

PORTUGAL TELECOM SGPS SA
Form 20-F
June 30, 2003

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2002

OR

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

Commission file number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of Registrant as specified in its charter)

Republic of Portugal

(Jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

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

Title of each class

**Name of each exchange
on which registered**

American Depositary Shares, each representing one ordinary share, nominal
value €1 per share
Ordinary shares, nominal value €1 each

New York Stock Exchange
New York Stock Exchange*

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

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

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

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

Ordinary shares, nominal value €1 per share	1,254,284,500
Class A shares, nominal value €1 per share	500

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark which financial statement item the registrant has elected to follow.

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CERTAIN DEFINED TERMS

Unless the context otherwise requires, the term "*Portugal*" refers to the Republic of Portugal, including the Madeira Islands and the Azores Islands; the term "*Portuguese Government*" refers to the government of the Republic of Portugal and, where the context requires, includes the Portuguese state; the term "*Parliament*" refers to the Assembly of the Republic of Portugal, the legislative body of the Portuguese state; the term "*EU*" refers to the European Union; the term "*EC Commission*" refers to the Commission of the European Communities; the terms "*United States*" and "*U.S.*" refer to the United States of America; the term "*Portugal Telecom*" refers to Portugal Telecom, SGPS, S.A.; and unless indicated otherwise, the terms "*we*," "*our*" or "*us*" refer to Portugal Telecom and its consolidated subsidiaries.

PRESENTATION OF FINANCIAL INFORMATION

We publish our financial statements in Euro, the single European currency adopted by certain participating member countries of the European Union, including Portugal, as of January 1, 1999. Unless otherwise specified, references to "Euros," "EUR" or "€" are to the Euro. References herein to "U.S. dollars," "\$" or "US\$" are to United States dollars. References to "Escudos" or "PTE" are to Portuguese Escudos. References to "Real," "Reais" or "R\$" are to Brazilian Reais. Certain Euro amounts have been translated into U.S. dollars at specified rates. Unless otherwise indicated, U.S. dollar equivalent information for amounts in Euro is based on the noon buying rate in the City of New York for cable transfers in Euros as certified for United States customs purposes by the Federal Reserve Bank of New York on December 31, 2002. For convenience and comparability, figures previously stated in Escudos have been converted to figures in Euros based on the fixed Escudo/Euro exchange rate of PTE 200.482 = €1.00. We are not representing that the Euro or US\$ amounts shown herein could have been or could be converted into US\$ or Euros, as the case may be, at any particular rate or at all. See "*Item 3 Key Information Exchange Rates*" for further information regarding the rates of exchange between Euros and U.S. dollars.

FORWARD LOOKING STATEMENTS

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

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

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

material adverse changes in economic conditions in Portugal or Brazil;

exchange rate fluctuations in the Brazilian Real and the U.S. dollar;

risks and uncertainties related to national and supranational regulation;

increased competition resulting from the liberalization of the telecommunications sector in Portugal and Brazil;

the success of our mobile operations in Brazil through our joint venture with Telefónica Móviles;

the development and marketing of new products and services and market acceptance of such products and services; and

the adverse determination of disputes under litigation.

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PART I

ITEM 1 IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

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

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ITEM 2 OFFER STATISTICS AND EXPECTED TIMETABLE

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

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ITEM 3 KEY INFORMATION

Selected Consolidated Financial Data

The selected consolidated balance sheet data as of December 31, 2001 and 2002 and selected consolidated statement of income and cash flow data for each of the years ended December 31, 2000, 2001 and 2002 have been derived from our audited consolidated financial statements included herein. The selected consolidated balance sheet data as of December 31, 1998, 1999 and 2000 and selected consolidated statement of income and cash flow data for each of the years ended December 31, 1998 and 1999 have been derived from our audited consolidated financial statements not included herein.

We prepare our audited consolidated financial statements in accordance with Portuguese GAAP, which differs in certain significant respects from U.S. GAAP. See "Item 5 Operating and Financial Review and Prospects Portuguese GAAP Compared with U.S. GAAP" and Notes 38, 39 and 40 to our audited consolidated financial statements for an explanation of the differences between Portuguese GAAP and U.S. GAAP. We have provided, in the information below, amounts in accordance with U.S. GAAP of operating revenues, operating income, net income, earnings per share and shareholders' equity for all periods and dates for which we have provided information.

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

During 1998, we acquired a 10.02% economic interest in, and voting control of, Telesp Celular S.A., or Telesp Celular, in Brazil. During 1999, we increased our economic interest in Telesp Celular to 13.92%. In January 2000, all shares of Telesp Celular owned by shareholders other than Telesp Celular Participações S.A., or TCP, were exchanged for newly-issued shares of TCP and Telesp Celular became the wholly-owned operating subsidiary of TCP. In June 2000, we conducted a tender offer in Brazil for ordinary shares in TCP. As a result of the tender offer, we increased our economic interest in TCP to 29.92%. On November 7, 2000, TCP completed a capital increase in which we subscribed for additional shares in TCP, and, upon acquisition of such shares, our economic interest in TCP increased to 36.20%. In November 2000, after we exchanged with Telefónica our minority interest in Telesp Fixa (the wireline operator in the Brazilian state of São Paulo controlled by Telefónica) for an additional interest in TCP, we increased our economic interest in TCP further to 41.23%, our voting interest to 85.06% and our ownership of TCP's preferred shares to 17.7%. TCP completed a rights offering in September 2002, in which we subscribed to a total of 247,224 million common shares and 326,831 million preferred shares, thereby increasing our economic interest in TCP to 65.12%, our voting interest to 93.7% and our ownership of TCP's preferred shares to 49.8%. In October 2002, in connection with our agreements with Telefónica Móviles, S.A., or Telefónica Móviles (Telefónica's mobile telecommunications subsidiary), for the formation of Brasilcel (the 50/50 joint venture with Telefónica Móviles for mobile operations in Brazil), we sold a 14.68% stake in TCP to Telefónica Móviles. On December 27, 2002 we transferred the rest of our interest in TCP to Brasilcel. We now hold, jointly with Telefónica Móviles, an indirect interest in TCP, as well as in the other Brazilian mobile telecommunications companies previously held directly by Telefónica Móviles. See "Item 4 Information on the Company Our Businesses Mobile Businesses Joint Venture with Telefónica Móviles in Brazil." and "Item 4 Information on the Company Strategic Alliances Alliance with Telefónica".

As a result of the transfer of our interest in TCP to Brasilcel on December 27, 2002 and our acquisition of a 50% ownership interest in Brasilcel as of that date, our consolidated balance sheet as of December 31, 2002 proportionally consolidates 50% of Brasilcel's assets and liabilities. Our consolidated statement of income and cash flow data for the year ended December 31, 2002 still includes the full consolidation of TCP's results and cash flows. Our consolidated statement of income

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and cash flow data will proportionally consolidate 50% of Brasilcel's income and cash flows from January 1, 2003.

In February 2001, TCP acquired an 83% indirect economic interest in Global Telecom (corresponding to 49% of the voting rights), a mobile telecommunications company operating in the Brazilian states of Paraná and Santa Catarina. On December 27, 2002, TCP purchased the remaining 51% of the voting shares of the three holding companies that own Global Telecom and as a result holds a 100% indirect economic interest in Global Telecom. Our consolidated results of operations for the year ended December 31, 2001 and 2002 presented below reflects the results of operations of Global Telecom based on the equity method of accounting. Global Telecom's assets and liabilities as of December 31, 2002 are reflected in our consolidated balance sheet through our proportional consolidation of Brasilcel. Global Telecom's statements of income and cash flows will in the future be reflected in our consolidated statements of income and cash flows through our proportional consolidation of Brasilcel's statements of income and cash flows.

From July 1, 1998 until the end of 1999, we accounted for our interest in Telesp Celular by the proportional consolidation of its results in our consolidated financial statements in accordance with Portuguese GAAP. For the purposes of the reconciliation of our audited consolidated financial statements with U.S. GAAP, the financial statements of TCP were consolidated from July 1, 1998 using the full consolidation method. Since we increased our economic interest in TCP in 2000, our financial statements for 2000 and 2001 fully consolidate the results of TCP in

accordance with Portuguese GAAP.

Information provided in U.S. dollars for the year ended December 31, 2002 has been calculated on the basis of the Euro/U.S. dollar exchange rate on that date of €0.9537 = US\$1.00. See " *Presentation of Financial Information*" and " *Key Information Exchange Rates*", below.

	Year Ended December 31,					
	2002	2002	2001	2000	1999	1998
	US\$	EUR	EUR	EUR	EUR	EUR
STATEMENT OF PROFIT AND LOSS DATA:						
Amounts in accordance with Portuguese GAAP						
Operating revenues:						
Services rendered	5,191.0	4,950.9	4,976.3	4,329.8	2,832.4	2,648.7
Sales of merchandise and products	515.9	492.0	613.5	684.7	213.1	141.5
Telephone directory	145.9	139.1	136.8	131.7	126.1	121.0
Total operating revenues	5,852.8	5,582.0	5,726.6	5,146.2	3,171.6	2,911.2
Operating costs and expenses:						
Wages and salaries	728.5	694.8	668.6	578.1	520.8	515.5
Post retirement benefits	192.1	183.2	140.7	103.4	95.5	96.1
Costs of telecommunications	653.1	622.9	715.1	470.7	161.9	167.3
Depreciation and amortization	1,009.5	962.8	956.2	1,021.5	636.7	612.4
Subsidies	(33.0)	(31.5)	(36.8)	(38.1)	(38.5)	(43.9)
Maintenance and repairs	135.6	129.2	120.1	105.7	68.9	61.3
Own work capitalized	(119.6)	(114.0)	(179.3)	(133.9)	(120.8)	(98.7)
Raw materials and consumables	101.9	97.2	139.1	97.3	85.4	76.3
Costs of products sold	485.1	462.7	619.8	658.0	238.4	148.4
Telephone directories	96.5	92.0	89.2	87.1	82.2	78.5
Marketing and publicity	114.1	108.8	142.0	157.5	68.5	71.3
Concession rent	18.8	18.0	14.5	22.7	22.2	21.6
Other general and administrative	968.7	923.9	997.1	847.0	386.7	343.2
Provision for doubtful receivables, inventories & other	139.2	132.8	130.7	188.6	63.5	61.1
Other net operating income	(47.5)	(45.3)	(45.3)	(51.9)	(47.5)	(40.9)
Taxes other than income taxes	81.6	77.8	87.1	95.7	34.5	30.8
Total operating costs and expenses	4,524.6	4,315.3	4,558.8	4,209.5	2,258.4	2,100.3
Operating income	1,328.1	1,266.7	1,167.8	936.8	913.2	810.9
Other expenses, net	570.2	543.9	1,063.5	423.8	261.5	132.3
Work force reduction program costs	56.3	53.7	183.9	252.7	457.7	71.7
Extraordinary items	16.4	15.6	281.1	(496.4)	(540.5)	(89.2)
Income before income taxes	685.2	653.5	(360.7)	756.7	734.5	696.1
Provision for income taxes	(353.4)	(337.1)	(174.6)	(258.6)	(241.9)	(252.4)
Consolidated net income before minority interests	331.8	316.4	(535.3)	498.1	492.6	443.7
Loss (income) applicable to minority interests	78.2	74.6	342.7	42.3	2.1	(2.6)
Consolidated net income	410.0	391.1	(192.6)	540.3	494.7	441.1

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Year Ended December 31,

Earnings per ordinary share, A share and ADS(1)	0.33	0.31	(0.15)	0.45	0.47	0.46
Cash dividends per ordinary share, A share and ADS(1)(2)(3)	0.17	0.16	0.10		0.20	0.20
Amounts in accordance with U.S. GAAP						
Operating revenues	6,299.1	6,007.7	6,042.8	5,199.9	4,107.3	3,502.9
Operating income as restated(6)	401.8	383.2	696.1	395.8	592.7	883.1
Net income before change in accounting principles as restated(6)	1,379.1	1,315.3	208.1	66.8	532.8	400.1
Cumulative effect of a change in accounting principles SAB 101				(126.7)		
Cumulative effect of a change in accounting principles SFAS 133			(57.5)			
Cumulative effect of a change in accounting principles SFAS 142	(1,089.3)	(1,038.9)				
Net income after change in accounting principles as restated(6)	289.8	276.4	150.6	(59.8)	532.8	400.1
Earnings per ordinary share, A share and ADS as restated(4)(6)	0.23	0.22	0.12	(0.05)	0.54	0.42
Diluted net income per share as restated(5)(6)	0.23	0.21	0.12	(0.05)	0.53	0.42
On a pro-forma basis(7)						
Net income before change in accounting principles SAB 101 as restated(6)	289.8	276.4	150.6	66.8	532.8	400.1
Net income after change in accounting principles SAB 101 as restated(6)	289.8	276.4	150.6	(59.8)	528.5	394.0
Earnings per ordinary share, A share and ADS after change in accounting principles SAB 101 as restated(4)(6)	0.23	0.22	0.12	(0.05)	0.53	0.41
Diluted net income per share after change in accounting principles SAB 101 as restated(5)(6)	0.23	0.21	0.12	(0.05)	0.52	0.41

- (1) Based on 950,000,000 ordinary and A shares issued in the year ended December 31, 1998 (as adjusted to give effect to the five-for-one share split effected in October 1999), 1,045,000,000 ordinary and A shares issued in the year ended

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December 31, 1999, 1,201,750,000 ordinary and A shares issued in the year ended December 31, 2000, 1,254,285,000 ordinary and A shares issued in the year ended December 31, 2001 and 2002.

