

PORTUGAL TELECOM SGPS SA

Form 6-K

March 17, 2010

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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 6-K

**Report of Foreign Private Issuer  
Pursuant to Rule 13a-16 or 15d-16 of the  
Securities Exchange Act of 1934**

**For the month of March 2010**

**Commission File Number 1-13758**

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**PORTUGAL TELECOM, SGPS, S.A.**

(Exact name of registrant as specified in its charter)

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

(Address of principal executive office)

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

Form 20-F            Form 40-F     

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

Yes            No     

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

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**Portugal**

Wireline Euro 1,948 million (revenues)	<ul style="list-style-type: none"> <li>• Retail, large corporates voice and data, ISP and broadband services [PT Comunicações100%]</li> <li>• SMEs voice and data [PT Prime 100%]</li> </ul>
Mobile Euro 1,518 million (revenues)	<ul style="list-style-type: none"> <li>• TMN 100%</li> </ul>

**Main international assets**

			<b>Revenues (Euromillion)</b>
Vivo 29.71%	• Brazil	• Mobile	3,138
Unitel 25% (*)	• Angola	• Mobile	1,120
CTM 28%	• Macao	• Wireline, mobile	219
MTC 34% (*)	• Namibia	• Mobile	124
CVT 40% (*)	• Cape Verde	• Wireline, mobile	71
Timor Telecom 41.12%	• East Timor	• Wireline, mobile	35
CST 51% (*)	• São Tomé e Príncipe	• Wireline, mobile	12
UOL 28.78%	• Brazil	• ISP, contents and Internet	n.a.

(\*) These stakes are held by Africatel, which is controlled 75% by PT.

**Support companies**

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

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

Call centres and telemarketing services [PT Contact 100%]; Pension funds management [Previsão 82.05%]

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**Chairman's message**

In 2009, PT consolidated the strategic path initiated at the end of the mandate of the 2006-08 triennium with the implementation of the plan that was presented to the Shareholders and that was approved by a large majority in the most participated Shareholders Meeting of PT's history, which took place on 2 March 2007. This plan was further extended and consolidated, in April 2008, with the approval of the strategic plan by the Board of Directors, which builds the foundations for future profitable growth.

Also during 2009, PT consolidated its presence in the markets where it operates, by continuing to launch new products and services that allowed the Company to maintain a leading competitive position in each respective market.

A new Board of Directors for the period between 2009 and 2011 was elected in the Annual General Meeting that took place in April 2009. This new Board of Directors will continue to define and implement PT's strategy, focused on the relentless pursuit of opportunities to grow and consolidate further PT's presence in the markets where the Company operates.

Despite the adverse economic environment, in 2009, PT's revenues grew by 0.9% y.o.y to Euro 6.8 billion and its EBITDA grew by 0.9% to Euro 2.5 billion. As a result of the strong focus in PT's international geographies, 51.5% of revenues and 44.0% of EBITDA were generated by international assets. PT delivered net income of Euro 684 million, up by 18.7% y.o.y, which represented an earnings per share of Euro 0.78, up by 22.9% y.o.y. I am fully convinced that this performance reflects the growth strategy defined by the Board of Directors and implemented by the Company. The diversification within different geographies has enabled PT to have a good growth profile and at the same time a stable cash-flow generation, which has allowed for a strong shareholder remuneration policy and the required investment for the sustainability of PT's business.

**PT is committed to having Portugal as one of the most advanced nations in information society**

During 2009, PT reinforced its commitment and investment in the development and implementation of new technologies, services and products to further promote the information society and the info-inclusion of all citizens in the market where it operates.

In Portugal, PT announced an ambitious project to cover one million households with fibre-to-the home (FTTH), thus taking a decisive and firm step to improve the speed and quality of the broadband access, turning Portugal a reference case in the development of next generation access networks. PT also continued to invest significantly in the next generation access wireless networks, with the continued development of the 3G and 3.5G technologies, both in terms of coverage and also in terms of capacity. PT also continued to promote the convergence of fixed and mobile networks and the convergence of telecoms, multimedia and information services as a means to develop further the access of individuals to information at anytime and anywhere and to develop further the services offered and fulfil the communication needs of corporations, SMEs and SOHOs.

In Brazil, PT also continued to promote the coverage of 3G and 3.5G technologies through Vivo. In the other international operations and geographies, PT, together with its partners, also continued to deploy efforts in the coverage and capacity of its wireless and fixed networks, thus



further contributing to the development of the information society in all countries where PT operates.

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**Shareholder remuneration policy**

In May 2009, PT announced a new shareholder remuneration policy consisting of the proposal to pay dividend per share of Euro 0.575 for the fiscal years 2009-11, the mandate of the new Board of Directors. With the announcement of this remuneration policy, PT aimed to provide clear, visible, predictable and attractive remuneration profile to its shareholders. This programme was proposed following a thorough assessment of PT's operational and financial prospects and intends to, while adequately remunerating shareholders, maintain the PT's operational and financial flexibility, thus allowing a continued investment in the development of new products and services and the ability of PT to continue to design and establish a growth paradigm in the markets where it operates.

This new shareholder remuneration package follows the one that was approved in the General Shareholders Meeting that was held in March 2007 and that was fully implemented with the payment, in April 2009, of the dividend related with fiscal year 2008 and that represented the return of Euro 5.8 billion to shareholders through dividends, share buyback and the spin-off of PT Multimedia. This new shareholder remuneration policy will start to be implemented, upon approval by shareholders in the upcoming Annual General Shareholder Meeting, with the payment of the dividend per share of Euro 0.575 related with fiscal year 2009, as proposed by the Board of Directors.

**Ambition for the future**

PT will continue to develop further its international agenda, aiming at continuing to be a relevant operator in the Portuguese-speaking geographies and in the international landscape. At the same time, PT will continue to position itself as a leading-edge technology operator, aiming at providing advanced and convergent services to meet the needs of all its customers and further enhance its growth profile. PT will also continue to be focused on providing attractive and adequate returns to its shareholders, while at the same time providing adequate compensation and opportunities to all its employees and stakeholders in general.

I would like to thank for the support and confidence we received from our shareholders and to ensure that the Company remains committed to continue to deliver on the strategy defined by the Board of Directors in the best interest of all shareholders.

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**CEO's message**

Dear Shareholders,

Building on the transformational process initiated in 2008, we set out five strategic business objectives at the onset of our current mandate for 2009-2011, namely:

1. Reach 100 million customers at the end of 2011;
2. Increase the contribution of international revenues to two-thirds of total revenues;
3. Reinforce our leadership in all the markets where we operate;
4. Achieve top quartile operational and financial performance among European peers, and
5. Become a reference in sustainability in all the geography where we operate.

It pleases me to inform you that Portugal Telecom's 2009 results have taken us a step closer to fulfilling these ambitious targets. Based on a business approach clearly focused on innovation and execution, in order to build a structural competitive advantage over time, PT's operational performance in 2009 confirmed the positive trends we started to witness in the previous year, namely:

- The continued success of the Meo triple-play offer in Portugal is supporting market share gains in Pay-TV and broadband, as well as leading to a significant improvement in fixed line disconnections. This has supported an acceleration of wireline retail revenues and positive growth in gross profit in the fourth quarter.
- Post-paid customer growth, underpinned by the success of wireless broadband, is improving the mobile customer mix in Portugal.
- Vivo's leadership in voice and data in Brazil was reinforced, notwithstanding aggressive competitive conditions, and against a backdrop of improving profitability derived from greater scale and efficiency.
- Assets in Africa and Asia continued to post solid growth in terms of customers (+23%) and financial results.

As a result, PT added nine million new customers across all our properties and reached a total of 72 million customers (+15%). During 2009, we continued to increase our international exposure. In fact, our international business now accounts for 84% of our customers,

with a significant portion coming from Brazil, 51.5% of our revenues and 43% of our net income.

**Domestic market**

Notwithstanding a challenging economic, regulatory and competitive environment, PT performed strongly across all its business segments, adopting an attacker mindset based on continuous innovation and an increased understanding of the shifting customer behaviours and preferences.

In the residential segment, PT continued to market Meo's Pay-TV service aggressively and launched new features aimed at continuously differentiating our offer. We also added new content, through partnerships signed with leading content suppliers, in particular with regard to Portuguese content. Meo continued to provide a disruptive Pay-TV offer in the market, offering access to a wide choice of channels, high-definition, latest

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generation set-top boxes with video recording (PVR), electronic programming guide, and remote PVR. Throughout 2009, we also introduced a number of new features such as a photo sharing service, games and information services, leveraging on the leading internet portal in Portugal ( Sapo ), which is owned by PT.

In the personal segment, PT continued to pursue several initiatives around mobile internet and TV, launching new smartphones and other data-enabled phones. PT also launched new applications aimed at increasing usage of data and other value added services, namely new interactive applications for social media and also launched a mobile TV offer, leveraging on Meo's brand.

In the SME and SOHO segment, PT continued to leverage on fixed-mobile convergent solutions, aimed at simplifying the communication services offered and also allowing PT to offer increasingly more customised solutions for specific market segments. In the corporate segment, we continued to take advantage of the blurring of the boundaries of telecoms and IT, offering new and more sophisticated high-value services to our customers, essentially with the aim of profitably increasing PT's share of wallet.

Overall, PT continued to strengthen its market share in the domestic market, across both the wireline and mobile platforms. In wireline, we continued to take significant share in Pay-TV, increasing our market share from 13.6% to 23.0% at the end of the year. The success of our triple-play offer also underpinned improving fixed broadband trends, with an increase in market share from 43.4% to 46.2%. Notably, the level of net fixed line disconnections also improved substantially from 173 thousand in 2008 to 96 thousand in 2009, of which only 31 thousand in the second half of 2009. In mobile, we also reinforced our leadership in the market, adding 319 thousand new SIM cards and improving the share of service revenues by 0.5pp to 43.1%. In terms of wireless broadband and smartphones, TMN is clearly the leader in the market with over 50% market share in both cases.

**International Market**

PT continued to centre its international strategy mainly on Portuguese-speaking countries and on a distinctive vision of continuous customer-driven innovation, bringing to bear best practices across all our operations. We specialised in two core international geographies: Brazil and Sub-Saharan Africa markets that will continue to be driven by significant growth in penetration of wireless services, and where we enjoy close cultural ties.

In Brazil, Vivo continued to build the foundations for future profitable growth, while ensuring the sustainability of its leadership in the Brazilian mobile market. Vivo's market share of customers remained flat at 30% in 2009, supported by strong commercial activity in 4Q09, when market share of net additions reached 37%. In a highly competitive environment, Vivo also improved the profitability of its operations, increasing its EBITDA margin to circa 30% in 2009. As a result, Vivo more than doubled its net income and announced a full payout for the second consecutive year.

Worth highlighting MTC in Namibia, which posted a solid performance during 2009, with customers growing by 27% and EBITDA by 25% in Euros. Against a backdrop of adverse economic and regulatory environment, CVT,



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Cape Verde's telecom operator, continued to invest in the quality of its infrastructure and in the differentiation of its services.

The performance of Timor Telecom was also noteworthy. In 2009, the company invested significantly in the coverage and quality of its services, and repositioned its brand and improved its commercial efforts. As a result, Timor Telecom increased its mobile customer base by 181%, which underpinned top line and EBITDA growth in the range of 30%.

In 2009, PT sold its equity stake in Medi Telecom, which generated a capital gain of Euro 267 million, in line with its commitment to its three core geographies and its strategic and financial discipline.

