2011, respectively.

Negative Pledge. The Euro Medium Term Notes, the exchangeable bonds, the credit facilities, the loans obtained from the EIB and the commercial paper programs are subject to negative pledge clauses, which restrict the granting of security interests in the assets of companies included in the consolidation.

The penalties applicable in the event of default in any of these covenants are generally the early payment of the loans obtained or the termination of available credit facilities. Our debt instruments generally include customary cross-acceleration or cross-default provisions. We believe that, as of December 31, 2012, we are in full compliance with the covenants described above.

We discuss our exposure to interest rate and exchange rate risk, as well as our use of derivative instruments, in "*Item 11 Quantitative and Qualitative Disclosures About Market Risk.*"

Post Retirement Benefits

On December 2, 2010, we reached an agreement with the Portuguese State for the transfer to Caixa Geral de Aposentações, the Portuguese institution responsible for managing post retirement benefits for civil servants, of the pension liabilities that were guaranteed by PT Comunicações relating to a portion of its active and former employees, as well as the pension fund assets associated with those liabilities. The transfer included the *Plano de Pensões do Pessoal da Portugal Telecom/CGA,* the *Plano de*

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Pensões Regulamentares da Companhia Portuguesa Rádio Marconi and the liabilities associated with the survival benefit in the *Plano de Pensões Marconi* (collectively, the "Regulated Pension Plans").

The present value of the liabilities associated with the Regulated Pension Plans, as of the date of transfer, was €2,803.8 million, as determined by an independent actuary. The market value of the pension fund assets transferred, as of the date of the transfer, was €1,782.1 million. Accordingly, the unfunded transferred liabilities amounted to €1,021.7 million, of which we paid €100 million in December 2010, €467 million in 2011 and the remaining €454 million in December 2012.

Following the transfer of certain pension plans to the Portuguese State, we are now responsible for a fixed monthly contribution to Social Security and the Caixa Geral de Aposentações in order to fund future benefits for the active beneficiaries included in these plans.

In addition, following our strategic investment in Oi, we proportionally consolidated its net post retirement benefits obligations, amounting to €72.7 million as of December 31, 2012, which relate to several plans with different characteristics, including defined contribution plans and defined benefits plans. Most of these plans are closed to new participants. Oi has several plans that are currently in a surplus position that is not recorded as an asset because it is not possible to obtain reimbursement of that surplus.

The following table shows the amount of our liabilities for post retirement benefits recorded on our statements of financial position as of December 31, 2010, 2011 and 2012:

	As of December 31,		
	2010	**2011**	**2012**
	(EUR Millions)		
Gross projected pension benefits obligations	129.9	121.6	127.3
Minus: Pension fund assets at fair value	(109.3)	(98.5)	(99.5)
Prior years' service gains(1)	5.2	4.5	