- (2) Dividends for the year ended December 31, 2000 were not paid.
- (3) Cash dividends per ordinary share, A share and ADS for the years ended December 31, 1998, 1999, 2001 and 2002 in US\$ were US\$ 0.24, US\$ 0.20, US\$ 0.10 and US\$ 0.17, respectively.
- (4) Based on the weighted average number of shares as of the date given and taking into consideration the number of shares issued pursuant to capital increases and all treasury shares, there were 950,000,000 shares for the year ended December 31, 1998, 991,182,122 shares for the year ended December 31, 1999, 1,091,826,182 shares for the year ended December 31, 2000, 1,228,392,386 shares for the year ended December 31, 2001 and 1,253,880,328 shares for the year ended December 31, 2002.
- (5) The weighted average number of shares is computed as a weighted average as of the date given and taking into consideration the number of shares from the exchangeable bonds issued on June 4, 1999 and December 6, 2001, assuming conversion of the bonds into ordinary shares. For the years ended December 31, 2000 and 2001, the effects of the exchangeable bonds have been excluded from the calculation of diluted earnings per share since they would be antidilutive.
- (6) Operating income and net income for the years ended December 31, 1999, 2000 and 2001 have been restated to include the effect of the reduction in the reported amortization expense for the translated carrying value of goodwill in Portugal Telecom's investment in Telesp Celular Participações, as

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discussed in Note 38 y) to our audited consolidated financial statements.

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The pro-forma information shows the application of SAB 101, as if it had been applied in the years ended December 31, 1998 and 1999.

	Year Ended December 31,					
	2002	2002	2001	2000	1999	1998
	US\$	EUR	EUR	EUR	EUR	EUR
CASH FLOW DATA:						
Amounts in accordance with Portuguese GAAP						
Cash flows from operating activities	2,193.8	2,092.3	1,475.4	1,357.6	1,109.6	1,160.5
Cash flows from investing activities	(1,058.6)	(1,009.6)	(2,528.5)	(2,343.2)	(741.3)	(3,683.6)
Cash flows from financing activities	(509.6)	(486.1)	1,839.9	1,131.0	(1,425.6)	3,681.8

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	Year Ended December 31,					
	2002	2002	2001	2000	1999	1998
	US\$	EUR	EUR	EUR	EUR	EUR
(in millions, except number of ordinary shares)						

BALANCE SHEET DATA:						
Amounts in accordance with Portuguese GAAP						
Current assets	5,086.2	4,850.9	3,628.1	2,032.6	1,205.1	2,166.8
Investments, net	394.6	376.4	2,000.3	1,295.3	1,498.2	1,307.2
Fixed assets, net	4,797.7	4,575.8	5,491.3	5,446.2	3,855.9	3,677.0
Intangible assets post retirement benefits			761.9	495.0	399.1	342.8
Intangible assets Other, net	3,112.7	2,968.7	4,934.4	3,878.8	1,492.3	1,737.3
Other non-current assets, net	1,000.6	954.3	820.3	68.3	67.1	46.3
Total assets	14,391.8	13,726.1	17,636.3	13,216.2	8,517.7	9,277.4
Current liabilities	3,101.5	2,958.0	3,240.0	3,154.2	1,535.6	4,935.6
Long-term debt	5,472.2	5,219.1	5,428.3	2,815.2	2,649.6	1,016.9
Accrued post retirement liability	1,113.0	1,061.5	1,810.0	1,488.0	1,228.0	829.8
Deferred income investment subsidies	53.5	51.1	63.1	113.7	153.4	194.1
Deferred income post retirement benefits			23.0	26.2	28.5	38.9
Other non-current liabilities	920.6	878.0	1,685.1	143.7	85.4	66.9
Total liabilities	10,660.8	10,167.6	12,249.5	7,741.0	5,680.5	7,082.2
Net assets	3,731.1	3,558.5	5,386.7	5,475.2	2,837.2	2,195.2
Minority interests	468.9	447.2	1,220.0	1,113.1	78.2	30.0
Total shareholders' equity	3,262.2	3,111.3	4,166.8	4,362.1	2,759.0	2,165.2

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Year Ended December 31,

Total liabilities and shareholders' equity	14,391.8	13,726.1	17,636.3	13,216.2	8,517.7	9,277.4
Number of ordinary shares	1,254,284,500	1,254,284,500	1,254,284,500	1,201,749,500	935,750,000	142,500,000
Amounts in accordance with U.S. GAAP						
Total assets as restated(1)	13,163.1	12,554.2	16,747.8	14,534.6	11,958.7	11,967.0
Total liabilities as restated(1)	10,661.0	10,167.9	11,902.5	9,019.4	7,121.8	8,038.5
Total shareholders' equity as restated(1)	2,457.4	2,343.7	3,736.5	4,191.8	3,342.3	2,548.9

(1) Assets, liabilities and shareholders' equity as of December 31, 2001, 2000 and 1999 have been restated to include the effect of translation of goodwill in Telesp Celular Participações and the minimum pension liability adjustment, as discussed in Note 38 y) to our audited consolidated financial statements.

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Exchange Rates

Euro

Effective January 1, 1999, Portugal and ten other member countries of the European Union adopted the Euro as their common currency. The Euro was traded on currency exchanges and was available for non-cash transactions during the transition period between January 1, 1999 and December 31, 2001. During this transition period, the national currencies remained legal tender in the participating countries as denominations of the Euro, and public and private parties paid for goods and services using either the Euro or the participating countries' existing currencies. On January 1, 2002, the Euro entered into cash circulation. Between January 1, 2002 and February 28, 2002 both the Euro and the Escudo were in circulation in Portugal. From March 1, 2002, the Euro became the sole circulating currency in Portugal.

For the years ended December 2001 and 2002, the majority of our revenues, assets and expenses were denominated in Euro, although a significant portion of our assets and liabilities are denominated in Brazilian Reals and certain of our liabilities denominated in U.S. dollars. We have published our audited consolidated financial statements in Euro and our shares trade in Euro on the Euronext Lisbon Stock Exchange. Our financial results could be affected by exchange rate fluctuations in the Brazilian Real and U.S. dollar. See *"Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources Exchange Rate Exposure to the Brazilian Real and the U.S. Dollar"*.

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

The following tables show, for the period and dates indicated, certain information regarding the U.S. dollar/Euro exchange rate. Unless otherwise noted, the information is based on the noon buying rate in the City of New York for cable transfers in Euro as certified for United States customs purposes by the Federal Reserve Bank of New York. On June 26, 2003, the Euro/U.S. dollar exchange rate was €0.8750 per US\$1.00.

Year ended December 31,	Average Rate(1)
	(EUR per US\$1.00)
1998(2)	
1999	0.9954
2000	1.0747
2001	1.1342
2002	1.0531

- (1) The average rate is calculated as the average of the noon buying rate on the last day of each month during the period.
- (2) The Euro was not introduced until January 1, 1999.

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Period	High	Low
	(EUR per US\$1.00)	
December 31, 2002	0.9569	0.9521
January 31, 2003	0.9328	0.9230
February 28, 2003	0.9321	0.9253
March 31, 2003	0.9278	0.9152
April 30, 2003	0.9041	0.8939
May 31, 2003	0.8495	0.8484

None of the 15 member countries of the European Union has imposed any exchange controls on the Euro.

Brazilian Real

Although the majority of our revenues, assets and expenses are denominated in Euros, most of the revenues, assets and expenses from our Brazilian investments are denominated in Brazilian Reais. Consequently, exchange rate fluctuations between the Euro and the Brazilian Real affect our revenues.

There are two legal exchange markets in Brazil:

the commercial rate exchange market; and

the floating rate exchange market.

The commercial rate exchange market is reserved primarily for foreign trade transactions and transactions that generally require prior approval from Brazilian monetary authorities, such as the purchase and sale of registered investments by foreign persons and related remittances of funds abroad. Purchases and sales of foreign exchange in the commercial rate exchange market may be carried out only through a financial institution in Brazil authorized to buy and sell currency in that market. The rate of exchange on the floating rate exchange market applies to transactions to which the rate of exchange on the commercial rate exchange market does not apply. Prior to the implementation of the Real Plan, which was introduced by the Brazilian Government in March 1995 to establish a trading band for the Real against the U.S. dollar and which resulted in the overall devaluation of the Real relative to the U.S. dollar, the prevailing selling rate for Brazilian currency into U.S. dollars on the commercial rate exchange market and the prevailing selling rate for Brazilian currency into U.S. dollars on the floating rate exchange market differed significantly at times. Since the introduction of the Real Plan, the two rates have not differed significantly, although there can be no assurance that the two rates will not differ significantly in the future. The rates of exchange on the commercial rate exchange market and the floating rate exchange market are freely negotiated but are strongly influenced by the Brazilian Central Bank.

Between March 1995 and January 1999, the Brazilian Central Bank maintained a band within which the exchange rate between the Real and the U.S. dollar fluctuated, and the Brazilian Central Bank intervened in the foreign exchange market from time to time. From January 20, 1998 through December 31, 1998, the Brazilian Central Bank maintained the band between R\$1.12 and R\$1.22 per US\$1.00. In January 1999, the Brazilian Central Bank attempted a controlled devaluation of the Real by widening the band within which the Real was permitted to trade, but subsequent Brazilian Central Bank intervention failed to keep the rate within the new band. On January 15, 1999 the Brazilian Central Bank announced that the Real would be permitted to float, with Brazilian Central Bank intervention to take place only in times of extreme volatility.

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

The following tables show, for the periods and date indicated, certain information regarding the Real/U.S. dollar exchange rate. On June 26, 2003, the Real/U.S. dollar exchange rate was R\$2.9000 per US\$1.00. The information is based on the noon buying rate in the City of New York for cable transfers in Brazilian Reais as certified for United States customs purposes by the Federal Reserve Bank of New York.

Year ended December 31	Average Rate(1)
	(R\$ per US\$1.00)
1998	1.1640
1999	1.8640
2000	1.8650
2001	2.3530
2002	2.9945

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

Period	High	Low
	(R\$ per US\$1.00)	
December 31, 2002	3.535	3.531
January 31, 2003	3.566	3.474
February 28, 2003	3.573	3.549
March 31, 2003	3.385	3.320
April 30, 2003	2.915	2.869
May 31, 2003	2.971	2.971

Escudo

As of January 1, 2002, we ceased to use the Escudo. Because, for the years ended December 31, 2001 and 2002, the majority of our revenues, assets and expenses were denominated in Euros, revenues, assets and expenses for years prior to the year 2001 have been translated from Escudos into Euros. All figures previously stated in Escudos have been converted to figures in Euro based on the fixed Escudo/Euro exchange rate, established on January 1, 1999 of PTE 200.482 per €1.00 or approximately €0.005 per PTE 1.00. See "Euro".