**Investment**

It is our belief that we can build a structural competitive advantage if we can bring to bear our investments in leading-edge technology to provide more and better quality services more quickly to our customers. We believe that it can be a key driver for growth in a continuously changing and evolving market.

In 2009, PT developed an ambitious investment programme on next generation access networks, both in fixed and mobile, with this objective in mind. At the end of the year, PT had covered 965 thousand households with fibre-to-the-home (FTTH), thus turning Portugal into a case study in the development of next generation access networks. It is our understanding that FTTH is the right technological investment for those companies that believe that the network is not a commodity and that network architecture can become a structural competitive advantage in the corporate and residential markets. PT also continued to invest significantly in the development of the 3G and 3.5G technologies, in terms of coverage and capacity, in both Portugal and Brazil.

**Financial results and remuneration**

In terms of financial performance, PT increased revenues and EBITDA in circa 1% in 2009 to Euro 6.8 and 2.5 billion respectively, while net income increased by 19% to Euro 684 million and earnings per share by 23% to Euro 0.78. From financial position standpoint, 2009 results reinforced the company's balance sheet strength, allowing for a reduction in overall indebtedness, notwithstanding the level of investment across all our operations.

With regard to the share price, PT performed very strongly in 2009, providing a total return to our shareholders of 55%, including the Euro 0.575 dividend paid, and which compares very favourably with the peer group that presented a total shareholder return of 19%.

**Sustainability**

Sustainability and social responsibility continued to be at the very heart of PT's strategy and operations. As a result of the continued investment in a sustainable business model, PT continued to be part of FTSE4Good index and was awarded in Portugal the Sustainable Development 2009 Award and the Citizenship of



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Corporations and Organisations 2009 Award. PT's corporate brand is amongst the fifty most valuable brands of the telecommunications sector across the world, while its two main commercial brands meo and tmn are the leading brands in Portugal in terms of brand recognition.

At the environmental level, PT continued to certify the energy performance of its buildings and reinforced the programme to replace lighting and cooling equipments by new and more efficient solutions. At the social level, PT developed several initiatives, of which it is worth highlighting the programme to support its unemployed customers, through a special offer, and the partnership with AMI to support the medical treatment of the dengue disease in Cape Verde. PT also continued to invest in the social inclusion in the communities where it is present, for example through the distribution of laptops and computers in countries like Cape Verde, São Tomé e Príncipe and East Timor.

**Future prospects**

We have set an ambitious growth agenda along the five strategic business objectives outlined above. In light of our business vision, which is underpinned by long-term investments to build a structural competitive advantage in our markets, we are challenging the status quo in our industry and laying the foundations to secure lasting growth and prosperity for our company and the creation of value for our shareholders. Internationally, we intend to manage our footprint depending on opportunities and our ability to create value, always abiding by a strict strategic and financial discipline.

On 14 May 2009 PT announced a new three-year dividend plan, which proposes to distribute a dividend per share of Euro 0.575 per annum. This plan offers an attractive and predictable remuneration policy to our shareholders, combined with above-average growth prospects, by leveraging on our international portfolio and improving domestic operations.

Finally, I would like to thank the support we received from our shareholders, the commitment and professionalism of our employees and the trust provided by both our customers and our suppliers, without all of whom these results would not have been possible.

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01

**Macroeconomic environment**

2009 was marked by a severe slowdown in activity in the largest economies areas as a consequence of the global financial crisis that began in 2007. This evolution was determined above all by the deterioration of economic agents, translated into a decline in demand and a collapse of the flow of international commerce during the first half of the year. The recession took place in a framework of less availability of liquidity in financial markets and, therefore, in a more restrictive financing environment. The authorities responded by lowering reference interest rates to levels close to zero, by injecting liquidity into the financial system and, in terms of budgetary policy, by using tax incentives to promote the consumption of durable goods and an increase in the public expenditure in infrastructures.

**GNP Growth, Selected Economies (%)**

Source: IMF, National Statistics Institutes.

As a result of the aggressiveness of these incentives, there were clear signs of acceleration of economic activity and also of financial stabilisation in 2H09, especially in 4Q09. This latter translated into a gradual narrowing of the spreads in the monetary and credit markets, reflecting a decrease in risk-aversion and an increase in the confidence levels of financial institutions. In the Euro Zone, as the main ECB interest rate decreased from 1.5% to 1%, the 3-month Euribor rate decreased throughout the year, from 2.89% to 0.7% . Although still at higher levels than before the crisis, credit spreads have narrowed, as the iTraxx Financials index, relative to Credit Default Swaps, has decreased from a maximum of 206 bps in March to 75 bps at the end of the year.

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**Liquidity Premium, Financial Sector**

**(Cash Bonds vs. CDS Spreads, base points)**

Source: Bloomberg.

Although oil prices soared in 2009 (from USD 42 to USD 77 per Brent barrel) the productivity increase observed in the main economies allowed growth to take place in an environment of low inflation and interest rates. This fact has benefited stock markets, especially from 2Q09 onwards. In the United States, Dow Jones, Nasdaq and S&P500 indices have increased by 18.8%, 43.9% and 23.5% per annum, respectively. In the Euro Zone, DAX, CAC 40 and IBEX indices have increased by 23.9%, 22.3% and 29.8%, respectively. As a reflection of the more favourable perspectives for emerging markets, the Bovespa (Brazil), Shanghai Composite (China) and Sensex (India) indices have increased by 82.7%, 79.9% and 81%, respectively.

**Year-on-Year Inflation Rate (%)**

Source: Bloomberg.

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**Main Stock Indices**

Source: Bloomberg.

**International Economic Environment**

The US economy was marked in 2009 by high levels of uncertainty as to the evolution of economic activity and the stability of the financial system, as the GDP fell in 1H09 (-6.4% and -0.7% in annual terms, in 1Q09 and 2Q09, respectively). Against this backdrop, the US authorities have reacted decisively. As to monetary policy, the Federal Reserve Bank, after bringing the reference interest rate to levels between 0% and 0.25% and adopting several measures to increase liquidity in 2008, increased the use of non-conventional measures in 2009. These included, among others, a program for the acquisition of mortgage-backed securities (up to USD 1,200,000 million) and another for the acquisition of public debt bonds (up to USD 300,000 million). The Fed's measures have contained the increase of 10-year Treasury yields (from 2.21% to 3.38% throughout the year). In terms of the US budget, there have been several incentives, such as the American Recovery and Reinvestment Act, involving an amount of nearly USD 800,000 million, comprised of tax reductions, fiscal credits for the acquisition of home and durable goods, social and financial support for the unemployed, and a reinforcement of public expenditure, particularly as regards infrastructures and energy.

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**Balance of the US Federal Reserve**

Source: Reuters EcoWin Pro.

As a result of monetary and budgetary incentives, the US economy showed a trend toward recovery in 2H09, with annualised growth of 5% in 4Q09. In this context, the GDP fell by only 2.6% in 2009. Private consumption and investment decreased in annual terms but with significant improvements in 2H09, particularly in the consumption of durable goods and residential investment. The beginning of a favourable cycle for investment in stock replenishment a more visible stabilisation of the housing sector and the impact of the USD depreciation on the competitiveness of American exports contributed also decisively to the improvement of economic activity.

**USD, Effective Exchange Rate**

Source: Reuters EcoWin Pro.

The commitment of the US authorities to economic and financial stability had an important impact on the confidence levels of economic agents, enabling the return of optimism to the markets right after March. This was expressed as a strong valuation of the main stock market indices and a narrowing of credit spreads.

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Besides the improvement in the economic outlook, the financial markets also benefited from the expectations of low inflation (-0.3% in 2009), along with high excessive productive capacity (of which unemployment, hitting 10% of the active population at the end of the year, noteworthy). The low interest rate environment has contributed to making the USD the main instrument of carry trade, financing investments in assets of higher return, especially in emerging and commodity-exporting economies. This fact has sustained USD depreciation, which surpassed 16% in effective terms between March and December.

The economy of the Euro Zone performed differently in 1H09 and 2H09. 1H09 was marked by a strong contraction in activity (declines of 2.4% and 0.2% q-o-q in 1Q09 and 2Q09, respectively) following the recession, which started in 2Q08, with declines in exports and investment. This performance should be analysed in the context of the consequences of the financial crisis, which was at its peak in September and October 2008. The contraction of liquidity and the strong deterioration in confidence levels in the last months of 2008 led to a general decrease in confidence and demand, translating into a strong contraction of external demand. This had an especially negative impact in Germany, with an expected GDP decrease close to 5% in 2009, the worst result since World War II. Several economies of the Euro Zone continued to suffer the effects of a recession in the housing sector, which amplified the negative adjustment of demand. Throughout the year, the GDP of the Euro Zone fell close to 4%.

3Q09 and 4Q09 showed, however, a return to positive activity growth (variations of 0.4% and 0.6% q-o-q, respectively) after five consecutive quarters of contraction. This performance benefited from an improvement in exports, a favourable effect of replenishment investments in stock (favouring industrial activity), and government monetary and budgetary incentives. Internal demand, however, has demonstrated poor performance, marked by restrictions in the financing of private consumption and investment, deterioration of the conditions of the labour market (especially the progressive increase in the unemployment rate up to 10% of the active population at the end of the year), and an increase in precautionary savings.

**Refi and Euribor Rates (%)**

Source: Bloomberg.



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As to prices, the average annual inflation was marginally above 0% (after 3.3% in 2008), as a result of the absence of upward pressures on prices from demand, as well as from the evolution of energy prices, with the statistical effect of the decrease in oil prices compared to 2008. In this context, until May, the European

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Central Bank implemented a policy of reduction of the reference interest rates. The European monetary authority lowered its main interest rate 50 base points twice in January and March and 25 base points twice in April and May. Since October 2008, the interest rate was reduced from 4.25% to 1% and the marginal lending and deposit rates were also reduced in 125 and 175 base points, respectively. Moreover, it supplied ample liquidity to the banking system as three unlimited 12-month operations to supply liquidity stand out (amounting to EUR 614,000 million), the first two with a fixed rate of 1% and the third one at a rate indexed to the refinancing operations.

**Euro Zone Spreads of Yields of**

**10-Year Public Debt Bonds**

Source: Bloomberg.

The expansionist budgetary policies carried out by national governments, aiming at stimulating internal demand, led to considerable deterioration of public accounts, as the budget deficit in the Euro Zone as a whole increased from 2% to 6% of GDP. The Current Accounts Deficits of Greece, Ireland and Spain are noteworthy, surpassing 10% of the GDP. This evolution translated itself into a deterioration of the sovereign risk (a widening of the public bond yield spread of these governments relative to German bonds) that especially penalised Greece and Ireland, which suffered downgrades of the respective ratings at the end of the year, as well as other economies of the periphery of the Euro Zone, such as Italy, Spain and Portugal, the last two suffering downgrades in the outlook of their respective ratings.

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**EUR/USD**

Source: Reuters EcoWin Pro.

**Economic Developments in PT's main geographies**

**Portugal**

Reflecting the effects of the global economic crisis, there was a 2.7% GDP contraction in the Portuguese economy. This performance was less intense than in Portugal's main partners within the European Union (GDP drops of 3.7% in Spain, 2.8% in France and 4.5% in the United Kingdom). Besides a less severe recession, Portugal was one of the first EU economies to abandon the cycle of negative variations of the GDP, right after the 2Q09.