Risk Factors

Rapidly Growing Competition From Mobile Telephone and From Other Wireline Operators Could Significantly Reduce Our Wireline Businesses' Revenues

During 2002, approximately 36% of our consolidated revenues were derived from services provided by our fixed telephone business unit. Currently, the competition for these services comes from the rapid growth of mobile telephone services and from other wireline providers. As a result of the substitution of mobile for fixed telephone services, combined with the introduction of competition, we have experienced, and may continue to experience, erosion of market share of both access lines and of outgoing domestic and international traffic. The number of activated mobile telephone cards in Portugal has overtaken the number of wireline main lines. Some of our wireline customers are using mobile services

as an alternative to wireline telephone services. Mobile operators can by-pass our international wireline network by interconnecting directly with wireline and mobile networks either in our domestic network or abroad. Competition is also forcing down the prices of our wireline telephone services for long distance and international calls. Lowering our international call prices has caused a significant decline in our revenues from international wireline telephone services.

The Portuguese telecommunications sector was opened to full competition on January 1, 2000. As a result, competitive pressure on our wireline telephone services has intensified. Other companies are now allowed to offer wireline telephone services to the general public. They can connect transmission lines they lease from us or from new network operators to our local and long distance network. They are also allowed to build their own networks.

The decrease in wireline traffic and lower tariffs resulting from competition could significantly harm our overall revenues. See "*Item 4 Information on the Company Competition Competition Facing PT Comunicações*".

A Growing Percentage of Our Revenue Is Derived From Businesses That Require Substantial Investments by Us and Are Increasingly Competitive

During 2002, approximately 64% of our consolidated revenues were derived from businesses other than our wireline telephone services, wholesale and other traditional businesses in Portugal. These businesses include mobile telecommunications, multimedia and Internet services, and data and business solutions, particularly in Portugal and Brazil. To ensure the continued growth and success of these businesses, we have to make significant investments of both capital and personnel.

We believe that the development of mobile telecommunications, multimedia, Internet and data and business solutions services presents our company with appreciable growth opportunities. However, the success of our mobile telecommunications, multimedia and Internet businesses is subject to increasing competition and rapid and sometimes unpredictable changes in technology. These businesses also may have unforeseen capital requirements and shifts in customer preferences and demographics. Our business and financial results could suffer:

if we fail to compete effectively in these new businesses and markets;

if we fail to obtain the financing to fund the requisite investments in these new businesses;

if we fail to adapt on a timely and efficient basis to changes in technology;

if we cannot attract and retain employees with the requisite skill level necessary to build these new businesses; or

if customer usage does not increase, or if it declines or evolves away from the technologies and businesses in which we are investing.

Burdensome Regulation in an Open Market May Put Us at a Disadvantage to Our Competitors

The Portuguese telecommunications sector is highly competitive and is now fully open to competition. The government, however, still imposes on us regulatory restrictions and obligations dating from the previous monopoly environment. Many of the restrictions and obligations do not apply to other telecommunications operators and service providers in Portugal. The substantial resources we must commit to fulfill these obligations could adversely affect our ability to compete. See "*Item 4 Information on the Company Regulation Portugal*".

Regulation of Our Interconnection Rates Could Give Other Service Providers an Unfair Competitive Advantage

European Union and Portuguese regulations require us to allow other telecommunications network operators and service providers to connect their networks to ours and terminate calls for them. We believe the interconnection rates should reflect the cost of operating our network in Portugal. The Portuguese regulatory authorities may, however, set our rates at levels comparable to rates in other EU countries, where interconnection rates are lower than the current rates in Portugal. See "*Item 4 Information on the Company Regulation Portugal*".

The Portuguese Government Could Terminate Our Concession and Licenses

Through our subsidiary PT Comunicações, S.A., we provide a significant number of services under a Concession and licenses granted to us by the Portuguese government. The Concession runs until 2025, with provisions for renewal. The Portuguese government can revoke the Concession after 2010 if it considers such revocation to be in the public interest. It can also terminate our Concession at any time if we fail to comply with our obligations under it. The Portuguese government can also terminate our licenses under certain circumstances. If the Portuguese government took such action, we would not be able to conduct the activities authorized by the Concession or the relevant licenses. This loss would eliminate an important source of our revenues. During 2002, we acquired the ownership of the basic network used for our fixed line services and such assets will no longer revert to the Portuguese State on termination of the Concession Agreement.

Litigation over Claims for Municipal Taxes and Fees Could Result in Liabilities for Back Taxes

The Portuguese municipality of Oporto has claimed that as of December 31, 2001 we owe them €0.6 million in taxes and fees because our infrastructure uses their public rights-of-way. The municipality of Lisbon had also brought claims relating to similar issues which are not currently being pursued. In contesting our obligation to pay the taxes and fees claimed by the municipality of Oporto, we and the Portuguese government have relied on provisions of our wireline concession from the Portuguese government and a law enacted in 1997, which the Portuguese government intended to exempt us from this type of tax or fee.

If the pending claims by Oporto were to be resolved against our interest, other municipalities might seek to make or renew claims against us. Portuguese law would prevent municipalities from claiming taxes for periods more than four years before the claim. If they were to make claims and prevail in lawsuits against us or the Portuguese government, we might have to pay substantial back taxes. See "*Item 8 Financial Information Legal Proceedings Claims for Municipal Taxes and Fees*".

Litigation by a Consumer Protection Association Could Result in Liabilities for Charges

A Portuguese consumer protection association, known as DECO, has brought claims against us relating to the call set-up charges we charged to customers in 1999. In November 2002, we appealed to the Supreme Judicial Court against an adverse ruling of the Lisbon District Court. We are unable to estimate the amount of any liability should we lose the case in the Supreme Judicial Court because we

cannot predict the number of subscribers who would bring a claim, the number of calls in respect of which such subscribers would claim, or whether such subscribers would be able to produce any necessary evidence in respect of such a claim. Nevertheless, if the pending case in the Supreme Judicial Court were to be resolved against our interest and subscribers representing a large number of calls were to bring claims and provide the necessary evidence, we might have to pay a substantial amount in repayment of the call set-up charges for calls in 1999. See "*Item 8 Financial Information Legal Proceedings Claims by a Consumer Protection Association*".

The Portuguese Government Holds All of Our A Shares and Such Shares Afford It Certain Special Approval Rights

All of our A shares are held by the Portuguese government. Under our articles of association, as the holder of all of our A shares, the Portuguese government may veto a number of actions of the shareholders of our company, including the following:

election of one-third of the directors, including the chairman of the board of directors;

authorization of a dividend in excess of 40% of our distributable net income in any year;

capital increases and other amendments to our articles of association;

issuance of bonds and other securities;

authorization for a shareholder that is engaged in an activity in competition with us to hold more than 10% of our ordinary shares;

altering our general objectives, strategy or policies; and

defining our investment policies, including the authorization of acquisitions and disposals.

An ADS Holder May Face Disadvantages Compared to an Ordinary Shareholder When Attempting to Exercise Voting Rights

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

We Are Exposed to Exchange Rate and Interest Rate Fluctuations

We are exposed to exchange rate fluctuation risks mainly due to the significant level of our investments in Brazil. These investments are not hedged against exchange rate fluctuations. We are required to make adjustments to our equity on our balance sheet in response to fluctuations in the value of foreign currencies in which we have made investments. For example, as of December 31, 2002, cumulative foreign currency transaction adjustments related to investments in Brazil were negative €2,259.2 million. Further devaluations in the Brazilian Real could result in further negative adjustments. See "*Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources Equity*"

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and "*Liquidity and Capital Resources Exchange Rate Exposure to the Brazilian Real and the U.S. Dollar*".

All of the debt of our Brazilian subsidiaries is either Real-denominated or has been swapped into Reais and, thus, is not exposed to exchange rate fluctuations.

We are also exposed to interest rate fluctuation risks. We have entered into financial instruments to reduce the impact on our earnings of an increase in market interest rates, but there can be no assurance that such instruments will continue to reduce the impact of interest rate fluctuations in the future or that these financial instruments will prevent unexpected and material fluctuations of interest rates from having any material adverse effect on our earnings.

An Economic Crisis in Brazil Could Reduce Expected Returns on Our Brazilian Investments

A material portion of our business, prospects, financial condition and results of operations is dependent on general economic conditions in Brazil. In particular, it depends on economic growth and its impact on demand for telecommunications and other related services. Since 1998, we have made significant investments in Brazil, including in telecommunications operators, such as Telesp Celular and Global Telecom, which were contributed to Brasilcel (the 50/50 joint venture with Telefónica Móviles for mobile operations in Brazil). The major factors that could have a material adverse effect on our investments in Brazil, including Brasilcel, and on our results of operations in Brazil, including Brasilcel's, are:

Adverse political and economic conditions. The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. The Brazilian government has utilized salary and price controls, currency devaluation and foreign exchange controls as tools in its previous attempts to stabilize the Brazilian economy and control inflation. Changes in the government's exchange control policy, or in general economic conditions in Brazil, could have a material adverse effect on the results of our operations in Brazil. Deterioration in economic and market conditions in other countries (mainly in other Latin American and emerging market countries) may adversely affect the Brazilian economy and our business.

Devaluation of the Real and increases in interest rates. The Brazilian currency has historically experienced frequent devaluations. The Real devalued against the Euro by 1.1% in 2000 and by 12.8% in 2001. During 2002, the Real continued to undergo significant devaluation due in part to the political uncertainty in connection with the elections and the global economic slowdown. In 2002, the Real devalued against the

Euro by 81.4%. In the period leading up to, and after general election in 2002, there was substantial uncertainty relating to the policies that the new government would pursue, including the potential implementation of macroeconomic policies that differed significantly from those of the prior administration. This uncertainty resulted in a loss of confidence in the Brazilian capital markets, and the continued devaluation of the Real. Although the new government has not yet departed in any material way from previous policy, we believe that it is premature to determine what policies might be implemented by the new government, whether these policies will be effective, and how investors and the capital markets will react to them. The Real has appreciated during 2003 and there are indications that the new government is doing better than expected. Any substantial negative reaction to the policies of the Brazilian government could have a negative impact, including further devaluation. The devaluation of the Real could negatively affect the stability of the Brazilian economy. A devaluation of the Real relative to the Euro could negatively affect the profitability and results of our operations. It would also increase costs associated with financing our operations in Brazil. In addition, a devaluation of the Real relative to the U.S. dollar may increase the costs of imported products and equipment. Our operations in Brazil rely on imported equipment and, as a result of such devaluation, such equipment would be more expensive to purchase.

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As all debt issued in Brazil is denominated in or swapped into Real, a devaluation of this currency against the Euro could decrease our total debt, although this impact could be offset by the differential between Euro and Real interest rates.

The current international economic environment is unfavorable and the flow of foreign investments into Brazil may be diminishing. To make up for the decrease in foreign and invested capital and revenue, the Brazilian government may have to raise funds at higher interest rates. The slowdown of the U.S. economy may also adversely affect the Brazilian economy, as well as interest rates in Brazil. An increase in interest rates could negatively affect our profitability and results of operations and would increase the costs associated with financing our operations in Brazil. In addition, such an increase would raise our interest rate costs because part of the interest on our debt, primarily Reais-denominated based on the commercial rate exchange market, is floating.

Inflation in Brazil. Brazil has historically experienced extremely high rates of inflation. Inflation, as well as governmental measures put in place to combat inflation, have had a material adverse effect on the Brazilian economy. Since the implementation of the Real Plan in 1994, the rate of inflation has been substantially lower than in previous periods. However, inflationary pressures persist, and actions taken in an effort to curb inflation, coupled with public speculation about possible future governmental actions, have contributed to economic uncertainty in Brazil and heightened volatility in the Brazilian securities market. The general price index, or the IGP-DI (the Índice Geral de Preços Disponibilidade Interna), an inflation index developed by the Fundação Getúlio Vargas, a private Brazilian economic organization, reflected inflation of 26.4% in 2002 compared to 10.4% in 2001 and 9.8% in 2000. If Brazil continues to experience significant inflation, Brasilcel may be unable to increase service rates to its customers in amounts that are sufficient to cover its increasing operating costs, and its business may be adversely affected.