This behaviour is explained by the fact that the demand was not affected, as in other economies, by strong negative richness-effects related to adjustments in the real estate market, nor by situations of instability in the financial system. Therefore, the recession of the Portuguese economy in 2009 was the result of the slump of external demand as well as of natural deterioration of trust levels of companies and families, with a negative impact on consumption and above all on investment. These two indicators were also affected by stronger restrictions of financing criteria of economic activity, as the result of less liquidity available in international financial markets. Therefore, in 2009, exports fell by 12.3% after having decreased by 0.5% in the previous year. This decrease was due to most goods and services, as well as most export destinations of the European Union. Reflecting the contraction of internal demand, imports fell by 10.7% throughout the year, after having increased by 2.1% in 2008.

The deterioration of expectations considering the evolution of internal and external demand, the high levels of uncertainty and tighter credit availability have weighed decisively on investment levels, which fell in real terms by 12.6%. Apart from fixed capital expenditures, this evolution was also due to a reduction of the level of stocks, which increased the negative contribution of investment to the GDP. Thus, the investment of companies fell in real terms by circa 15%, which was not compensated by the strong increase in public expenditure (circa 13%),

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the main expression of budgetary incentives to economic activity (public expenditure increased in real terms by 2%). Family investment in housing enhanced the downward trend observed in the previous year, which was close to -12%.

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A decline in confidence levels and increased uncertainty translated into a fall of around 0.8% in private consumption. This evolution took place in spite of a raise of the available income of families as the result of the fall of the interest rates and above all of the increase of the State transfers, being explained mostly by an attitude of precaution adopted by families. Therefore, 2009 was marked by a significant increase of the savings rate, to a value slightly above 8% of the available income. This increase interrupted a continued downward trend in family savings observed since 2002. The negative evolution of private consumption is explained by the strong decline of consumption of durable goods, as expenses in non-durable goods increased marginally above zero. Purchasing power of families took advantage of negative inflation throughout 2009. In average annual terms, inflation fell from 2.6% to -0.8% . This fact contributed in the first place to a strong increase in the price of raw materials (especially oil), but it is also result of the recession environment in 2009, which strongly restricted the ability of companies to increase prices.

**Portugal Main Macroeconomic Indicators**

<b>Real growth rates (%), except when indicated.</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009 E</b>
GDP	0.8	-0.8	1.5	0.9	1.4	1.9	0.0	-2.6
Private Consumption	1.3	-0.1	2.5	2.0	1.9	1.6	1.6	-0.8
Public Expenditure	2.6	0.2	2.6	3.2	-1.4	0.0	0.5	2.0
Investment	-4.7	-8.3	2.5	-1.5	-0.3	3.2	-0.1	-12.6
Exports	1.5	3.9	4.0	2.0	8.7	7.5	-0.5	-12.3
Imports	-0.7	-0.8	6.7	3.5	5.1	5.6	2.1	-10.7
Inflation (Consumer Price Index)	3.6	3.3	2.4	2.3	3.1	2.5	2.6	-0.8
Budget Deficit (% of GDP)	-2.8	-2.9	-3.4	-6.1	-3.9	-2.6	-2.7	-9.3
Public Debt (% PIB)	55.5	56.9	58.3	63.6	64.7	63.5	66.4	76.6
Unemployment Rate (% of active population)	5.1	6.4	6.7	7.6	7.7	8.0	7.6	9.2
Current Accounts Deficit(% of GDP)	-6.0	-3.3	-5.7	-8.3	-9.3	-8.1	-10.5	-8.3

Sources: INE, Bank of Portugal, Ministry of Finance, European Commission, OECD, ES Research.

Notwithstanding the negative evolution of exports, 2009 was marked by a correction of the Current Accounts Deficit or External Deficit, from 10.5% to a value around 8.3% of the GDP. This fact reflects the process of deleverage undertaken by the private sector in 2009, as well as a reduction of the energy deficit. The reduction of the needs of financing of the private sector meant an increase in the needs of financing of the Public Administrations mainly as a result of the budgetary incentives to economic activity, but also reflecting the effects of the bottom phase of the economic cycle on public accounts. In this framework, the budget deficit rose from 2.7% to 9.3% of the GDP.

**Emerging Markets**

One of the most significant facts in 2009 was the relative dynamism of emerging economies. Although decelerating in comparison to 2008, the GDP of these economies grew 2.1%, as compared to -3.2% in developed economies and -0.8% in world economy. This dynamism is the result of a lower direct exposure to the financial crisis and, in some economies, of greater speed and aggressiveness in using activity incentives. Nevertheless, more than a mere conjunctural effect, this favourable performance should be associated with a structural trend. The strong growth of urban population and of income per capita in emerging economies demand an enormous effort of investment in infrastructures, including transportation, energy, communications and information. Investment in the main economies of Asia, Latin America, and Africa are thus one of the main drivers of the world's economic growth.



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**Growth of World GDP, Emerging vs, Developing Markets  
(Quarterly Variations per Annum, %).**

Source: IMF, ES Research.

In 2009, in the context of emerging markets, the case of China stands out. The strong Chinese economic growth not only promotes intra-Asian dynamism, but also propels the exporting sectors of the main advanced and emerging economies. Chinese GDP grew by 9% in 2009, accelerating towards the end of the year with double-digit growths, bringing it closer to the dynamism observed before the global financial crisis. The performance of the Chinese economy was mostly the result of strong increase in investment and consumption. China reacted promptly to the recessive cycle of global activity, reorienting the growth pattern towards internal demand, from a strong acceleration of the credit volume (benefiting consumption and housing investment) and an aggressive investment effort in infrastructures.

**Latin America, especially Brazil**

Altogether, Latin American economies suffered the impact of the global economic crisis due to the increased global restrictions on financial markets and, above all, the decline of the flows of international commerce in the first half of the year. This decline resulted in less favourable evolution of exports, with negative impacts on investment. Within this framework, GDP growth of Latin American economies fell from 4.2% to -2.7%. The performance within the region varied among different economies, where Brazil's economy stood out, with an annual GDP change around 0% and a very visible recovery in the second half of the year.

The resilience of the Brazilian economy vis-à-vis the worst period of the global recession in 2009 enabled a process of quick recovery of the main economic and financial indicators, in line with the other BRIC countries such as China and India. The implementation of an expansionist economic policy similar to the ones adopted by the main global economies did not result in a significant deterioration of the sustainability indicators of the public and external accounts, enabling the country to maintain a positive outlook of reduction of mid- and long-term credit risk indices. Sovereign ratings were confirmed in the first degree of investment grade by Standard & Poor's and Fitch (BBB-) and aligned by Moody's from Baa3 to Baa2 with positive outlook in 2009.

Market perception as to Brazil's recovery capacity allowed its sovereign risk premium, expressed through the spreads of its 5-year Credit Default Swaps to be reduced from 300.5 base points to 122.5 base points throughout 2009. Such narrowing of the risk-aversion reverted the fall of financial flux from USD 48,900 million in 2008 to a net inflow of USD 18,800 million in 2009, increasing the amount of international reserves



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of Brazil's Central Bank to a historical maximum of USD 239,000 million (USD 207,000 million in 2008) and the appreciation of the BRL/USD of 25.5%, to a final value of USD/BRL = 1.74.

**BRL/USD, BRL/EUR and  
(5-year) CDS spreads, base points.**

Source: Bloomberg.

Monetary policy was conducted to contain the negative effects of recession initiated at the end of 2008. In an environment of low inflation, the SELIC rate (the interest rate of reference) was reduced to a historical minimum of 8.75% in July and kept unchanged until the end of 2009, after successive cuts (after reaching 13.75% in December 2008). The inflation rate (IPCA) ended 2009 below the central target of 4.5% but with a 4.3% variation, considering the maximum of 5.9% in 2008.

The budget indicators followed the dynamics of reduction of the economic activity and of adoption of incentives that reduced fiscal revenues in an environment of expenditure reduction, causing an increase in the nominal deficit to 3.2% of GDP until November 2009, compared to the 1.9% deficit observed in 2008. Notwithstanding the effects of interest on public debt, the primary budgetary result until November 2009 was a surplus of 2.25% of GDP, compared to 3.5% in 2008. Consolidated public debt reached 43.4% of GDP until November 2009, compared to 37.3% in 2008, but not much higher than that observed in 2007 (42.8% of GDP).

In this context, Brazilian GDP demonstrated a real variation around 0% in 2009, after a strong expansion of 5.1% in 2008. Nevertheless, between the 1H09 and 2H09, activity indicators showed a very positive evolution, mostly due to internal demand (consumption and investment). Domestic factors had the most significant weight in the evolution of economic activity, especially taking into account the relatively low level of openness of the Brazilian economy. In the 4Q09, GDP showed a q-o-q growth of 4%, and an expansion of the Brazilian economy around 5% is to be expected in 2010.



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**Brazil Retail Sales**  
**(y-o-y rate of change, %)**

Source: Bloomberg.

The recovery of economic indicators and the reduced reference interest rates enabled the enlargement of the domestic credit volume to 44.9% of GDP through November 2009 (compared to 39.7% at the end of 2008). Such an evolution was the result of a bigger contribution from the credit offered by the public sector and a limited deterioration of the indicators of unsettled credit from the total of credit of the financial system, from 4.4% in 2008 to 5.8% in 2009. The financial system kept solid solvability indices, and the Basel Index kept well above the minimum requirement of 11% (18.4%, according to available data for the consolidated banking system in June 2009, compared to 17.7% in December 2008).

More sensitive to the slump of global economic activity and the subsequent fall in commodity volume and prices, Brazilian exports showed a 21.8% decrease in 2009 (+23.2% in 2008), as imports decreased 25.3% (+43.5%) in 2008. Consequently, there was a trade surplus of USD 24.9 billion in 2009 compared to USD 25.3 billion in 2008. The current accounts deficit decreased to 1.4% of GDP, compared to 1.8% in 2008. The global decline of the direct investment flows observed in 2009 also affected Brazil, where inflows of financial resources through November amounted to USD 21 billion, compared to USD 45 billion in 2008.

The risk balance evidences the solid base for recovery of Brazilian economy that contributes first of all to a strong reduction of risk-aversion and later on to a growing risk-propensity throughout 2009. This, in turn, as led to an appreciation of assets exposed to the mid- and long- term potential of economic expansion that is best expressed through the circa 83% appreciation of the Bovespa stock market index.

As to other Latin American economies, it is worth mentioning the negative GDP growth observed in Argentina (-2.5%), México (-7.3%) and Venezuela (-2%).

**Africa, especially Angola**

In Africa, the impact of world recession was initially felt in the economies most integrated in international financial markets, such as South Africa (with an annual GDP decline of 2.2%) . This impact later spread to oil-exporting countries, including Angola, Algeria, Libya and Nigeria, as well as economies that export industrial

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goods such as Morocco and Tunisia. Nevertheless, the recovery of the international trade flows and the stabilisation of financial conditions in the second half of the year translated into a visible recovery of economic activity in the main African economies and a clear improvement of the growth perspectives for 2010 and 2011. Throughout 2009, Africa's GDP grew by 1.9%, well above the world average. Individually speaking, it is worth mentioning, in Northern Africa, the 2.1% growth in Algeria, 5% in Morocco, and 1.8% in Libya. Among Portuguese-speaking African countries, Mozambique and Cape Verde grew by 6.1% and 3.5%, respectively.

In Angola, economic activity was directly affected by the decline in oil exports. On the other hand, the decrease of oil revenues (and consequently fiscal revenues) had a negative impact on liquidity in the economy, penalising investment in non-oil sectors. In this framework, GDP growth fell from 13.2% to circa 2% in 2009.

**Angola Oil Production (mb/d)**

Source: OPEC.