Our Strategy of Enhancing Our Mobile Operations in Brazil Through Our Joint Venture With Telefónica Móviles May Not Be Successful

The successful implementation of our strategy for our mobile operations in Brazil depends on the development of our mobile services joint venture company, Brasilcel, with Telefónica Móviles. On December 27, 2002, PT Móveis - Serviços de Telecomunicações, SGPS, S.A. or PT Móveis, which holds our interests in international mobile telecommunications companies, and Telefónica Móviles transferred their direct and indirect interests in Brazilian mobile operators to the joint venture company, named Brasilcel, with headquarters in the Netherlands.

As in any joint venture, it is possible that Telefónica Móviles and we will not agree on Brasilcel's strategy, operations or other matters. Any inability of Telefónica Móviles and us to jointly operate Brasilcel could have a negative impact on Brasilcel's operations, which could have a negative impact on our strategy in Brazil and could have a material adverse effect on our results of operations. In addition, we cannot be sure that Brasilcel will be able to take advantage of its position in the Brazilian market to increase the scope and scale of its operations or that any anticipated benefits of the joint venture will be realized. See "Item 4 Information on the Company Strategic Alliances Alliance with Telefónica".

Regulation May Have a Material Adverse Effect on Brasilcel's Results

Our mobile business in Brazil is subject to certain regulatory restrictions and obligations relating to licenses, competition, taxes and rates (including interconnection rates) applicable to mobile telephone services. Changes in the regulatory framework and the opening of the market to other competitors in the mobile telecommunication sector may have a negative impact on Brasilcel's revenues and results of operations. Moreover, Brasilcel's operating subsidiaries are restricted from increasing some of the rates that they charge for services provided even if the devaluation of the Real and an increase of interest

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rates by the Brazilian government increase their costs. Such circumstances may have a material adverse effect on Brasilcel's results of operations.

The Conditions Applying to Brasilcel's Subsidiaries Under the New SMP Licensing Regime May Result in Reducing Our Revenues and Results of Operations

In September 2000, ANATEL introduced a new mobile services licensing regime, or SMP. The new regime permits existing mobile service providers operating under concessions to migrate to the new regime and become SMP license holders. Each of Brasilcel's subsidiaries has migrated to the new regime and now holds a SMP license instead of their previous concessions.

The new SMP regime imposes restrictions on the provision of wireline services. As a result of the restrictions, because ANATEL considers Brasilcel's subsidiaries to be affiliated with Telefónica, which provides wireline long distance services in the state of São Paulo and was awarded a license to provide such services nationwide, ANATEL will not award a wireline long distance license to any of Brasilcel's subsidiaries. As a result, Brasilcel's subsidiaries no longer receive revenues from long distance services but receive revenues from interconnection fees paid by wireline long distance operators for long distance traffic originating and terminating on their networks. The interconnection fees may not compensate for the loss of long distance revenues and as a result overall revenues of Brasilcel's subsidiaries may be significantly reduced. See "*Item 4 Information on the Company Regulation Brazil SMP Regulation*".

Interconnection Negotiations May Not Result in Sufficiently Remunerative Revenues for Terminating Calls on the Mobile Networks of Brasilcel's Subsidiaries and May Negatively Affect our Revenues

Under the new SMP regime, interconnection fees for termination of calls on mobile networks will be determined by commercial negotiation between Brasilcel's subsidiaries and the wireline operators after June 30, 2004. Because a significant number of mobile subscribers use prepaid mobile services and typically receive more calls than they make, Brasilcel's subsidiaries derive an important part of their revenues from the interconnection fees paid to them by the wireline operators due to traffic originating on wireline networks and terminating on their mobile networks. If the interconnection fees are reduced, operating revenues may be negatively affected as a result.

Brasilcel Faces Substantial Competition in Each of its Markets that may Reduce its Market Share and Harm our Financial Performance

Several licenses have been granted for mobile telecommunications services in the areas where Brasilcel's subsidiaries operate since the opening of the Brazilian market for mobile telecommunications services in 1998. The introduction of the SMP regime has further increased the number of licensees, which has intensified competition. There has been consolidation in the Brazilian telecommunications market, and we believe this trend may continue. Consolidation may result in increased competitive pressures within the market, for example if financially stronger companies are better positioned to compete with Brasilcel's subsidiaries or if some brand names become better known than others. Brasilcel's subsidiaries may be unable to respond adequately to pricing and other competitive pressures resulting from consolidation, which would adversely affect their businesses, financial condition and results of operations. The level of competition from wireline service providers is also increasing. Failure by Brasilcel's subsidiaries to compete successfully could result in them losing market share and revenues. For more information about the various bands of licenses granted for mobile services in Brasilcel's coverage areas and competing operators, see "*Item 4 Information on the Company Competition Competition Facing Our Mobile Businesses Telesp Celular in Brazil*".

ITEM 4 INFORMATION ON THE COMPANY

Overview

Portugal Telecom's legal and commercial name is Portugal Telecom, SGPS, S.A. Portugal Telecom is a limited liability holding company, organized as a *Sociedade Gestora de Participações Sociais* under the laws of the Republic of Portugal. The company was originally incorporated as Portugal Telecom, S.A., a *sociedade anónima* in June 1994. Our principal offices are located at Avenida Fontes Pereira de Melo, 40, 1069-300 Lisboa, Portugal. Our telephone number is +351 21 500 1701 and our facsimile number is +351 21 355 6623. Portugal Telecom's agent for service of process in the United States is CT Corporation System at 111 Eighth Avenue, New York, New York 10011. Our home page is located at www.telecom.pt. The information on our website is not part of this report. The website address is included as an indicative textual

reference only.

We provide telecommunications and multimedia services in Portugal and Brazil, as well as in other international markets. Our service offering covers a full range of:

fixed line telephone services for retail and wholesale customers, leased lines, interconnection and distribution of programming for TV and radio broadcasters;

data and business solutions, such as data communications, business-to-business e-commerce and data and networking solutions, solutions using Internet protocol, or IP, as well as outsourcing telecommunications systems;

mobile telecommunications services, such as voice, data and Internet-related services, as well as sales of mobile equipment in Portugal, Brazil and other international markets;

multimedia services, such as cable and satellite television services and TV programming, film distribution and screening, newspaper publishing and distribution, radio programming and Internet access, portal and e-commerce services; and

sales of telecommunications equipment in Portugal.

In Portugal, we are the leading provider of all of these services. The provision of fixed line telephone services in Portugal continues to account for a large proportion of our revenues (27% during 2002) as compared to revenues derived from any other line of business in our group. In Brazil, we have a leading position in the mobile market. To strengthen our position in the Brazilian mobile telecommunications market, we entered into a strategic alliance with Telefónica Móviles, the Spanish telecommunications company, pursuant to which we created a new mobile telecommunications services company in Brazil, Brasilcel, on December 27, 2002. See " *Joint Venture with Telefónica Móviles in Brazil*", below.

We are focusing our efforts on market segments and businesses that have the potential for high growth, and we are positioning our company as the leading integrated supplier of a full range of telecommunications services in Portugal. We derive an increasing share of our revenues from new services in fast-growing businesses in Portugal and Brazil, such as the mobile voice and data services, multimedia and Internet services and data and business solutions listed above.

The telecommunications market is increasingly characterized by new opportunities resulting from technological development, the growth in demand for mobile and Internet-related services and the increasing use of information technology in telecommunications services. Our objectives are to:

exploit new growth opportunities in service areas, such as mobile services, multimedia and Internet services and data and business solutions in Portugal, Brazil and other international markets;

continue to leverage our experience as the leading provider of all these services in Portugal and pursuing opportunities for growth in Brazil and in other international markets; and

capitalize on our leading position in the Portuguese market for fixed line services to preserve the profitability and cash flow of these businesses.

Our Businesses

Business Units

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Our market is characterized by increasing competition and rapid technological change. In 1999, the board of directors of Portugal Telecom adopted a plan to reorganize the company to better position it in this competitive market. As part of our reorganization, Portugal Telecom changed its name and corporate purpose from Portugal Telecom, S.A., a telecommunications operating company, to Portugal Telecom, SGPS, S.A., a group holding company, and we aligned our subsidiaries according to business lines. Portugal Telecom's business unit subsidiaries are held by Portugal Telecom in its role as holding company. We are currently in the process of integrating different functions across the board, with particular emphasis on information systems (PT Sistemas de Informação), research and development capabilities (PT Inovação) and back office activities (PT Pro). Additionally, we have created a central purchasing unit, PT Compras, which will be operated as a separate company responsible for all purchasing of the PT group. See "Item 5 Operating and Financial Review and Prospects Overview Our Business Reorganization and Revenue Reporting Categories".

The diagram below presents our corporate structure, taking into account our reorganization:

The business unit subsidiaries hold subsidiaries through which they operate in Portugal, Brazil and other countries. In our discussions of these businesses below, we have provided diagrams of the organizational structures of PT Prime, SGPS, S.A., or PT Prime, PT Multimedia - Serviços de Telecomunicações e Multimedia, SGPS, S.A., or PT Multimedia, and PT Móveis.

PT Comunicações

PT Comunicações holds and operates our fixed line network. We provide fixed line telephone services pursuant to a Concession granted to us by the Portuguese government and transferred to PT Comunicações pursuant to decree Law 219/2000 of September 9, 2000. On December 11, 2002, PT Comunicações entered into a definitive agreement to acquire full ownership of the basic telecommunications network from the Portuguese Government for €365 million, which includes the 2002 Concession rental payment of €16.6 million. Since then, PT Comunicações owns the basic telecommunications network.

Our fixed line services are based on the use of the fixed line network. They consist of:

fixed line telephone services for retail customers, including public domestic and international call services;

wholesale services, including leased lines, transmission of television and radio signals and interconnection services, including Internet interconnection; and

telecommunications equipment sales and other revenues.

Fixed Line Telephone Services General. Our group's largest business is providing public fixed line telephone services in Portugal to retail customers. This business area provided €1,512.1 million, €1,712.8 million and €1,541.2 million to our consolidated operating revenues during 2002, 2001 and 2000, respectively. Subscribers to our public fixed line telephone services are charged for network access on the basis of a monthly line rental as well as rates based on amount and type of usage in addition to an initial installation fee. Since January 1, 2000, public switched fixed line telephone services in Portugal have been fully open to competition.

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As a result of the introduction of competition, combined with substitution of mobile for fixed-line services, we have experienced, and may continue to experience, increased erosion of market share of both access lines and of outgoing domestic and international traffic. See "*Competition Competition Facing PT Comunicações.*"

Our consolidated financial statements do not classify our telephone services revenues according to type of service or traffic. However, we distinguish two principal types of telephone services:

Domestic Fixed Line Telephone Services: these include domestic telephone services provided by PT Comunicações directly to subscribers that originate or terminate calls on its fixed line network; and

International Fixed Line Telephone Services: these include international telephone services provided by PT Comunicações directly to users that originate calls on its fixed line network or receive incoming calls from outside Portugal and also include calls which pass through but do not terminate or originate on its network, or transit traffic.

Traffic. Measured in minutes, total fixed line traffic originating on PT Comunicações' fixed line network decreased by 5.5% during 2002, compared with 2001. The decrease was primarily due to the effects of mobile substitution, the migration of heavy dial-up Internet users to ADSL and a more challenging economic environment. During the five-year period from 1998 through 2002, total traffic originating on the network increased by an average of 6.0% per year, although 2002 was the first year in which it decreased. The chart below sets forth the rate of growth or decrease of traffic originated on our fixed line network.

Total Growth of Originated Traffic

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The following table shows the breakdown of fixed line traffic originated on our fixed line network among mobile, Internet and data and other domestic and international traffic for the periods indicated.