Nevertheless, the recovery of economic activity at global level and the increase in oil prices observed in the 2H09 contributed to make visible, during the 2H09, signs of acceleration of the Angolan economy both in the oil sector and in the non-oil sectors. In 2009, Angola showed an average oil production level of 1.8 million barrels per day, recovering vis-à-vis the decrease observed during the first months of the year. At the end of the year, Angola was the seventh biggest oil exporter to the US and the biggest to China.

The promotion of recovery of national production by the Angolan authorities, the decrease of the costs of private activities and the improvement of the social conditions of the population contributed to improved conditions in 2H09, maintaining an environment of macroeconomic stability. In this context, a growth close to 10% is to be expected in 2010.



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**Angola External Reserves  
(USD thousands million)**

Source: BNA.

**Angola AOA/USD and AOA/EUR**

Source: Bloomberg.

Due to the depreciation of the kwanza vis-à-vis the currencies of Angola's main commercial partners, which contributes to making imports more expensive, especially food, 2009 was marked by inflationist pressures. This effect was augmented by constraints in terms of logistics and distribution capacity. Annual inflation rose from 12.5% to a value close to 14%. This increase justified the adoption of restrictive measures in terms of monetary policy and reinforced the priority of developing logistics infrastructures (warehousing, transportation and distribution), as well as the increase of internal productive facilities.





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02

**Regulatory background**

**Portugal**

**Broadband markets.** On 5 January the European Commission sent a letter to ANACOM, approving the deregulation of wholesale broadband access markets in the competitive areas. Those areas cover around 61% of all the Portuguese broadband lines and correspond to 184 main exchanges of Portugal Telecom.

On 14 January 2009, a final decision was issued, taking into consideration comments received from the European Commission, on the definition of the product and geographic markets, as well as SMP assessments and the imposition, maintenance, change or suppression of regulatory obligations with respect to the markets for wholesale (physical) network infrastructure access at a fixed location and wholesale broadband access.

Number Portability. On 4 February 2009, ANACOM approved Regulation 87/2009, which amends Regulation 58/2005 of 18 August - Portability Regulation, as well as the respective final consultation report. Regulation 87/2009 came partially into force on 4 March, 2009 and on 20 July, the rules concerning technical aspects and new deadline for number portability within mobile telephone services came into effect. On 8 July 2009, ANACOM approved Regulation 302/2009, implementing an additional amendment to the portability regulation, which clarified the method for calculating the terms applicable to the prior notice for submission of the electronic portability request and maximum response time to said request by the Donor Operator.

Next Generation Access Networks. On 18 February 2009, ANACOM granted an approval to the public consultation report on the regulatory approach to next generation access networks (NGAN). According to the principle of proportionality in the imposition of obligations, ANACOM considered a step by step approach:

- In competitive areas, only access to ducts is imposed, with improvements and equality of access, whereas other obligations are imposed (access to the actual fibre or dark fibre) only where there is a lack of space in ducts. As a last resort, where there is agreement between the parties, and as an alternative to access to own fibre or dark fibre, the option of virtual access to the network may be considered;
- In non-competitive areas, in addition to access to ducts, access to own fibre or dark fibre is also imposed, as well as virtual access to the network (advanced bitstream).

Between May and July, the Assistant Secretary of State for Public Works and Communications, approved the programmes and tender specifications of the public tenders for the installation, management, operation and maintenance of high-speed electronic communication networks in the Centre, North, Alentejo and Algarve Zones of Mainland Portugal, as well as Azores and Madeira.

On 6 February 2010, the Minister of Public Works and Communications announced the decision on the public tenders for the installation, management, operation and maintenance of high-speed electronic communication networks in the Centre, North, Alentejo and Algarve Zones of Mainland Portugal.

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Digital Terrestrial Television. On 9 June 2009, ANACOM announced that PT Comunicações would be granted the certificates that allocate rights of use of frequencies, pursuant to the provision of the digital terrestrial television service (DTT), to which Multiplexers B to F (MUX B to F) are associated.

DTT began to be broadcasted on 29 April 2009, in 29 Portuguese municipalities. In September and at year-end, 60% and about 80%, respectively, of Portuguese households were already covered.

In December 2009, the pay-TV platform was finally granted to PT Comunicações by decision of the Administrative Court, putting an end to a litigation involving PT Comunicações and Air Plus.

Following PT Comunicações' request, ANACOM decided, on 29 January 2010, to approve the draft decision to repeal the act of granting of rights of use of frequencies associated with Multiplexers B to F and, as a consequence, the five titles which evidenced the rights allocated to PT Comunicações, without forfeiture of the guarantee bond. It was likewise determined that the decision to repeal shall be retroactive in effect from the date of this draft decision.

The Board of the Regulatory Authority for the Media (ERC) decided, on 23 March 2009, to exclude the two applications submitted under the public tender for the licensing of a generalist programme service on a national basis with free unrestricted access (the 5th Channel). The applications were excluded because they failed to meet the legal and regulatory requirements for admission to the tender.

The interested parties have appealed and, on October 2009, the Court decided in favour of the appeal presented by one of the parties. ERC informed to appeal from the Court Decision. Up to date the licence for the 5th Channel has not been granted.

Electronic communications networks and infrastructure: (Decree-Law No. 123/2009). On 26 February 2009, the Council of Ministers approved a draft legislation establishing the framework applicable to the construction, access and installation of electronic communication networks and infrastructure, with the aim of facilitating either the removal or the mitigation of barriers to the construction of next generation network infrastructure. This draft was subjected to a public consultation procedure.

According to the communication issued by the Council of Ministers, this proposal «*will respond to the clear need to define the framework governing development and investment by investors and/or operators of electronic communications in Next Generation Networks, as well as for the functioning of a competitive market. All are called upon to intervene in order to advance investment in the information society*».

Pursuant to the draft approved by the Council of Ministers and taking into account the several contributions addressed by the entities that took part in the consultation procedure, Decree-Law No. 123/2009, dated 21 May 2009, in the Official Gazette, no. 98, Series I, establishes a new framework that applies to the construction of infrastructure apt for the accommodation of electronic communications networks, to the set up of electronic communications networks and to the construction of infrastructures for telecommunications in housing developments. This decree-law has already been amended, by Decree-Law No. 258/2009, of 25 September 2009, the latter having corrected some failures and having also

clarified some aspects of the installation of infrastructures of Telecommunications in buildings (ITED) and of Infrastructures of Telecommunications in housing developments, urban settlements and concentrations of buildings (ITUR).

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In particular, Decree-Law No 123/2009 sets forth several obligations in order to allow electronic communications operators to enjoy better conditions necessary to the installation and development of electronic communications networks.

For the above mentioned purpose, Decree-Law No. 123/2009 foresees the implementation of a Centralized Information System (SIC) to be managed and operated by ANACOM, whose main objective is to render available information on infrastructure apt for the installation of electronic communications networks, the basis of which is the information provided by the several entities subject to Decree-Law No. 123/2009, such as the State, Autonomous Regions, municipalities, publicly held companies or concessionaires, other entities owning or exploring infrastructure part of the public domain of the State, Autonomous Regions or municipalities and electronic communications undertakings.

On 16 December 2009 ANACOM approved the launch of a public consultation to render information available within the SIC. The deadline for submitting comments ends on 9 February 2010.

ITED manual (2nd edition) and ITUR manual (1st edition). On 25 November 2009, ANACOM approved the final version of the 2nd edition of the manual of Telecommunications infrastructures in buildings (ITED) and of the 1st edition of the manual of Infrastructures for Telecommunications in housing developments, urban settlements and concentrations of buildings (ITUR), which entered into force on 1 January 2010.

It was further decided to establish a transition period for the 2nd edition of the ITED Manual until 31 March 2010. During this period, ITED projects which are in accordance with the requirements and specifications of the previous version of the Manual (ITED Manual - 1st edition) will continue to be considered valid. For such purpose, the date considered shall be the date of submission of the project to the Municipalities in what concerns the referred to in article 71 of Decree-Law No. 123/2009 of 21 May, or the project's conclusion date, referenced expressly in the Statement of Liability for the cases set out in article 72 of said Decree-Law.

The changes implemented in the ITED Manual and the ITUR Manual have the objective of standardising the procedures related to the installation of optical fibre in housing developments, urban settlements and concentrations of buildings.

Quality of service of wholesale offers. On 11 March 2009, ANACOM issued a final decision regarding the publication of levels of performance in the quality of service (QoS) in the RUO (Reference Unbundling Offer), LLRO (leased lines reference offer), RDAO (reference ducts access offer), Rede ADSL PT and SLRO (subscriber line resale offer) wholesale offers.

Wholesale market for voice call termination on individual mobile networks. On 7 May 2009, the European Commission (EC) adopted a recommendation on the regulatory treatment of fixed and mobile termination rates in the European Union. The Recommendation sets out that national regulatory authorities (NRAs) should determine the national termination rates (both in fixed and in mobile networks) based on the costs incurred by an efficient operator for terminating calls on its network. A specific cost methodology is established (a bottom-up LRIC model) for calculating the rate, with the purpose of allowing operators to recover just what are considered to be relevant costs incurred in the provision of call termination services to third parties. NRAs must take the utmost account of the Recommendation, ensuring that termination rates are applied at a symmetric and cost-efficient level by the end of 2012. However, there is also a provision, in exceptional circumstances, for national regulators to be able to use alternative approaches up to 1 July 2014,



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if these methods lead to a result which is consistent with the Recommendation and with a competitive market. The EC expectation is that by the end of 2012 MTRs will lie in the range between 1.5 and 3 eurocents.

On 14 January 2010, ANACOM approved the draft decisions on the definition of relevant wholesale markets for voice call termination on individual mobile networks, the assessment of SMP in these markets and the imposition, maintenance, amendment or withdrawal of regulatory obligations, as well as the details of the implementation of the obligation to control prices.

Spectrum. On 20 May 2009, ANACOM approved the draft of the auction Regulation for the granting of frequencies rights of use for broadband wireless access (BWA).

On 17 June 2009, ANACOM approved the report on the public consultation on the allocation of usage rights in the 2500-2690 MHz frequency range (also known as the 2.6 GHz band).

On 29 July 2009, ANACOM approved the report of the public consultation on the digital dividend.

New European rules were published in the Official Journal of the European Union on 20 October 2009, opening up the GSM radio spectrum band to new services, including 3G and 4G devices as well as mobile broadband. The new rules make it possible for GSM systems (2G mobile equipment) and UMTS (3G phones that add high-speed mobile internet to regular phone services) to co-exist on the 900 MHz and 1800 MHz GSM frequency bands. These measures are due to be implemented by Europe's 27 Member States within six months, in the case of the Directive, so that GSM spectrum bands are effectively made available for 3G services.

On 23 December 2009, ANACOM approved the draft revision of the National Frequency Allocation Plan (NFAP), 2009/2010 edition, for submission to the general consultation, under the terms of article 8 of the Law of Electronic Communications.

Regulation on the settlement and collection of fees. On 1 July 2009, ANACOM approved a final decision on the Regulation on the adoption, settlement and collection of fees due to this Authority.

Universal Service. On 11 March 2009 ANACOM decided not to oppose the proposal for the public payphones tariffs, as presented by PT Comunicações on 11 February 2009 and that came into force on 1 April 2009.

On 3 November 2009, ANACOM decided not to oppose the proposal for the fixed telephone service residential tariffs, within the scope of the universal service, as presented by PT Comunicações on October 27, 2009, subject to the obligations of transparency.

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Regarding the Universal Service financing, ANACOM continued in 2009 the preparation of a public consultation by which ANACOM intends to define a methodology to calculate the net costs of Universal Service and the concept of excessive burden, and to define the compensation for NCUS over the period 2001-2003. Throughout the year, PT Comunicações and ANACOM exchanged views and information and held various meetings over this matter.

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



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withdrawal of regulatory obligations in relation to the market for the retail provision of leased lines and the wholesale markets for the provision of terminating and trunk segments of leased lines.

**New Regulatory Framework.** On 19 December 2009, the legislation comprising the new regulatory framework for telecommunications entered into force, with its publication in the Official Journal of the European Union.

The package, consisting of two directives and one regulation, is due to be signed on 25 November by the presidents of the European Parliament and the Council, entering into force upon its publication in the Official Journal of the European Union, scheduled for 18 December 2009. Directives have to be transposed into national laws within 18 months from the date of their respective publication.

**Call Centres.** The Government approved Decree-Law No. 134/2009, imposing several obligations concerning the operation of call centres, such as maximum response time, follow up on requests and processing of calls according to their order of arrival.

**Value Added Services based on messages.** The Government approved Decree-Law No. 63/2009, published in March, imposing several obligations concerning value-added services based on message, such as the adoption of measures of tariff transparency, blocking mechanisms (by request of the consumer and at no cost to the consumer) and the inclusion of these services in the National Numbering Plan (with different access codes based on the nature and content of the service).

**Brazil**

The main regulatory events of 2009. ANATEL maintained its supervision, which was intensified with the effectiveness of number portability throughout the Brazilian and by ANATEL's oversight, together with that of consumer advocacy organizations, of compliance by Vivo of its Customer Care Services with Decree 6523/2008 (General Rules on Customer Care Services Provided by Telephone), which entered into effect on 1 December 2008. Published Public Consultations and Resolutions regarding changes to the regulatory framework focused on increasing competition and consumer rights.

Consultations undertaken by ANATEL. Public Consultation 31/2009 regarding a new 2.5 GHz frequency band, including, among other issues, the primary allocation of the 120 MHz frequency band in 2013 and of the 140 MHz frequency band in 2016 to Personal Mobile Services. The period for comment ended on 16 October 2009.

In December 2009, ANATEL launched Public Consultation 51/2009 regarding the Bidding Terms for the H band radiofrequency, the remainders of frequencies A, D, E, and M bands, the TDD band and band extensions in 900 MHz and 1800 MHz.

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Also in December, pursuant to Resolution 516/2008 (General Plan to Revise Telecommunications Regulations in Brazil - PGR), ANATEL launched Public Consultation 50/2009 regarding two new types of virtual operations: Certified and Authorized Virtual Networks.

Resolutions issued by ANATEL. Resolution 535/2009 by which it established a calculation methodology for the Weighted Average Cost of Capital - WACC.

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On 6 May 2009, Law 11,934/2009 was enacted, setting limits for the human exposure to electrical, magnetic and electromagnetic fields generated by radio transmitter stations, by user terminals, and by electrical systems that operate in a band of up to 300 GHz. Pursuant to this new law, the limits on human exposure proposed by the International Commission on Non-Ionising Radiation Protection (ICNIRP) are mandatory and must be implemented in all of Brazil. Those limits have been announced by the World Health Organization and have already been adopted by ANATEL Resolution 303/2002.

ANATEL Publication 002/2007/SPV ANATEL (3G Auction) of December 2007 established mobile coverage goals for Brazilian municipalities with no coverage, as well as benchmarks for 3G services in the frequencies subject to bid. Immediately after the extension of mobile coverage to the abovementioned municipalities, we expect the redemption (on a proportional basis depending on the amount of municipalities that have been covered) of the guarantees offered by the company in April 2008 of compliance with ANATEL's goals. Pursuant to Order 5,954/2009, ANATEL confirmed that the first-year goals regarding the extension of the coverage and 3G services have been met.

Notwithstanding the agreement reached by fixed and mobile operators, ANATEL refused the request of operators for the readjustment of maximum prices for calls involving the SMP network under STFC Basic Plans (including both Local and Long Distance Services). Consequently, there was no adjustment to VU-M prices for 2008-2009.

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03

**Strategic profile**

**Business context**

**Global telecommunications sector**

**Development of new access technologies.** The development of new access technologies and networks continued to accelerate, with operators announcing plans, trials and investments in Next Generation Access Networks ( NGAN ), namely Fibre-To-The-Home ( FTTH ) and DOCSIS 3.0 cable networks in the fixed business, and Long Term Evolution ( LTE ) in the mobile business. Examples include KPN 's announcement to provide FTTH to 1.3 million Dutch homes by the end of 2012 and Verizon 's plans to provide LTE service in 25 US cities by the end of 2010.

**Enhanced convergence trend.** The availability of new access technologies and the proliferation of IP-enabled equipment has been driving an increasing convergence of contents and services across platforms. Consumption patterns are changing, with final interface and customer experience emerging as key decision criteria. For instance, mobile operator selection is increasingly based on available handsets and less on the network itself (smartphone sales increased by 22% in 2009, already accounting for 16% of global handset sales) and social networking is complementary to voice as a communication vehicle. This trend has led to the appearance of new business models and players in the broad communications and entertainment markets, embracing not only telecommunications operators, but also IS/IT companies, ISPs and content providers.

**Emerging markets as a growth engine.** In 2009, emerging markets continued to be a major source of growth for the telecommunications industry. Telecom value-added in BRIC countries grew by 9.2% in 2009, as compared to 1.7% in North America and Western Europe. Within these markets, it is important to highlight the phenomenon of fixed-to-mobile migration, which continued to accelerate, namely in countries with relatively limited scope and breadth of fixed network infrastructure. Additionally, the debate whether companies should reinvest in developed countries or reallocate capital to emerging markets continued throughout 2009. Examples of these movements include the bid that Vivendi successfully launched over the fixed telecom Brazilian operator GVT, the fourth investment of Telefonica in China, increasing its stake in China Unicom from 5% to 8%, and continued investment interest expressed by France Telecom and Vodafone in Africa.

**Telecommunications context in Portugal**

**Consolidation of bundled offers.** 2009 was marked by a proliferation of bundled packages among the various market participants, with triple-play offers (bundling TV, voice and broadband), becoming increasingly more popular and attractive. The major transformation initiated in 2008 continued, with the consolidation of the presence of cable operators in the voice segment and commercial aggressiveness of alternative fixed operators.

**Increased competitiveness in urban areas.** In 2009, there was a significant change in the landscape of the Portuguese telecommunications market, with operators investing in fibre, namely PT, having announced the investment to cover one million households with FTTH, but also cable and alternative fixed operators. This

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trend benefited from increased regulatory visibility, with a new regulation concept that followed a geographical segmentation approach, removing some restrictions on PT's broadband offer.

**PT's positioning**

In the domestic market, PT plans to: (1) consolidate the inflection of the historical trend in the wireline business, leveraging its successful TV strategy (having already achieved a market share of 23% in the Portuguese pay-TV market); (2) develop innovative data and internet access products in the mobile business, and (3) launch leading edge convergent products and services for the enterprise segments.

At an international level, the focus of PT is on the operational performance of its assets and on the sharing of best practices across the various businesses. The expansion of international operations to multiple geographies is one of the most important catalysts of value creation in the telecommunications sector and PT is no exception. PT has been building a relevant portfolio of international operations which, in 2009, already represents 51.5% of revenues, up by 1.8pp y.o.y, and 44.0% of EBITDA, up by 5.0pp y.o.y.

**Domestic operations**

**Reversal of the historic trend in the wireline business.** During 2009, the wireline business consolidated the turnaround of its historical downward trend, which was initiated at the end of 2008. Retail revenue generated units (RGUs) increased by 289 thousand underpinned by pay-TV and ADSL retail net adds of 269 thousand and 152 thousand respectively. This success has more than compensated the net loss of 96 thousand fixed lines, which compares to 173 thousand lines lost in 2008 and 313 thousand in 2007. The growth in retail accesses underpinned growth in retail revenues, which increased by 1.8% y.o.y, and operating revenue growth (+0.8% y.o.y). During 2009, the pay-TV business continued to gain scale reaching 581 thousand customers (still below critical mass), leading to a significant improvement in the evolution of gross profit, which declined by 0.4% y.o.y and already increased by 0.4% in 4Q09. This sustained recovery of the wireline business is based on the development of the pay-TV offer and of triple-play packages, including TV, broadband and voice services. PT has become a true European case-study by reaching a 23% market share in only 21 months after having launched its pay-TV offering, with an implied monthly market share gain of 1.1pp (the closest performance by a European operator only reaches 7.6% market share in 21 months, a 0.4pp monthly share gain).

**Development of innovative data and internet wireless access products and services.** Against the backdrop of a challenging environment, PT continued to develop an ambitious data growth strategy focused on the rollout of mobile broadband offers, competitive smartphone offering, promotion of value added services and development of innovative convergent offers to all market segments. PT continued to invest in the quality and coverage of its 3G and 3.5G networks, reaching more than 90% of the population and gaining the recognition of the national regulator and consumers as the best network. During 2009, PT continued to consolidate its leadership position in the mobile market, with mobile customers growing 4.6% y.o.y, underpinned by the increased popularity of the wireless broadband offers.

**Leading-hedge convergent products.** In 2009, PT strategically captured the potential of fixed-mobile convergence opportunities. Targeting the SoHo and SME segment, PT continued to market Office Box, a national and European reference in the provision of integrated telecommunications services of fixed and mobile voice and data. PT also maintained its offering of software and hardware productivity tools and



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advanced solutions for the corporate segment. Additionally, PT continued to market mobile broadband packaged with residential bundled offers for TV and ADSL customers, with the objective of further differentiating its offers by giving mobility to its customers.

**International operations**

**Leadership in the Brazilian mobile market.** During 2009, Vivo continued to focus its efforts on maintaining a clear leadership position in the Brazilian mobile market, with the development of new and competitive voice offers and rollout of mobile broadband offers. The quality and coverage of its 3G and 3.5G networks continued to be core to Vivo, with the objective of delivering high quality services and outstanding customer experience both in voice and data while consolidating its GSM switch strategy. Simultaneously, Vivo continued to engage in several projects to increase its productivity levels and consolidate all the previous operating companies.

**Sharing of best practices.** The continuous focus on efficiency in international operations and sharing of best practices has allowed for a significant revenue growth and profitability increase of these operations in 2009. An additional effort is being made by having top management travel frequently to PT's operations around the world to better follow-up the developments in each geography.

**New operational and organisational structure**

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

- Stronger customer focus: PT abandoned a structure organised around fixed and mobile platforms, and changed to a structure centred on the specific needs of each segment, implementing a new organisation around five customer segments: Residential, Personal, SMEs/SoHo, Corporate and Wholesale.
- Superior operational efficiency: PT eliminated several decision processes and layers, and reduced the number of directors, enabling a leaner and more agile company to effectively compete in an increasingly challenging environment.

**Strategy**

**Consolidate competitiveness at domestic level, while developing an international growth agenda.** PT remains committed to a cost, operational, financial and strategic discipline, aiming at focusing the development of its resources in its core businesses and in its core regions, Portugal, Brazil and sub-Saharan Africa. PT has established five key ambitious objectives for the 2009-11 triennium: (1) grow the customer base



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to 100 million customers; (2) increase its exposure to international businesses up to two thirds of revenues; (3) reinforce leadership in all domestic market segments; (4) achieve a top-quartile performance in shareholder return and results, and (5) become a reference in terms of sustainability.