Year ended December 31,				
1998	1999	2000	2001	2002
(%)	(%)	(%)	(%)	(%)

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Year ended December 31,

	Millions of minutes		Millions of minutes		Millions of minutes		Millions of minutes		Millions of minutes	
Domestic	10,633	82.1	9,972	69.4	8,933	53.7	7,431	43.0	6,480	39.6
International	384	3.0	410	2.8	413	2.5	411	2.4	402	2.5
Fixed-to-Mobile	743	5.7	1,083	7.5	1,290	7.8	1,215	7.0	1,119	6.8
Internet	1,100	8.5	2,800	19.5	5,630	33.8	6,920	40.0	6,581	40.3
Other	96	0.7	114	0.8	379	2.2	1,319	7.6	1,758	10.8
Total	12,956	100.0	14,379	100.0	16,645	100.0	17,296	100.0	16,340	100.0

During 2002, Internet-related traffic accounted for approximately 40% of the total traffic originated on the fixed line network compared with 40% during 2001. We estimate that in 2002, each Internet access call on the fixed line network averaged approximately 17.5 minutes. This compared with only 2.6 minutes for the average voice telephone call. However, PT Comunicações receives less revenue for Internet traffic than voice traffic on a per-minute basis. Internet-related traffic generates €0.0075 of revenue per minute as compared with voice-related traffic which generates €0.0828 of revenue per minute. According to an ANACOM administrative decision of February 21, 2001, PT Comunicações changed its billing structure for Internet service. The present billing regime accommodates two different types of billing arrangements. Under the first method, ISPs pay a call origination charge to PT Comunicações, and, if the ISPs request that PT Comunicações invoice customers on their behalf, they pay PT Comunicações the correspondent invoicing charge. Under the second method of billing, PT Comunicações charges the ISPs a wholesale flat rate and the ISPs bill their own customers. For additional information, see "Item 5 Operating and Financial Review and Prospects Overview Internet Interconnection Charges".

PT Comunicações is required to provide carrier selection to its customers on all kinds of traffic. See "Regulation Portugal Number Portability and Carrier Selection." Carrier selection has not yet resulted in large-scale reduction in its traffic.

Except for customer pre-selection and Internet traffic, PT Comunicações accounts for traffic originating on its network in its fixed line telephone services unit. Traffic originating on other networks but terminating on PT Comunicações' network is allocated to its wholesale unit. Until the fourth quarter of 2000, PT Comunicações did not "own" traffic that originated on its network and terminated on mobile networks. It collected the revenues for such traffic and transferred them to the mobile network operators which then repaid PT Comunicações the amount allocable to the fixed line portion of the call under its interconnection agreements. This repayment was accounted for by PT Comunicações as wholesale revenues. Since October 1, 2000, PT Comunicações "owns" this traffic. As a result, PT Comunicações bills its customers for fixed-to-mobile traffic, while mobile operators charge PT Comunicações for call termination. PT Comunicações allocates the retained revenue to its fixed line telephone service revenue. As a result of this change, PT Comunicações' absolute margins have not changed, but its percentage margins decreased. See "Wholesale Services Traffic", below.

Fixed Line Network. PT Comunicações maintained approximately 4.1 million main lines in service at December 31, 2002, excluding external supplementary lines, direct extensions and active multiple numbers. Because of their large capacity, we count ISDN lines, which transmit voice and data at higher rates than analog lines, as equivalent to either two or up to 30 (depending on whether they are basic or primary ISDN lines) traditional main lines. Using this counting convention, total main lines included approximately 826,000 equivalent ISDN lines. Of the total number of main lines, approximately 67%

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were used for residential subscribers, 32% were used for business subscribers and 1% were used for public pay phones.

The following table shows the numbers of our main lines by category.

	As of December 31,				
	1998	1999	2000	2001	2002
Fixed line main lines in service (thousands)					
Traditional main lines	3,803	3,753	3,650	3,501	3,317
ISDN main line equivalents	314	477	653	800	826

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As of December 31,

	As of December 31,				
Total	4,117	4,230	4,303	4,301	4,143
PTC fixed line main lines per 100 inhabitants	40.6	41.5	41.9	42.3	41.9
Public pay phones (thousands)	40.0	42.5	44.6	45.5	43.8

Over past years, PT Comunicações made significant investments to meet subscriber demand for lines and to modernize its fixed line network. As a result, the number of PTC's main lines per 100 inhabitants more than doubled from 20.9 fixed line main lines at the end of 1989 to approximately 41.9 fixed line main lines at the end of 2002.

In September 1999, the number of activated mobile cards (the mobile equivalent of main lines) overtook the number of fixed line main lines in Portugal, and traffic that once was transmitted in whole or in part on our fixed line network is being carried on our mobile network or on the network of other mobile operators. PT Comunicações is addressing this trend by encouraging increased use of its fixed line network for Internet and other data services.

All of PT Comunicações' local switches in Portugal have been digital since 1999. Digital technology is used on all long distance and trunk connections. This level of digitalization of our fixed line network permits PT Comunicações to market and provide network-based value-added services, such as call waiting, call forwarding and voice mail, resulting in increased line usage. By the end of December 2002, PT Comunicações was providing approximately 1,222,000 voicemail boxes.

PT Comunicações' fixed line network includes ISDN lines, which transmit voice and data at higher rates than analog lines. PT Comunicações has offered ISDN services commercially since 1994. It offers a basic-rate service, which provides two communications channels. PT Comunicações also offers a primary-rate service which provides up to 30 communications channels. At the end of December 2002, PT Comunicações had 269,000 subscribers to the basic-rate ISDN service and 9,600 subscribers to the primary-rate ISDN service.

The following chart sets forth the number of ISDN equivalent main lines at the end of each of the last five years:

By the end of 2002, ISDN lines represented 19.9% of PT Comunicações' total equivalent fixed line main lines, as compared with 18.6% one year before. The conversion of traditional main lines to ISDN lines results in increased quality of service, and PT Comunicações' ISDN subscribers tend to produce higher levels of usage per line than traditional main line subscribers.

PT Comunicações has started to deploy higher-speed ADSL lines and has launched ADSL service on a wholesale basis in Lisbon and Oporto, covering 78% and 68% of those cities, respectively. In 2002, ADSL services were made available in the rest of Portugal, increasing total coverage throughout Portugal to 60.7%.

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PT Comunicações' had 0.3 billing complaints per 1,000 bills and 10.2 reported faults per 100 main lines in the year ended December 31, 2002. The percentage of faults repaired in less than 12 working hours was 88.1% in the year ended December 31, 2002, compared with 76.3% in 2001. This increase in the percentage of faults repaired was due in part to heavy rainfall and floods in Portugal in the beginning of 2001 that caused customers to experience a greater number of faults in 2001 than in 2002. PT Comunicações offers residential customers detailed billing on request without extra charge.

Fixed Line Telephone Services Marketing. PT Comunicações is increasing its marketing efforts towards customers loyalty and promoting increased usage of its wireline telephone services:

Promotional Efforts and Market Analysis. PT Comunicações has increased its promotional and marketing campaigns. It wants the public to recognize that it provides better service and more attractive billing packages than its competitors. PT Comunicações is aggressively promoting the sale of minutes of fixed line network time for traditional voice services as well as connection to the Internet through:

the launch of the ADSL wholesale service;

the offering of special tariffs on "PT Days" (Mother's Day, Father's Day, Valentine's Day) and on special occasions and holidays such as Christmas;

the launch and promotion of innovative products and services, such as the voice portal, "FM Voice Mail Service," a fixed-mobile convergence service, the multilingual "Hello CardPT", "PT Cyberlan Free", integrated Internet/Intranet and fax solutions services designed for small and medium-sized enterprises, "PT Netbiz", "PT NetBox", "PT Confort", "PT Free", "PT Cyberkit RDIS Plus", "PT Central Free" and "PT Centralphone";

the promotion of Voice Mail, Voice Mail Familiar and other service facilities such as call forwarding or call waiting;

the promotion of special pricing packages, namely "Local+", "PT 1ª Vez," "Family and Friends" and "Poupadinha Domingo," addressed both to the residential and business markets and designed to promote domestic and international traffic, the launch of PT Option plans; and

the launch of "the netPoint", a new public phone cabin which allows the use of Internet services and the making of calls simultaneously.

Internet customers can also profit from special programs created by PT Comunicações that provide special conditions to access and use of PT Comunicações' network. PT Comunicações also plans to sell higher-speed Internet access, including ADSL services to take advantage of the growing use of Internet services in Portugal and of the group's various Internet-related services.

PT Comunicações uses market research programs to evaluate customer satisfaction and service quality and to help develop products. PT Comunicações focuses its marketing on different segments of its residential and business market. It has a state-of-the-art billing and customer information system and a marketing information database that combines usage and other data.

Targeted Subscriber Packages. PT Comunicações has targeted its products and pricing packages to specific segments of the retail market, such as family groups and small and medium-sized enterprises.

Customer Care. To provide support and marketing services to its residential and business customers, PT Comunicações has developed a network of regional organizations and retail service centers. In addition, it has separate call centers dedicated to increasing services to its residential and business customers. The call centers are interconnected and cover the whole country. This system allows PT Comunicações' customer service representatives to access the history of customers' telephone use and commercial dealings with PT Comunicações.

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Increased Selling Efforts. PT Comunicações has developed its distribution network through its retail service centers and agents such as supermarkets and other retail outlets. Its customer support system enables it to develop strategies to sell new and expanded services to its customers. In addition, PT Comunicações is expanding its telemarketing activities, addressing both residential and small and medium-sized enterprise marketing segments and developing more proactive and closer relationships with its customers.

Fixed Line Telephone Services Domestic. PT Comunicações estimates that domestic fixed line telephone services generated operating revenues of €1,291.8 million in 2002, €1,502.3 million in 2001 and €1,289.2 million in 2000. PT Comunicações estimates that in 2002, 51.3% of these domestic fixed line telephone service revenues came from traffic charges and 48.7% came from fixed charges, compared to an estimated 57.5% of these domestic fixed line telephone services revenues coming from traffic charges and 42.5% coming from fixed charges in 2001. Fixed charges include installation charges, a monthly subscription charge and telephone set rental charges.

Traffic. PT Comunicações estimates that, as measured in number of minutes, total originating traffic generated by its domestic fixed line telephone services decreased by 5.6% in 2002 over 2001. This decreased usage was driven by decreased voice usage. PT Comunicações estimates that there was a decrease in total domestic traffic on its fixed line network of 3.8% in 2002 compared with 2001. In terms of minutes, its estimated market share reduced by 2.9 percentage points to 89.3% in 2002. This reduction in its market share was in line with its expectations. PT Comunicações believes this reflects the overall impact of competition on our business. See " *Competition Competition Facing PT Comunicações*".

Prices. PT Comunicações charges its domestic fixed line telephone subscribers a one-time installation charge, monthly line rental fees and traffic fees for calls. As of December 31, 2002, the installation charge was €71.83. The standard line rental fee is €11.85 per month for standard lines and €23.89 per month for ISDN basic lines, in each case excluding value-added tax. In 1999, its charging system for traffic was based on a fixed line price pulse. On January 1, 2000, PT Comunicações introduced a system for charging its customers on a per-second basis, after a time credit included in the initial call price. PT Comunicações has three domestic tariffs: local, regional and national. Between the end of 1998 and the end of 2002, weighted average prices for domestic fixed line telephone services decreased by 6.1% per year in nominal terms. Compared with 2001 over the course of 2002, domestic prices decreased a further 0.9% in nominal and annual terms. PT Comunicações is committed to change its prices annually in accordance with our pricing convention. See " *Regulation Portugal Pricing of Fixed Line Services*".

The chart below illustrates changes in PT Comunicações' prices and fees from 1998 through 2002. The call prices from 1998 through 2002 are for a three-minute call at peak rates in 2002 constant prices. All prices are in Euros and exclude VAT.

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Principal Prices and Fees for Domestic Fixed Line Telephone Services(1)

	As at December 31,				
	1998	1999	2000(2)	2001	2002
Local call prices	0.10	0.10	0.13	0.12	0.12
Regional call prices	0.34	0.31	0.31	0.24	0.23
National call prices	0.77	0.66	0.42	0.35	0.33
Installation fee	81.78	79.94	77.69	74.41	71.83
Line rental per month	11.41	11.66	12.08	12.27	11.85

(1) Amounts rounded to nearest hundredth.

(2) For a three-minute call the prices are greater in 2000 than in previous periods due to the new per-second pricing.

Prices for local, regional and national calls did not change in 2002. The average annual reduction in 2002 for the basket of prices was about 0.13% in nominal terms. PT Comunicações' pricing structure has come more into line with pricing structures in the rest of the EU over the last eight years. The following table compares its estimates of average domestic services prices per minute, excluding VAT, for a three-minute call at peak rates in the EU with average prices in Portugal in effect at December 31, 2002.