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**Domestic leadership in all segments**

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

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

**International expansion**

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

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

**Innovation**

**PT as a specialist innovator.** PT aims to be a competitive operator in the innovation arena, thus ensuring its own space in the global sector. As such, PT is concentrating its operation around distinctive skills, eliminating activities and operations where the organization does not have this differentiating factor. This way, PT believes that it can build a structural competitive advantage if it can bring to bear its investments in leading-edge technology to provide more and better quality services to customers in reduced time-to-market – a key driver for growth in a continuously changing and evolving market.

With that positioning in mind, PT is establishing open and strategic partnerships with key suppliers and also leveraging its innovation program - OPEN – to build an innovation culture and a time-balanced portfolio of investments (long-term structural projects, medium-term business development, and short-term business optimization).



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Regarding strategic partnerships, as a global innovation leader with a proven track record, PT has been able to attract leading global and local suppliers to create partnerships that aim at accelerating the development of new technologies, services, and products to our customers. Throughout 2009, PT signed collaboration agreements with six global companies, all leaders in their own fields, and we expect this to be a win-win collaborative process whereby PT secures access to state-of-the-art technological solutions and provides feedback and input to the innovation process of our partners.

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04

**Research and development**

**Innovation drivers**

2009 was a reference year for Portugal Telecom as regards the development of sustained innovation in Research and Development.

The launch of the OPEN program and the implementation of systematic research and information processing practices, the involvement of internal and external experts, and the implementation of projects, have not only enriched the portfolio of the various business areas, but also created an innovation mindset oriented towards achieving differentiated results.

The competitive environment we are experiencing, combined with the impact of the economic downturn, mobilized the search for innovative solutions at all levels within the Company. This was a particularly interesting year, with the various companies in the Company significantly contributing to an increase in competitiveness vis-à-vis the competition.

In 2009, Portugal Telecom invested around Euro 213 million on Applied Research and Development, representing an increase of about 42% over the amount recorded in 2008.

On a broader perspective, the organization fostered innovation on several fronts, in addition to the traditional business components (products, services and technologies). For this reason other components were also addressed such as operational efficiency, customer relations, the development of new business models and the creation of a more efficient organizational culture.

**Domestic operations**

In the domestic operations, PT has been implementing various activities and projects.

**Product and Service Development**

During 2009 the emphasis was clear regarding the development of new products and services. The investments made were fundamentally aimed at ensuring greater differentiation from the competition, the development of services which added value and thus promote the retention of the current client base, enhance the features offered to the customer and improve the quality of the service provided.

In this context, PT's commitment to the massive implementation of FTTH should be underlined. This investment positioned the company as a leader in the number of households with fibre access in Portugal, paving the way for the launch of new features on the client's home access. As a result, and according to the European FTTH Council, Portugal entered the world ranking of countries with the highest penetration of fiber access.

In addition, the company invested in new services and features for its IPTV platform, such as Meo Kids, Cross-Platform Access (TV, Mobile and Online), multi-access remote recording, and the implementation of Multi-Room and Overlay services on RF, eliminating the need for set top boxes at the customer's home. This

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commitment has earned the trust of the Portuguese population, and MEO's customer data base grew in an overwhelmingly positive way over 2009, surpassing the 550,000 customer mark.

In the mobile market, throughout the year, PT was a pioneer in Portugal, creating specific business offers, regarding new equipment, such as its own brand Bluebelt and Silverbelt terminals on the Windows Phone platform. Thus PT revolutionised the national scene in the smartphone market, leveraging and enabling mass adoption of in mobile Internet and meo mobile services, the latter an innovative mobile TV service.

In addition, PT was the first Portuguese operator to launch a mobile terminal based on the Android platform, besides the world premiere of the Microsoft Phone.

The development of Mobile Apps on the Android, Symbian, Windows Phone and iPhone platforms is an area requiring considerable R&D investment, and PT has been managing all its resources to keep up with the latest trends in the mobile market and provide innovative services to its current customer base.

Finally, the ongoing commitment to new segmented business offers, supported on technology- and application-enabled converging solutions, has allowed the company to meet the needs of different market sectors in an innovative way.

Instances of this are the services launched in the business segment, application-enabled services over Framework Office box, on a SaaS logic, as well as Telepresence and Web conferencing services, supporting remote work solutions and solutions that increase professional productivity.

**Development of Web Solutions**

The growing trend towards a blend between the real world and virtual world led Portugal Telecom to take this on as a strategic area of enormous technological and functional evolution.

Throughout the year, several projects took shape and were differentiation tools for conquering new areas of opportunity.

We highlight the development of the Pond, a new service that allows users to manage and aggregate multiple online profiles in a single application, integrating multiple web2.0 platforms (such as access to blogging, social networks and user-generated content YouTube, Flickr, Sapo videos or Picasa), with access via PC, TV or Mobile Handset.

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In order to fill another market need, Sapo developed an Online Advertising multi-platform, named Sapo Ads – an online advertising solution, contextualized and segmented by behavior, which is very favourably positioned against the international benchmarks of the Web market.

In IPTV sector, the Sapo portal was also released on Meo, allowing customers to access videos, up-to-date news, newspapers and weather services seamlessly on their television.

### **Technological and Network Infrastructures**

Technological and network infrastructures are a key component of PT's business strategy and thus a highly differentiating factor when approaching markets and sustaining its competitive position, it was given particular relevance in terms of:



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*Convergence Solutions:*

- The evolution of the network control architecture for a solution based on the standard IP Multimedia Subsystem (IMS) enhancing a more efficient provision of fixed-mobile convergence services;
- The implementation of a pilot and the evaluation of Femtocell-based solutions, enabling mobile coverage expansion to shadow areas (home or business), using a fixed infrastructure.

*As regards improving the quality and characteristics of services:*

- The evolution of radio technology with highest spectral efficiency in mobile networks allowed the implementation of HSPA+ solutions to 21 Mbps in the network;
- The implementation of major changes in the transmission network system enabled by the evolution of the mobile backhaul component for an IP-based architecture;
- The offer of fiber-based solutions (GPON) during the year 2009, allowed greater flexibility with regard to the existing supply, improving the service characteristics in addition to promoting higher service quality. Within this project, PT studied and developed mass deployment techniques of this technology including optimized RF and Home Networking components.

**Operational Efficiency**

Throughout 2009, Portugal Telecom has committed strongly to areas that have direct impact on operational efficiency.

In this context, and with a view to increasing the productivity of operation and maintenance teams, several projects were implemented:

**Operation Route Optimization** a platform oriented to the wireline business, through which a solution is guaranteed to optimize the routes of the Field Force intervention teams. The solution correlates at each moment the geographic locations of the teams on the ground with the location of customer requests, allowing the identification of the team best positioned for each intervention, thus minimizing consumption and intervention times.

**Mobile Field Force Tools** - a reference in terms of digitalizing Field Force teams, the project aimed to provide installation and maintenance teams with Hand Held Devices associated with a Field Force Management application. Intervention orders were then sent directly to the various teams' mobile equipment, thus increasing productivity, reducing paper use and minimizing error rates.

**WorkForce Management Tools for Contact Centers** - internally known as the TEFRA project, it uses a software tool that manages physical and human resources (space and people) as well as associated costs, ensuring the optimization of available resources and improving the team's performance rates.

**Fiber Operations Center** - in the context of fiber optic mass deployment in access network, a single integrated call center for fiber-access customers was created, with direct impact on the increased efficiency of the teams involved, speeding up their learning curve resulting in a lower average volume of incidents.

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**Customer Relations**

Customer relation is one of the strategic pillars of PT. Some of the exemplary projects were developed, which had a positive impact on improving customer relations:

**ONE project** implementation of a single application for managing customer relations, in a horizontal approach to the entire service portfolio, aggregating the client's entire information. Adopting this innovative solution had an impact on the productivity levels of front office teams, improving the whole process of interaction and customer experience, in moments of contact with the company.

**Heka project** development of a knowledge-oriented customer service base, where all relevant and transversal information of the various businesses is gathered (operating procedures, pricing plans, instructions for client activation, equipment features, and product portfolio, among others).

**Creation of the Tactical Operations Center** - This operation center aims at expediting the resolution of problems identified through client-contact channels, through systematic analysis of discontinuities in operational indicators. Thus, the resolution of customer constraints has become more effective and definite.

**Society and Environment**

One of the company's strategic desiderata relates to Sustainability, which became a reference for the telecommunications sector.

Portugal Telecom's position has always been grounded on fundamental principles of growth, contribution and innovation, with a view to better integration in and prosperity of the social context in which it operates.

At this point, several initiatives competitively contributed to continuous improvement. One of the transversal projects adopted by the organization was the replacement of traditional lighting systems with high energetic efficiency lamp systems (LEEE), with a direct impact on reducing costs and decreasing the carbon footprint.

In its daily operations, some steps were also taken to reduce the costs associated with printing, by implementing measures to minimize paper and ink cartridge consumption by changing the printers and print-servers' parameters.

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The implementation of Free Cooling solutions in small and medium-sized PABX should also be mentioned. These reshaped the traditional temperature control process in technical rooms, and significantly reduced energy consumption and the subsequent environmental impact.

Finally, reflecting this business sustainability mindset, new policies were also adopted for procurement procedures as regards the selection and evaluation of the different tenders submitted by suppliers. Thus, the process of analyzing proposals considers, among its various evaluation criteria, such factors as the lower energy dependence of the equipment to be purchased.

From a different perspective and in accordance with a market approach, specific projects and solutions were developed for the Central Administration, Education and Health, of which the following should be highlighted:

- Solutions for the Central Administration Portal da Segurança (the security portal): a solution developed for the Ministry of Internal Affairs where any citizen can access data that allows them to

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get in touch faster with the Security Forces, the Border and Foreign Citizen Service, and the National Authority for Civil Protection;

- Solutions for the Education sector – the e-Escolas and e-Escolinhas projects are a reference with a view to providing students with laptop computers connected to the Internet via mobile broadband (from the first cycle of Basic Education to Higher Education); a project to develop schools with educational content, which carries technologies into the classroom in an integrated manner; the Scratch project, in partnership with MIT, focused on the development of new human-machine interfaces;

- Solutions for the Health sector – in particular concerning a service management platform for healthcare providers units, with an impact on the optimization of resources and processes, which is reflected in reduced assistance time. Also at the level of information sharing, PT has aimed to create a Digital Health Network which uses fibre to connect all entities providing health-related services (hospitals, health centers, and pharmacies, among others).

**Research and Development Ecosystem**

The structured and continuous investment in Research and Development is fundamental to the growth and improvement of innovative products and technologies.

Portugal Telecom has been investing in intellectual capital and methodologies with the aim of creating a culture of innovation, therefore ensuring new technological achievements.

In terms of intellectual property, regarding issues related to optical communication and optimization of electronic communication processes, PT Inovação submitted two provisional patent applications and converted two other provisional requests to definitive applications requests. One of these is an international patent application.

In this area, PT Inovação has played a key role in the development of prototypes and business support solutions for PT. In 2009, it explored the following areas of knowledge:

- Context Awareness services and applications to support future IP multimedia environments;
- Participation in the Future Internet Platform and its areas of architecture, new business models and virtualization systems;

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- Identity management architecture at transport, network and service level;
- Promotion of technological solutions to support communities with health care needs;
- Cloud computing;
- Development of Content Delivery and interactivity solutions for TV platforms;
- Multifunctional systems to manage vehicles and road infrastructures;
- Creation of training solutions in virtual 3D environments, in an e-learning services framework;

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- Trial of optical communications evolution solutions, in particular of wireless optical access and high bandwidth;
- Development of authentication, security and privacy solutions for new generation telecommunications networks.

Within the investment in projects which, by their characteristics, may contribute significantly to innovation, PT maintains its INESC participation, aimed at promoting academic projects with potential impact on PT's business, as well as at furthering the Sapo Labs (a partnership between Sapo and the University of Aveiro). The latter led to the development of Sapo Campus, a tool to support students and teachers in the classroom context (blogs, videos and photos in the classroom environment).

In this context, SAPO has also played an important role in enhancing the company-university relationship, establishing protocols with several Portuguese universities, including the University of Aveiro, the University of Porto School of Engineering, the University of Coimbra, the University of Minho and the University of Lisbon School of Sciences.

There are numerous initiatives, including several areas of knowledge, of which the following stand out:

- WEB technologies applied to educational contexts embodied in the SAPO CAMPUS project a tool that brings the services of the new Web 2.0 (blogs, videos, photos, wiki, Messenger and widgets) closer to PLE Personal Learning Environment concepts;
- WEONTV project Social Networking for IPTV environment this seeks to explore emerging social contexts in the daily use of television, taking advantage of various dynamics of recommendation and content sharing;
- VERBATIM P project dedicated to natural language processing, through the development of advanced artificial intelligence systems in the textual recognition of patterns;
- SYLVESTER project - development of a social trend parser, using social tools (such as Twitter and Facebook) automatically analyzing feelings and fostering a more accurate modeling of content recommendation systems and social network analysis;
- MIR project - Dedicated to the advanced graphics processing, through the development of advanced artificial intelligence systems in pattern recognition in images and video;

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- REACTION project - oriented to computational journalism with technologies involving information recovery, extraction and aggregation for news integration and organization;

In addition, in the context of its active involvement in the Carnegie Mellon University Program, Portugal Telecom not only supported the participation of several students in the Professional Masters and PhD programs, but also received students who completed the program's 1st edition, reinforcing the commitment to capture young talent in Technological and Research and Development areas.

In this Program, PT assumed the position of main Industrial partner, involving training and applied research projects associated to masters thesis. In this context, the following should be noted:



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- The creation of the PT - Security Lab project, aimed at supporting the reinforcement of offers in security solutions for networks and cyberspace;
- The NetOptima project - which involves PT researchers and academics, as well as Master's degree students, to create a modeling tool for corporate networks that supports interactive and graphical validation of QoS policies and security;
- A conceptual usability and interaction study of a portal for children (SAPO kids) as part of a MHCI thesis;
- Proof of Concept of a content recommendation engine as part of a MSE thesis.

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05

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

	2009	2008	y.o.y
<b>Operating revenues</b>	<b>6,784.7</b>	<b>6,720.9</b>	<b>0.9%</b>
Wireline (2)	1,947.8	1,931.4	0.8%
Domestic mobile • TMN (2)	1,517.8	1,593.6	(4.8)%
Brazilian mobile • Vivo (1)	3,138.1	3,034.3	3.4%
Other and eliminations	181.0	161.6	12.0%
<b>Operating costs, excluding PRB s and D&amp;A</b>	<b>4,282.4</b>	<b>4,240.6</b>	<b>1.0%</b>
Wages and salaries	693.2	616.6	12.4%
Direct costs	1,135.1	1,086.9	4.4%
Commercial costs	1,113.5	1,232.9	(9.7)%
Other operating costs	1,340.6	1,304.2	2.8%
<b>EBITDA (3)</b>	<b>2,502.3</b>	<b>2,480.3</b>	<b>0.9%</b>
Post retirement benefits	89.6	44.8	100.3%
Depreciation and amortisation	1,437.9	1,268.3	13.4%
<b>Income from operations (4)</b>	<b>974.7</b>	<b>1,167.2</b>	<b>(16.5)%</b>
<b>Other expenses (income)</b>	<b>64.0</b>	<b>110.5</b>	<b>(42.0)%</b>
Curtailement costs, net	14.8	100.0	(85.2)%
Net losses (gains) on disposal of fixed assets	(0.4)	(19.5)	(97.9)%
Net other costs (gains)	49.7	30.0	65.6%
<b>Income before financial results and income taxes</b>	<b>910.7</b>	<b>1,056.7</b>	<b>(13.8)%</b>
<b>Financial expenses (income)</b>	<b>(109.1)</b>	<b>129.5</b>	<b>n.m.</b>
Net interest expenses	302.3	272.4	11.0%
Equity in earnings of affiliates, net	(456.0)	(171.0)	166.7%
Net other financial losses (gains)	44.7	28.1	59.1%
<b>Income before income taxes</b>	<b>1,019.7</b>	<b>927.2</b>	<b>10.0%</b>
Provision for income taxes	(233.2)	(231.4)	0.8%
<b>Income from continued operations</b>	<b>786.5</b>	<b>695.8</b>	<b>13.0%</b>
Losses (income) attributable to minority interests	(102.6)	(119.7)	(14.3)%
<b>Consolidated net income</b>	<b>683.9</b>	<b>576.1</b>	<b>18.7%</b>

(1) Considering a Euro/Real average exchange rate of 2.7674 in 2009 and 2.6737 in 2008. (2) Wireline and domestic mobile operating revenues include the impact of the decline in regulated mobile termination rates (MTRs). At TMN, this impact amounted to Euro 62.1 million in 2009 and Euro 4.8 million in 4Q09. (3) EBITDA = income from operations + post retirement benefits + depreciation and amortisation. (4) Income from operations = income before financials and income taxes + curtailement costs + losses (gains) on disposal of fixed assets + other costs (gains).

**Consolidated operating revenues**

In 2009, **consolidated operating revenues** increased by 0.9% y.o.y to Euro 6,785 million, as a result of revenue growth in wireline and Vivo, which more than offset the decline in revenues of TMN due to the negative impact of the 41% decline in MTRs from 30 June 2008 to 31 December 2009, and the negative impact of the Real devaluation. Adjusting for the effects of the consolidation of Telemig, lower MTRs and using constant exchange rate, consolidated operating revenues would have increased by 2.3% y.o.y.

In 2009, revenues from domestic operations decreased by 1.9% y.o.y. The financial performance of the domestic operations was negatively impacted by lower equipment sales, which declined by Euro 26 million in

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2009, and lower MTRs. Excluding the adverse impact of MTRs, revenues from domestic operations would have remained broadly flat despite lower equipment sales.

In 2009, wireline operating revenues increased by 0.8% y.o.y, from Euro 1,931 million to Euro 1,948 million, underpinned by the inflection of retail revenues, which posted a 1.8% y.o.y increase, from Euro 953 million to Euro 971 million. The growth in retail revenues was achieved on the back of the continued strong performance of the Meo triple-play offer (voice, data and video), which in turn mitigated significantly fixed line disconnections, which stood at 96 thousand in 2009 compared to 173 thousand in 2008 and 313 thousand in 2007. Moreover, net disconnections of traffic generating lines stood at 56 thousand in 2009, compared to 110 thousand in 2008, an improvement in performance of almost 50% y.o.y.

Retail net additions reached 325 thousand in 2009, driven by the success of PT's Meo triple-play offer, decelerating fixed line disconnections and gain in broadband market share. ADSL retail customers increased 21.5% y.o.y in 2009, reaching 862 thousand customers. Broadband retail net additions reached 152 thousand in 2009 compared to 73 thousand in 2008, reflecting a clear and steady improvement over the last five quarters. PT's Meo offer continues to see strong demand in the market. Pay-TV net additions reached 269 thousand in 2009 and total pay-TV customers stood at 581 thousand, equivalent to 67.4% penetration of the ADSL retail customer base. Retail RGU per access increased by 12.2% y.o.y in 2009 from 1.36 to 1.53.

In 2009, TMN's operating revenues decreased by 4.8% y.o.y to Euro 1,518 million, mainly due to the negative impact of lower MTRs (Euro 62 million) and lower equipment sales (Euro 15 million), which more than offset growth in customer revenues (+0.5% y.o.y in 2009) underpinned by growth in post paid customers and data revenues. Non-SMS data revenues continued to be an important source of growth, on the back of increasing penetration of smartphones and wireless data cards. Excluding the impact of lower MTRs, TMN's operating revenues would have decreased by 0.9% y.o.y in 2009, as a result of declining equipment sales, whilst service revenues would have remained flat.

Vivo's operating revenues increased by 3.4% y.o.y in Euros and 7.0% y.o.y in Reais, on the back of continued customer growth (15.1% increase y.o.y in the customer base). Excluding the impact of the consolidation of Telemig and using constant exchange rate, Vivo's operating revenues would have increased by 4.4% y.o.y, driven by growth in service revenues (7.2% y.o.y).

Other revenues, including intra-group eliminations, increased by 12.0% y.o.y in 2009, mainly due to the improved revenue performance of Dedic, PT's contact centre business in Brazil, MTC, in Namibia, and Timor Telecom, which more than offset the loss of fees resulting from the termination of Vivo's management contract in August 2008 and the revenue contraction at CVT in Cape Verde, primarily due to adverse regulatory and economic conditions.

**Revenues by region**

**Euro million**

	2009	2008	y.o.y
Domestic operations (1)	3,320.9	3,386.6	(1.9)%
Brazil (2)	3,240.1	3,111.5	4.1%
Other and eliminations (3)	223.7	222.8	0.4%
<b>Total operating revenues</b>	<b>6,784.7</b>	<b>6,720.9</b>	<b>0.9%</b>

(1) Domestic operations include the wireline segment, domestic mobile, PT Inovação, PT SI, PT Pro, PT Contact and PT Sales. (2) Considering a Euro/Real average exchange rate of 2.7674 in 2009 and 2.6737 in 2008. Includes primarily Vivo and Dedic, PT's contact centre business. (3) Includes fully consolidated international assets, namely MTC, CVT, CST and Timor Telecom, and also the holding companies.

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In 2009, the contribution from fully and proportionally consolidated international assets to operating revenues stood at 51.5% and Brazil accounted for 47.8% of consolidated operating revenues, an increase of 1.5pp y.o.y, despite the depreciation of the Real against the Euro in the period.

**Consolidated operating costs, excluding PRBs and depreciation and amortization**

**Consolidated operating costs excluding post retirement benefits (PRBs) and depreciation and amortization (D&A)**, increased by 1.0% y.o.y to Euro 4,282 million in 2009, as compared to Euro 4,241 million in the same period of last year, primarily explained by higher contributions from (1) the wireline business (Euro 104 million), due to increased commercial activity, in line with the roll-out of its pay-TV service which led to higher programming costs, and (2) PT's call centre business in Brasil (Euro 29 million). These effects were partially offset by decreases (1) at Vivo (Euro 11 million), reflecting the net effect of the impacts of depreciation of the Real (Euro 75 million) and consolidation of Telemig (Euro 58 million), and (2) at TMN, mainly due to the reduction in MTRs. Adjusting for the effects of the consolidation of Telemig and lower MTRs and using a constant exchange rate, operating costs would have increased by 2.5% y.o.y.

**Wages and salaries** increased by 12.4% y.o.y in 2009 to Euro 693 million, primarily explained by higher contributions from Vivo and from our call centre operation in Brazil. Wages and salaries accounted for 10.2% of consolidated operating revenues.