Principal Prices for Domestic Fixed Line Telephone Services: EU and Portugal

	As of December 31, 2002	
	EU Average	Portugal
Local call prices	0.039	0.040
Regional call prices	0.064	0.078
National call prices	0.071	0.111

To increase its price competitiveness, PT Comunicações is promoting innovative differentiated pricing plans for market segments. For example, it offers various plans specially designed for business customers as well as other plans for residential customers. PT Comunicações also offers a prepaid card and pricing plans suited for Internet users, as well as plans aimed at the development of education and the information society.

Fixed Line Telephone Services International. PT Comunicações estimates that operating revenues from international fixed line telephone services were €220.3 million in 2002 compared with €210.5 million in 2001 and €223.2 million in 2000 (which, consistent with our current method of accounting, excludes the amount of €28.7 million related to incoming traffic in 2000 that was included at that time in fixed line telephone services revenues). Revenues from international fixed line telephone services come primarily from charges to its individual and business subscribers in Portugal for outgoing calls. PT Comunicações must pay a portion of these charges to other international operators whose facilities carry the calls. The other primary source of revenue from international fixed line telephone services is receipts from the calls of other international telecommunications operators that PT Comunicações carries and that terminate with PT Comunicações' customers on a joint or correspondent basis. Payments between PT Comunicações and other international operators for incoming and outgoing calls are made in accordance with bilateral settlement arrangements referred to as "accounting rates" in the telecommunications industry. These arrangements include agreements on rates payable for incoming and outgoing calls. See "Accounting Rates" below. In 2002, 2001 and in 2000, PT Comunicações' revenues from international fixed line telephone services decreased while international traffic continued to grow. This decrease in revenues resulted from decreases in

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international accounting rates and decreases in prices for outgoing international calls. PT Comunicações expects these decreases to continue.

Traffic. The table below shows the total incoming and outgoing international traffic and international transit traffic carried by PT Comunicações during the period 1998 through 2002.

**International Traffic and Transit Traffic
(millions of minutes, except as indicated)**

	Year ended December 31,				
	1998	1999	2000	2001	2002
Outgoing traffic	470	539	620	721	745
Growth in total outgoing traffic (% per annum)	20	15	15	16	3
Incoming traffic	712	797	897	1,000	1,013
Growth in total incoming traffic (% per annum)	13	12	13	12	1
Ratio of incoming to outgoing	1.51	1.48	1.45	1.39	1.36
Switched transit traffic	39	30	35	32	64
Growth (decrease) in switched transit traffic (% per annum)	(11)	(25)	17	(11)	103

PT Comunicações believes that the total amount of international traffic has grown in recent years principally because it has reduced traffic charges, developed new services and increased the capacity and quality of international services. International prices decreased on average by 0.4% over the course of 2002. With the introduction of full competition in the Portuguese fixed line telephone services market at the beginning of 2000, competitors may now provide international connections without using PT Comunicações' network. PT Comunicações has been encountering competitive pricing from new entrants to the international fixed line telephone services market. In 2002, the share of the market of our wireline businesses (including both PT Comunicações and PT Prime) in international traffic was approximately 76.7% compared with 76.3%

in 2001.

In percentage terms, PT Comunicações estimates that fixed line traffic accounted for approximately 54% of the Portugal Telecom group's total outgoing international traffic and approximately 63% of total incoming international traffic in 2002, as compared to 57% and 65% in 2001 and 67% and 71% in 2000, respectively. These reductions, which PT Comunicações expects to continue, are due to the growth of international mobile traffic and traffic originated on other fixed line operators in substitution for PT Comunicações' international fixed line telephone services. To the extent that PT Comunicações transmits outgoing or incoming calls for mobile networks, operating revenues from such international mobile traffic is accounted for in its wholesale services category. The costs of payments to other international operators are accounted for as costs of telecommunications. The increase in international mobile traffic contributed substantially in 2000, 2001 and 2002 to increases in wholesale operating revenues and the costs of telecommunications. See "Item 5 Operating and Financial Review and Prospects Results of Operations".

Accounting Rates. Historically, the amount of incoming traffic has been significantly greater than the amount of outgoing traffic. As a result of this imbalance, PT Comunicações receives higher payments from other international telecommunications operators than it pays out to these operators. PT Comunicações negotiates the amount of the payments with these operators periodically.

In recent years, the accounting rates among operators have been declining steadily, both for incoming and outgoing traffic. PT Comunicações estimates, however, that, on an aggregate basis in Euros, termination rates for international traffic at the end of 2002 decreased by a weighted average of approximately 0.2% for incoming traffic and decreased by 25.4% for outgoing traffic as compared to the end of 2001.

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With the opening of competition in the Portuguese market on January 1, 2000, international telecommunications operators are now able to provide services directly in Portugal. They can lease lines from PT Comunicações or obtain international lines from other operators and then interconnect with PT Comunicações' fixed line network. The revenues PT Comunicações receives from such services are interconnection fees and thus fall into the wholesale business category of its fixed line businesses. As a result, while its share of the international market has declined, increases in PT Comunicações' wholesale business have, to a substantial extent, offset this decline.

Prices. PT Comunicações sets traffic charges for international fixed line telephone services in a number of different groups of countries. Within each group, it charges different prices according to the time of day and the day of the week that the customer makes the call.

Between the end of 1998 and the end of 2002, PT Comunicações experienced aggregate reductions in real terms of 42% in international traffic. These included an average reduction in nominal terms of 0.4% for international calls over the course of 2002.

The table below shows changes in prices for our international fixed line telephone services to selected destinations since 1998. The prices for 1998 through 2002 are peak rate prices per minute on the basis of a three minute call, set at 2002 constant prices. They are in Euros and exclude VAT.

Selected Prices for the International Services(1)

	As of December 31,				
	1998	1999	2000	2001	2002
EU(2)	0.43	0.38	0.29	0.28	0.27
Other European countries(3)	0.78	0.70	0.67	0.63	0.61
United States	0.53	0.38	0.30	0.29	0.28
Canada	0.53	0.39	0.30	0.29	0.28
Brazil	0.95	0.70	0.67	0.59	0.57

(1) Euro amounts rounded to nearest hundredth.

(2)

Including Switzerland.

(3)

Excluding Norway and Iceland.

Wholesale Services. PT Comunicações' wholesale services consist of:

domestic and international interconnection telephone services that it provides to other telecommunications service providers in Portugal, including other companies in our group;

leasing of Portuguese and international lines to other telecommunications service providers and Portuguese cable television operators, including other companies in our group;

transmission of television and radio signals for major broadcast television companies in Portugal; and

Internet interconnection services, which it began to provide to ISPs in Portugal, including ISPs in our group, in June 2001.

Consolidated operating revenues from PT Comunicações' wholesale services provided to companies outside our group were €269.2 million in 2002, €268.1 million in 2001 and €218.1 million in 2000.

Interconnection. Interconnection traffic comprises about 40% of PT Comunicações' wholesale business in terms of revenues. The service providers who purchase interconnection services include mobile telephone network operators, data communications providers, Internet service providers and

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value-added service providers. Providing interconnection services means allowing third parties to connect their networks to PT Comunicações' network, and vice versa. This interconnection is necessary, for example, to allow calls or data signals that originate on another network to terminate on PT Comunicações' network, and vice versa. Since the introduction of full competition into the Portuguese telecommunications market on January 1, 2000, PT Comunicações has begun to provide interconnection telephone services to 11 other operators of public switched voice telephone networks, although traffic volume has been low. PT Comunicações has interconnection rates for call termination, call origination, transits and international interconnection. At this time, interconnection rates per minute for call termination include local transit rates equal to €0.82, single transit rates equal to €1.20 and double transit rates equal to €1.76, each based on a three-minute call made during peak hours. PT Comunicações also classifies value-added services, including audiotext services, on an interconnection basis. PT Comunicações published the latest version of its reference offer for unbundled access to our local loops on December 27, 2002, and since then has made available to its competitors, where technical and space conditions are available, all of the local switches, 14 of which are co-located. See "*Regulation Portugal Unbundling of the Local Loop*" and "*Regulation Portugal Number Portability and Carrier Selection*".

On February 21, 2001, ANACOM issued an administrative decision instructing PT Comunicações to submit a reference Internet access offer proposal changing its billing structure for the connection of ISPs to its fixed line network from a model based on revenue sharing to one based on call origination charges and establishing maximum prices that PT Comunicações is permitted to charge ISPs for Internet access service. PT Comunicações published such a proposal on March 1, 2001. As discussed below in "*Item 8 Financial Information Legal Proceedings*," PT Comunicações has submitted a claim to the Lisbon administrative court requesting relief from this decision and contesting its legality. See also "*Regulation Portugal Internet Interconnection*".

Leased Lines. PT Comunicações leases lines to other telecommunications providers for mobile and data communications services, including our subsidiaries and competitors. Since 1996, PT Comunicações has leased lines to resellers who offer voice services to corporate networks and closed user groups. Leased line service involves making a permanent point-to-point connection for voice and data traffic between two geographically separate points.

PT Comunicações' Concession requires it to provide leased lines to third parties. ANACOM defined a minimum set of leased lines as including 2-wire and 4-wire traditional lines and 64 kbit/s to 34 Mbit/s digital lines. PT Comunicações is also providing higher capacity 140 Mbit/s digital lines and higher to third parties in Portugal.

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The three current mobile telephone operators, our subsidiary TMN, Vodafone and Optimus, are among PT Comunicações' largest leased line customers. PT Comunicações leases lines to TMN and to our other subsidiaries PT Prime, Telepac and TV Cabo on a basis that does not discriminate against other customers. PT Comunicações expects that the opening of the Portuguese telecommunications market to competition and the entrance of new service providers will significantly increase its leased line services in the next few years. PT Comunicações also expects to face more competition from new leased line providers. This increased competition will probably cause it to reduce its leased line prices further.

PT Comunicações leased approximately 57,700 lines on a wholesale basis at the end of 2002 to other telecommunications service providers in Portugal, including other companies in our group. Compared with about 58,800 lines at the end of 2001, this represents a decrease of approximately 1.8%. PT Comunicações had 1,421,000 64 Kbps equivalent leased lines at the end of 2002, a decrease of 3.6% compared with 2001. The largest portion of wholesale leased lines is provided to mobile operators and data and Internet service providers. Of the total wholesale leased lines at the end of 2002, 98.6% were digital in terms of capacity.

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Traffic. Wholesale services traffic is generated by the interconnection portion of PT Comunicações' wholesale business. Its revenues from leased lines and television signal transmission do not depend on traffic levels. Domestic traffic generated by PT Comunicações' wholesale interconnection services increased by 3.2% in 2002 compared with 2001. This increase was primarily due to increases in indirect access traffic. The following table sets forth the total amount of wholesale services domestic traffic on PT Comunicações' fixed line network during the period 1998 through 2002.

Wholesale Services Domestic Traffic (millions of minutes)

	Year ended December 31,				
	1998	1999	2000	2001	2002
Mobile	763	1,192	1,172	1,061	998
Internet	1,100	2,800	5,630	6,916	6,687
Other	97	114	594	2,336	2,960
Total	1,959	4,106	7,396	10,313	10,645

The traffic figures for mobile include fixed-to-mobile, mobile-to-fixed and mobile-to-mobile traffic between different networks. Since October 1, 2000, fixed-to-mobile traffic has been allocated to PT Comunicações' fixed line telephone services revenues instead of PT Comunicações' wholesale business revenues. The data presented for previous years was adjusted in accordance with this allocation. See "*Fixed Line Telephone Services General Traffic*", above.

PT Comunicações estimates that international wholesale mobile traffic accounted for approximately 43% of the Portugal Telecom group's total outgoing international traffic and approximately 37% of total incoming international traffic in 2002. PT Comunicações estimates that, in 2001, these percentages were approximately 38% and 35%, respectively.

Prices. The net prices and fees PT Comunicações receives from providing access to its fixed line network on a wholesale basis are less per minute than those it charges for domestic and international fixed line telephone services. PT Comunicações has entered into a variety of different pricing arrangements for providing access to its fixed line network. PT Comunicações usually negotiates the amount of these prices with the service provider. The prices usually include a negotiated volume-based discount.

Domestic interconnection revenue per minute for calls terminated on our network declined by 17% in nominal terms in 2002 compared with 2001. International interconnection revenue per minute increased by 2.9% in nominal terms in 2002 compared with 2001. In accordance with EU and Portuguese regulation, PT Comunicações' interconnection prices are cost-oriented and non-discriminatory.

Since December 31, 2000, there have been no restrictions on leased line pricing, and PT Comunicações is able to negotiate freely prices for leased lines. See "*Regulation Pricing of Fixed Line Services*". PT Comunicações does not discriminate on prices between retail customers and customers that provide services to other providers, such as data network service providers and Internet service providers, although it does offer discounts according to the usage of the customer.

Fixed Line Sales and Other Revenues. PT Comunicações sells telecommunications equipment and other related items in Portugal. It also provides telex and telegraphy services, maritime mobile services, submarine cable and satellite maintenance services and earns other supplementary revenues generated by services rendered by other fixed line businesses. These fixed line sales and other services generated operating revenues of €201.7 million during 2002, €203.8 million in 2001 and €197.2 million in 2000. These revenues include revenues from our directories business, which amounted to €139.1 million in

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2002, €136.8 million in 2001 and €131.7 million in 2000. We subcontract to Páginas Amarelas (an associated company 25% owned by us) for the publication and distribution of telephone directories throughout Portugal in return for an annual payment of approximately 64% of its gross revenues from the sale of advertising space. Currently, the provision of yellow page directory services is not subject to significant competition.

PT Prime

PT Prime SGPS, S.A., or PT Prime SGPS, focuses through its operating subsidiaries on corporate customers, including the top 6,500 companies in Portugal, that have a need for complex telecommunications solutions. It offers those customers data and business solutions, such as:

low speed data communications	consultancy services
digital leased lines	web design and site management
broadband data	fixed line and mobile convergence services
networking and systems integration solutions	business-to-business e-commerce
Internet-related services and applications including Intranet and Extranet services	housing and hosting solutions, including ASP and enterprise resource planning, or ERP
interactive systems and related applications	telephone services using Internet protocol
outsourcing of telecommunications application systems	

PT Prime SGPS, through its operating subsidiaries, is the leading supplier of the full range of these services in Portugal. Operating revenues from this business amounted to €264.9 million in 2002, €215.9 million in 2001 and 176.8 million in 2000. Currently, we hold 100% of the share capital of PT Prime SGPS.

PT Prime SGPS holds subsidiaries engaged in different types of services as follows:

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- (1) During the fourth quarter of 2002, PT Prime disposed of its 100% interest in PrimeSys to PT Brasil, our fully owned holding company for Brazilian operations other than our mobile businesses.
- (2) In October 2002, PT Prime SGPS sold its 63.61% interest in Megamédia to PT Sistemas de Informação. See "*PT Sistemas de Informação, PT Inovação, PT Pro and PT Compras*", below.

PT Prime SGPS offers data communications services in Portugal through PT Prime, S.A., or PT Prime, and has set up Tradecom, S.A., or Tradecom, for its business-to-business e-commerce activities. PT Prime SGPS provided data communications services in Brazil through PrimeSys until November 30, 2002, when this subsidiary was sold to PT Brasil, and also interactive IT consulting and web-enabling services through Megamédia until October 2002, when this subsidiary was sold to PT Sistemas de Informação.

PT Prime, S.A. PT Prime offers corporate customers in Portugal a "one-stop-shop" for a variety of flexible, efficient and innovative solutions using information technology, telecommunications, Internet and outsourcing. PT Prime SGPS holds 87.5% of the share capital of PT Prime. SIBS, the Portuguese entity operating the ATM network and the inter-bank payment system, holds the remaining 12.5%.

Services. PT Prime is the focal point for our group's interface with corporate customers in Portugal for our data, Internet, fixed line and mobile services. PT Prime has developed a full range of telecommunications services, and it integrates these services, as well as other services within the group, such as fixed line services provided by PT Comunicações and mobile services provided by TMN, to provide its customers with packaged groups of services. In addition, PT Prime has its own license to provide a full range of telecommunications and related services in Portugal. By combining its communications capabilities with its software-based integrated systems and applications, PT Prime can offer integrated voice, data and image solutions, virtual private networks, convergence solutions, consultancy and outsourcing on a single commercial interface. We believe that PT Prime is the main service provider in Portugal capable of offering customers a full range of integrated and customized services rather than stand-alone services. Despite increasing competition, overall demand for its services has been increasing. As a result of competition, it has reduced its prices for leased lines and data services.

PT Prime has been structured to respond to the changing needs of its customers as quickly as new entrants in the Portuguese market do and to be able to pursue and form strategic partnerships to take advantage of opportunities in international markets such as Brazil. It offers its services in partnership with leading operators and service providers such as Concert, Telefónica and Equant. It uses systems and networks in partnership with Siemens, Unisphere, Alcatel, Cisco Systems, Newbridge, Motorola, Nortel Networks, Matra/EADS Telecom and IBM.

PT Prime leases lines and broadband capacity to large businesses for data communications and other private uses and provides related services. It also provides integrated voice and data services to corporate customers. It offers X.25/X.32 synchronous services and X.28 asynchronous services and other switched and non-switched data communications services, such as frame relay, virtual private networks over IP for data communications, security/firewall services and VSAT satellite communications services. In addition, it offers a new range of data, voice

and Internet services, such as Intranet, Extranet and managed services, including "voice over IP". It is using IP-based solutions to improve interconnections between companies and their employees and between customers and commercial partners through remote access, and exploring virtual private network capabilities. These solutions enable customers to integrate voice, video and data services in a flexible cost-effective manner with add-on capacity. The offering of web contact centers solutions represents an evolution of the classic call center for customers.

PT Prime provides a range of broadband solutions. The type of solution depends on the type (voice, data or image), volume, priority level and stability of information flow required by its customers.

PT Prime also provides reporting services targeted to special customers to control service level agreements and the overall performance of the network.

In addition, PT Prime is outsourcing corporate networks and services for our group's customers. For example, PT Prime operates and manages the SIBS network as well as the corporate networks of its strategic partners, Caixa Geral de Depósitos and Banco Espírito Santo. Consequently, PT Prime has developed substantial experience structuring and managing the network infrastructures of major Portuguese financial institutions. PT Prime delivers international seamless services aimed at multinational customers in association with Telefónica Data, BT Ignite/Concert, Infonet or Equant.

PT Prime has entered into a partnership with ANA-Aeropostos de Portugal, S.A., or ANA, to create a company that will be owned 40% by PT Prime and 60% by ANA which intends to provide corporate network services to airports in Portugal and abroad. PT Prime has also entered into a partnership with Casa da Moeda, CTT and SIBS to create a company called Multicert with PT Prime, Casa da Moeda and CTT each holding a 20% stake and SIBS holding the remaining 40%, which intends to provide digital certificates and communications security services to both consumer and business segments.

Networks. PT Prime network services use its own switched and access points in customer premises, its own network and lines leased from our PT Comunicações' business unit's fixed line network. PT Prime provides its services over the largest IP backbone in Portugal, leasing the necessary fixed line capacity from PT Comunicações' fixed line business. It has points of presence in all major cities throughout Portugal. This broadband data transmission network provides high capacity, flexibility and security. It can progressively incorporate current voice and data infrastructures at lower costs than alternative networks. On December 12, 2000, PT Prime began to provide high speed Internet access through asymmetric digital subscriber lines, known as ADSL. The ADSL lines are linked to digital subscriber line access multiplexes, or DSLAMs, located at fixed line network switching centers. PT Prime leases the necessary fixed line capacity from PT Comunicações. PT Prime supplies full IP and broadband connectivity for our whole group.

Revenues from services that offer leased lines of PT Comunicações are typically divided between PT Prime own direct billings to its customers and our leased line revenues from PT Comunicações' fixed line wholesale business. Revenues from our group's fixed line voice services for corporate customers are not reflected directly in PT Prime's revenues. PT Prime obtains fixed line voice services from PT Comunicações. Because PT Prime is integrating the services of other companies in the group such as PT Comunicações and TMN, it receives agency fees for arranging and selling these services which are cancelled out in the group's financial consolidation process. In 2002, these agency fees amounted to approximately €13 million.

Systems Integration. PT Prime offers an integrated range of telecommunications and information technology services to the corporate market. PT Prime's goal is to service all of its customers' telecommunications needs and to leverage the traditional offering of products and services from our group.

PT Prime has a strong and competitive position in the development of information technology solutions where communications are an integral part of the services provided. To reinforce its position as a leader in this area, PT Prime is pursuing a partnership strategy with the main information technology suppliers in the market, particularly software and hardware providers. PT Prime is also exploring synergies arising from its relationship with our subsidiary PT Sistemas de Informação, the information technology arm of our group.

To support these new services and to respond to the increasing demand of e-business integrators, PT Prime developed a corporate Internet Data Center. This facility allows it to provide services, such as co-location, sophisticated web hosting, ISP services, data storage and ASP services. To develop, build up and manage the Internet Data Center, PT Prime has selected IBM Global Services, the world leader in this market segment, as its partner. Pursuant to the terms of an agreement between PT Prime

and IBM, the Corporate Internet Data Center began to provide Internet hosting services for corporate customers in April 2001.

PT Prime also offers service focused on the integrated management of networks ranging from local area networks, or LANs, to software applications, including PC management.

Marketing and Customer Care. PT Prime is focusing significant resources on marketing and customer care. Over 380 of PT Prime's 665 employees are involved in marketing services directly to corporate customers. Account managers are being given clear incentives to meet and exceed sales targets. PT Prime is implementing a sophisticated customer relationship management platform, or CRM, to increase focus on market and Internet efficiency.

PT Prime is seeking to compete in Portugal on the basis of the quality of its services as well as its position as the leading supplier of integrated telecommunications and IT services. PT Prime is pricing its various service offerings on the basis of the volume of traffic, the duration of service agreements and the scope of the services offered to each customer.

PT Prime offers its customers services available from other companies in our group. PTM.com, for example, provides significant support for product development and the marketing of Internet access and web hosting services for small and medium-sized enterprises. PT Prime offers mobile telephone services options for corporate accounts while TMN also maintains its own direct relationships with this important customer segment.

PT Prime uses customer care capabilities that were developed for PT Comunicações. However, it has also established its own billing and customer care relationships for its largest accounts. To maximize customer loyalty, PT Prime is developing systems that provide integrated assessments of their profile, based on a customer relationship management system. The first release of CRM for marketing, sales and services is currently in production. We believe that to reinforce its competitiveness, PT Prime must change and optimize its processes and focus the entire organization on its customers more effectively.

PrimeSys. On December 13, 2000, PT Prime SGPS entered into an agreement with Unibanco-União de Bancos Brasileiros, S.A. and Banco Bradesco, S.A. Pursuant to this agreement, Unibanco and Banco Bradesco transferred their private telecommunications networks to a new company called BUS. BUS has wide geographical coverage and a large network with 11,507 points of presence on December 31, 2002. The initial stages of the project were launched in January 2001. On June 29, 2001 PrimeSys acquired a 73% economic interest in BUS by acquiring 19.9% of the voting shares and 100% of the non-voting shares of BUS, and increased its ownership to 100% of voting shares in June 2002.

PT Prime SGPS has set up PrimeSys Brasil to explore opportunities to outsource corporate networks in Brazil. We expect such outsourcing arrangements to provide an opportunity to develop corporate solutions in Brazil similar to the network services that PT Prime has developed in Portugal. We believe that corporate solutions are undersourced in Brazil and represent an important opportunity for growth for PrimeSys.

PrimeSys is seeking to provide a full spectrum of services to assist businesses in integrating Internet and IT services into their current business operations. Such services include outsourcing of both communications and IT services as well as high margin services such as web enabling and systems integration.

Tradecom. PT Prime SGPS has a business-to-business e-commerce solutions business which is conducted through its subsidiary Tradecom S.A., or Tradecom, and its equity investment in PMELink. Additionally, PT Prime has an equity investment in Tradecom International, N.V., or Tradecom International, a partnership which was established for the development of business-to-business e-commerce in Brazil and Argentina.