**Direct costs** increased by 4.4% y.o.y to Euro 1,135 million in 2009 and accounted for 16.7% of consolidated operating revenues. This growth is primarily explained by higher contributions from: (1) the wireline business (Euro 18 million), with the increase in programming costs (Euro 50 million), related to the roll-out of the pay-TV service, being partially offset by the impact of the decline in MTRs; and (2) Vivo (Euro 47 million), reflecting increases in interconnection costs and lease costs 3G related and also the impact of the consolidation of Telemig (Euro 20 million), which more than offset the effect of the depreciation of the Real (Euro 21 million). These effects were partially offset by a reduction in direct costs from the domestic mobile business (Euro 20 million), primarily explained by the impact of the decline in MTRs (Euro 32 million).

**Commercial costs** decreased by 9.7% y.o.y. to Euro 1,113 million in 2009 and accounted for 16.4% of consolidated operating revenues. The decreases at TMN (Euro 47 million) and Vivo (Euro 74 million) are primarily explained by lower equipment sales, while Vivo's commercial costs were also impacted by the net effects of the depreciation of the Real (Euro 25 million) and consolidation of Telemig (Euro 16 million).

**Other operating costs**, which mainly include support services, supplies and external services, indirect taxes and provisions, increased by 2.8% y.o.y to Euro 1,341 million in 2009, as compared to Euro 1,304 million in the same period of last year. Adjusting for the effect of the consolidation of Telemig (Euro 16 million) and on a constant currency basis (Euro 23 million), other operating costs would have increased by 3.3% y.o.y in 2009 to Euro 1,347 million, primarily explained by a higher contribution from the wireline business, due to increased commercial activity and higher support service and customer care costs related to the strong take up of the pay-tv service. Regarding Vivo and also adjusting for the effects mentioned above, other operating costs would have increased by 0.9% y.o.y in 2009, with the reduction in provisions for trade receivables and the impact of the termination of the management fee contract in August 2008 being more than offset by increases in electricity, commercial support and billing expenses, primarily explained by increased commercial activity and the take-up of the GSM and 3G services.



Table of Contents**EBITDA**

**EBITDA** increased by 0.9% y.o.y in 2009 to Euro 2,502 million, equivalent to a margin of 36.9% . Excluding the impact of the consolidation of Telemig, lower MTRs and using constant exchange rate, consolidated EBITDA would have increased by 2.0% y.o.y. EBITDA performance in the period was supported by growth at Vivo and other international assets, which was partially offset by the decrease in the domestic businesses, as a result of lower MTRs, investments in the roll-out of triple-play offers and the termination of Vivo's management contract.

Wireline EBITDA amounted to Euro 800 million in 2009, equivalent to a 41.1% margin. EBITDA margin continued to be impacted primarily by higher programming, customer care and support service costs in connection with the roll-out of the triple play offers. EBITDA decline has been improving during the course of the year. In 2009, wages and salaries in the wireline segment increased by 2.9% y.o.y as a result of:

(1) headcount migration from the domestic mobile due to the reorganisation of the domestic fixed and mobile business along customer segments, and (2) the decision to halt the redundancy programme and focus efforts in the insourcing of certain core functions. As a result of the halting of the redundancy programme, the projected benefit obligations related to salaries payable to pre-retired and suspended employees fell by Euro 116 million, and the corresponding cash outflow was as a result also Euro 12 million lower in the period.

In 2009, TMN's EBITDA decreased by 1.1% y.o.y to Euro 674 million as a result of the decrease in MTRs. Excluding the negative impact of Euro 30 million due to lower MTRs, TMN's EBITDA would have increased by 3.2% y.o.y in 2009. EBITDA margin reached 44.4%, an increase of 1.6pp compared to 2008 as a result of continued growth in post paid customers, data revenues and cost reductions.

In 2009, Vivo's EBITDA increased by 13.8% y.o.y, underpinned by customer growth. Excluding the consolidation of Telemig and using constant exchange rate, Vivo's EBITDA would have increased by 15.3% y.o.y. Vivo's EBITDA margin reached 30.2% in 2009, an improvement of 2.7pp compared to 2008.

Other EBITDA increased by 3.2% y.o.y to Euro 81 million in 2009, mainly as a result of the improved performance of Dedic, PT's contact centre business in Brazil, MTC, in Namibia, and Timor Telecom, notwithstanding the loss of fees due to the termination of Vivo's management contract as from August 2008 and weaker performance of CVT due to adverse economic and regulatory conditions.

**EBITDA by business segment (1)(2)****Euro million**

	2009	2008	y.o.y
Wireline	799.6	887.1	(9.9)%
Domestic mobile • TMN	674.1	681.9	(1.1)%
Brazilian mobile • Vivo (1)	947.2	832.5	13.8%
Other and eliminations	81.3	78.8	3.2%
<b>EBITDA (2)</b>	<b>2,502.3</b>	<b>2,480.3</b>	<b>0.9%</b>
EBITDA margin (%)	36.9	36.9	(0.0)pp
Domestic operations (3)	1,467.5	1,563.1	(6.1)%
Brazil (1)(4)	958.4	844.0	13.6%



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Other (5)	76.4	73.2	4.4%
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(1) Considering a Euro/Real average exchange rate of 2.7674 in 2009 and 2.6737 in 2008. (2) EBITDA = income from operations + post retirement benefits + depreciation and amortisation. (3) Domestic operations includes the wireline segment, domestic mobile, PT Inovação, PT SI, PT Pro, PT Contact and PT Sales. (4) Includes mainly Vivo and Dedic. (5) Includes only fully consolidated international assets, namely MTC, CVT, CST and Timor Telecom, and also the holding companies.

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Fully and proportionally consolidated international assets contributed to 44.0% of PT's consolidated EBITDA in 2009. Brazilian businesses accounted for 38.3% of EBITDA in 2009. Fully consolidated African businesses accounted for 4.6% of EBITDA in 2009.

**Net income**

**Post retirement benefit costs** amounted to Euro 90 million in 2009, compared to Euro 45 million in 2008, as a result of lower return on assets in 2008 compared to the actuarial assumption of 6% (Euro 40 million), following the decline in the value of assets under management in 2008.

**Depreciation and amortisation costs** increased by 13.4% y.o.y to Euro 1,438 million, reflecting higher contributions from: (1) Vivo, which accounted for approximately 60% of the increase in D&A, as a result the consolidation of Telemig, the amortisation of 3G licenses and higher depreciation rates for the CDMA network following the GSM network rollout, and (2) wireline in Portugal, as a result of the investments in the rollout of pay-TV service and the revaluation of ducts and certain real estate assets undertaken during 2008.

**Curtailement costs** decreased to Euro 15 million in 2009 from Euro 100 million in 2008, due to the halting of the redundancy programme.

**Net gains on disposal of fixed assets** amounted to Euro 0.4 million in 2009 compared to Euro 19 million in 2008. Gains recorded in 2008 were mainly related to real estate disposals.

**Net interest expenses** rose by Euro 30 million to Euro 302 million in 2009 as a result of the increase in PT's average net debt in the period due to the post completion of the share buyback programme in 2008 and the acquisitions of Telemig and 3G licences in Brazil. In 2009, consolidated average cost of debt has remained flat at 5.0% compared to 2008. Excluding Brazil, the average cost of debt stood at 4.3%.

**Equity in earnings of affiliates** includes primarily PT's share in the earnings of Unitel, CTM, Médi Télécom and UOL and amounted to Euro 456 million in 2009 compared to Euro 171 million in 2008. In 2009, this caption includes the capital gain related to the disposal of the stake in Médi Télécom (Euro 267 million) while in 2008 includes gains related to the disposal of PT's interest in Banco Best (Euro 9 million).

**Net other financial losses**, which include foreign currency gains, net gains on financial assets and other financial expenses, amounted to Euro 45 million in 2009, compared to Euro 28 million in 2008. Net foreign currency gains amounted to Euro 20 million in 2009 compared to net losses of Euro 9 million in 2008 as a result of positive foreign currency adjustments related to investments in Brazil. Net gains on financial assets amounted to Euro 8 million in 2009 compared to Euro 19 million in 2008, and were related to the change in the fair value of free-standing cross-currency derivative instruments. The change in the fair value is explained by the appreciation of the US Dollar against the Euro until April 2009, when these derivatives were settled. In 2008, net gains on financial assets included primarily: (1) the change in fair value of free-standing cross currency derivatives, which resulted in a gain of Euro 10 million due to the appreciation of the US Dollar against the Euro and the Real, and (2) the gain obtained from the disposal of a 3% stake in Africatel in 3Q08 amounting to Euro 9 million. Other financial expenses, which include banking services, financial discounts and other financing costs, increased to Euro 73 million in 2009, compared to Euro 39 million in 2008. The increase in this caption in 2009 is largely explained by the debt restructuring undertaken in 2009 in connection with the acquisition of 3G licenses in Brazil, which consisted of the early repayment of certain loans.



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**Provision for income taxes** increased from Euro 231 million in 2008 to Euro 233 million in 2009, corresponding to an effective tax rate of 25.0% in 2008 and 22.9% in 2009.

**Income attributable to minority interests** decreased to Euro 103 million in 2009 from Euro 120 million in 2008. The reduction in this caption is primarily explained by the decrease in minority interests from Vivo, which amounted to Euro 43 million in 2009 compared to Euro 52 million in 2008, and Africatel which amounted to Euro 52 million in 2009 compared to Euro 62 million in 2008.

**Net income** increased by 18.7% y.o.y in 2009 to Euro 684 million, compared to Euro 576 million in 2008, with the capital gain related to the disposal of Médi Télécom being partially offset by higher costs related to post retirement benefits, depreciation and amortisation and net interest. In 2008, net income also included Euro 37 million of extraordinary gains.

**Earnings per Share**

In 2009, **basic earnings per share** increased by 22.9% y.o.y to Euro 78 cents from Euro 64 cents in 2008. The average number of shares outstanding decreased by 3.4% y.o.y to 876 million in 2009, whilst the diluted average number of shares outstanding over the same period declined by 3.2% y.o.y to 941 million.

**Earnings per share**

**Million (shares outstanding); Euro (per share data)**

	2009	2008	y.o.y
<b>Average number of shares outstanding</b>			
Basic (1)	875,9	907,1	(3,4)%
Diluted (2)	940,5	971,8	(3,2)%
<b>Earnings per share</b>			
Basic	0,78	0,64	22,9%
Diluted (2)(3)	0,76	0,62	21,8%

(1) Adjusted for the 20.6 million own shares held through equity swaps. (2) Diluted shares are calculated assuming the full exercise of convertible bonds. (3) Diluted earnings are computed adjusting for the costs of convertible bonds.

**Capex**

**Capex** increased by 2.1% y.o.y (Euro 26 million) in 2009 to Euro 1,268 million, equivalent to 18.7% of revenues, as a result of increase in wireline capex, which more than offset capex reductions at TMN and Vivo.

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Wireline capex increased from Euro 403 million in 2008 to Euro 565 million in 2009, primarily as a result of the FTTH rollout, which allows for increased bandwidth for both residential and corporate customers, and investment in IPTV services namely in relation to growth in customers. At the end of 2009, PT had 965 thousand homes under construction or available with fibre to the home.

TMN's capex decreased by 26.4% y.o.y to Euro 180 million in 2009. The decrease in TMN's capex is explained by the investments in the deployment of 3G/3.5G networks, both in terms of capacity and coverage, carried out in 2008, which resulted in improved quality of mobile voice and data services in Portugal. As a result, in a recent study undertaken by the Portuguese telecoms regulator, TMN was considered as having the most reliable and stable network performance in Portugal.

Capex at Vivo decreased by 17.5% y.o.y to Euro 421 million in 2009. Excluding the consolidation of Telemig (Euro 8 million) and the depreciation of the Real against the Euro (Euro 14 million), capex at Vivo would have