Tradecom S.A. Launched in May 2000 by PT Prime SGPS, Tradecom focuses on the management and development of business-to-business e-commerce solutions. Tradecom provides an e-commerce platform for the business sector in Portugal, on which it expects to implement e-procurement solutions and e-marketplaces through the development of non-specialized horizontal portals and specialized Vortals for products and services transactions between companies. This platform is based on the technology of Commerce One, a leading company in global business-to-business e-commerce solutions. Our partners in Tradecom are the Banco Espírito Santo and Caixa Geral de Depósitos groups. PT Prime SGPS holds 66%, and Banco Espírito Santo, through BES.com, and Caixa Geral de Depósitos, through Caixaweb, each hold 17%, of the share capital of Tradecom. PT Prime has the right to install and use the business-to-business platform of Commerce One in Portugal and it may also use this platform to provide services in other markets by connecting its infrastructure in Portugal to customers in other markets.

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PMELink. The PMELink initiative is a business center providing a wide range of products and services through the Internet for small and medium-sized enterprises. The initiative has been developed in partnership with relevant service providers in the following areas:

procurement, using Tradecom's technological solutions;

legal advisory;

financial and accounting services;

IT services;

marketing and sales;

human resources;

logistics; and

strategic advisory services.

PT Prime SGPS holds one-ninth of the share capital of PMELink, with two-ninths being held by other members of the Portugal Telecom group. The Banco Espírito Santo group and the Caixa Geral de Depósitos group each hold one-third of the share capital of PMELink.

Tradecom International. In 2000, PT Prime SGPS entered into a partnership with Unibanco-União de Bancos Brasileiros S.A., from Brazil and Grupo Financiero Galicia, from Argentina. This partnership offers business-to-business e-commerce solutions in Latin American countries, where companies, such as Telesp Celular, are already using these solutions. This partnership is part of the expansion and internationalization strategy of PT Prime SGPS for business-to-business solutions in strategic businesses.

These e-commerce solutions are based on a technological platform from Commerce One and are operated from Portugal by Tradecom. This partnership capitalizes on:

Unibanco's and Grupo Financiero Galicia's position in the business sectors of their respective countries;

PT Prime's know-how in telecommunications and data communications; and

Tradecom's expertise using e-commerce platforms from Commerce One.

The partnership was developed through the incorporation of the holding company Tradecom International, which holds 100% of each of the local companies Tradecom Brazil and Tradecom Argentina. PT Prime SGPS holds 20% of the share capital of Tradecom International, Unibanco holds 53% and Grupo Financiero Galicia 27%. The total investment to set up the business portal and launch

operations was US\$37.5 million. Unibanco, Telesp Celular and Grupo Financiero Galicia in Argentina used Tradecom International solutions for their purchases.

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Megamédia. In 2001, PT Prime SGPS entered into a strategic alliance with Banco Espírito Santo to acquire Megamédia for the development of IT consulting and web-based strategies. Megamédia is a web-enabling company with a clear leadership position in the Portuguese business solutions market. At June 30, 2002, PT Prime SGPS owned 63.61% of the share capital of Megamédia and BES.com, Banco Espírito Santo's e-commerce business, held 15%. In October 2002, PT Prime SGPS and BES.com sold their Megamédia shares to our wholly-owned subsidiary PT Sistemas de Informação and subsequently PT Sistemas de Informação acquired the remaining share capital of Megamédia. In April 2003, Megamédia merged with PT Sistemas de Informação.

PTM.com

PTM.com is the leading Internet company in Portugal, operating as an Internet service provider, or ISP, through Telepac, and in portal and related activities, through Saber e Lazer, the owner of SAPO.PT, Portuguese's leading Internet portal.

Formation and Development. PTM.com was formed in March 2000 by PT Multimedia to aggregate all its Internet activities focused on the residential and small and medium size enterprise markets.

In June 2000, PTM.com increased its share capital, issued new shares in a public offering to PT Multimedia's shareholders and was listed on the Euronext Lisbon Stock Exchange. In June 2000, PT Multimedia sold approximately 7.5% of the share capital of PTM.com in a private placement to two strategic shareholders, Banco Espírito Santo and Caixa Geral de Depósitos, and to PPTV. See "*Strategic Alliances Alliance with Banco Espírito Santo and Caixa Geral de Depósitos*".

In January 2001, PT Multimedia announced the launch of an exchange offer in Portugal to acquire all of the outstanding shares of PTM.com that it did not already hold in exchange for PT Multimedia shares. Subsequently, PTM.com's shares were delisted from the Euronext Lisbon Stock Exchange in March 2002.

On October 17, 2002, we entered into an agreement with PT Multimedia to acquire its 100% interest in PTM.com. The sale of PT Multimedia's Internet business to us was intended to encourage the continued growth of our broadband businesses and increase the loyalty of fixed line subscribers, while providing a single platform for investment and development of on-line services and content for the Portugal Telecom group.

The results from PTM.com in the 2002 financial year are included in the PT Multimedia business segment in the first three quarters of 2002 and its results in the fourth quarter are included under "Other". In the 2003 financial year, the results from our Internet activities, through PTM.com, will be included in a separate sub-segment within the wireline reportable segment. See "*Item 5 Operating and Financial Review and Prospects Overview Our Business Reorganization and Reporting Categories*".

Internet Operations. Our Internet activities grew quickly in 1999 and developed considerably in the subsequent years. Our main activities are described below.

Internet Service Provider (ISP). Through Telepac, its Internet service provider, or ISP, PTM.com is the leader in providing Internet access in Portugal. By December 31, 2002, Telepac had approximately 940,000 access subscribers in Portugal. This was an overall increase of 53% over one year before. We estimate that 33% of Portuguese Internet traffic in minutes was connected through Telepac during 2002. Telepac offers dial-up paid and free Internet access services. We estimate that altogether Telepac provided Internet access to about 30% of the Portuguese subscriber market at December 31, 2002. The number of hours of subscriber use in 2002 decreased by 9% to 33 million hours compared to 37 million hours in 2001, reflecting the increasing penetration of broadband, soft cable and ADSL in Portugal.

Telepac is now also offering high-speed Internet access through ADSL services. A plug & play solution ADSL service was launched in the third quarter of 2002, targeting residential customers and a taylor-made service developed for SOHO, and small and medium enterprise, or SME customers. PTM.com had approximately 60,000 modem sales and 42,500 ADSL customers at the end of 2002.

Portal Activities. Saber e Lazer-Informática e Comunicação, S.A., a company fully owned by PTM.com, is the owner of sapo.pt, Portugal's leading Internet portal.

In December 2002, sapo.pt reached 2.3 million unique visitors and over 190 million page views. Sapo.pt serves as the multi-access portal for the Portugal Telecom group. We view our Internet portal as a platform to provide services produced by PTM.com's portals and to aggregate high-quality content from third parties for PTM.com's portals.

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Sapo.pt offers a wide variety of channels, including:

Leisure	Auctions	Finance
Economy	Business	Geo Sapo (location)
News	Horoscope and Personal Development	Campus (Student portal)
Health	Genealogy	

In addition, through its vertical portals, or Vortals, sapo.pt provides current and rich content on various topics, including music, automobiles and video games in connection with e-commerce services, e-learning, sports and employment.

Sapo.pt's services include free e-mail, web-chat, forum access, free download programs, the leading directory of Internet sites in Portugal, e-cards, personal homepages, instant messaging services and third-party services, such as community chat rooms. Through an agreement with Google, one of the leading global search engines, sapo.pt provides its users with global search capability for information in the Portuguese language.

Advertising. PTM.com's portals provide advertising through which advertisers may target particular categories of content or segments of its user base. The types of advertising it provides include banner advertisements, advertisements linked with its search capabilities, sponsorship of various channels and services and e-mail advertising.

E-commerce. PTM.com provides e-commerce through its sapo.pt portal in Portugal. Through sapo.pt's on-line "shopping mall," viewers may purchase products from over 95 retailers in Portugal as of December 31, 2002. Shopping sapo, launched in April 1999, is the largest virtual shopping center in Portugal.

Application Service Provider (ASP). Telepac also provides application service provider, or ASP, services in Portugal. These activities include remote applications services, web hosting and web design services to small and medium-sized enterprises. Telepac had approximately 3.4 thousand customers for its ASP business at December 31, 2002.

ISP Traffic Revenues. PTM.com provides its Internet services in cooperation with our other companies in the group. It offers Internet access through the lines of our fixed line network. Until June 1, 2001, in accordance with regulation of ANACOM, the Portuguese telecommunications regulator, PTM.com recovered 35% of the revenues from the fixed line traffic from PT Comunicações, which retained 65% of such revenues. From September 2001, PTM.com retains all of the revenues from Internet traffic and pays PT Comunicações for use of the fixed line network. See "*Item 5 Operating and Financial Review and Prospects Overview Internet Connection Charges*".

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Mobile Businesses

We provide mobile telephone services in Portugal, Brazil, Morocco, Botswana and Angola through our mobile operating companies. As a consequence of our reorganization, by the end of 2002 our interests in mobile assets in Brazil, Morocco and Botswana were held by PT Móveis, which in turn was 100% owned by TMN. We also plan to transfer our interest in the Angolan mobile operator to PT Móveis. Our mobile services are growing, and the number of users of these services is also increasing. In Portugal, there are now more mobile subscribers than there are wireline subscribers. The increase in usage of mobile services is contributing to the growth in mobile revenues and cash flows. Traffic of voice calls is growing in overall terms as calls from mobile to mobile telephones increase in number and duration. Traffic on mobile networks is also increasing because subscribers are increasingly using their mobile telephones in place of wireline telephones. The traffic generated by these users is an increasingly important part of our group's revenues.

Until recently, our mobile operations in Brazil, a country with a population of about 175 million people, had been active only in the states of São Paulo, Paraná and Santa Catarina. On January 23, 2001, we entered into a strategic agreement with Telefónica Móviles to create a new mobile services company in Brazil to which we and Telefónica Móviles contributed our respective investments in the mobile telecommunications sector in Brazil on December 27, 2002. The new mobile services company, Brasilcel, is positioned to be the leading provider of mobile telecommunications services in Brazil, with 13.7 million activated mobile telephones operating in eight states in Brazil that together guarantee over 70% of Brazil's gross domestic product, or GDP.

Although we transferred all of our interests in mobile telecommunications companies in Brazil to Brasilcel on December 27, 2002, our consolidated statements of income and cash flows for the year ended December 31, 2002 continued to fully consolidate TCP's results. However, our balance sheet as of December 31, 2002 proportionally consolidates all the assets and liabilities of Brasilcel. See "*Joint Venture with Telefónica Móviles in Brazil*". In addition, on December 27, 2002, TCP purchased the remaining 51% of the voting shares of Global Telecom, a mobile telecommunications company operating in the states of Paraná and Santa Catarina. In our consolidated statements of income and cash

flows for the year ended December 31, 2002, we continued to account for the results of operations of Global Telecom based on the equity method of accounting. However, TCP's balance sheet as of December 31, 2002, fully consolidates all the assets and liabilities of Global Telecom and accordingly our balance sheet proportionately consolidates all the assets and liabilities of Global Telecom. See " *Joint Venture with Telefónica Móviles in Brazil - Global Telecom*", below.

The diagram below presents, in a simplified way, the ownership structure of our mobile businesses:

We believe that as our mobile operations make new services available, the market for mobile telephone and other related services is providing an opportunity for further growth in both the number of mobile subscribers and their use of our mobile services. In May 2000, TMN, our Portuguese mobile operating company, launched Internet access by WAP through mobile handsets in Portugal. WAP service was launched in Brazil in June 2000. We expect our mobile operating companies to take advantage of other opportunities as services and network access infrastructures converge in the telecommunications industry. For example, in November 2000 we introduced in Lisbon and Oporto the general packet radio service system, or GPRS, with potential speeds in excess of 100 kb per second, and in October 2001 we launched such services in all other areas of Portugal and in April 2002 we entered into a GPRS roaming service agreement with Telefónica. Systems like GPRS enable mobile operators to offer "always on" connection to Internet services. We introduced similar mobile services in Brazil in December 2001. The higher speeds resulting from increased capacity will enable us to offer advanced Internet-related services over mobile phones. In May 2002, we launched Multimedia Message Services (MMS), which combine picture and sound messages and we believe that these services will increase our revenues. We also believe that third generation mobile services in Portugal, where we have been awarded a license to provide these services, will represent an additional important opportunity for our mobile business. See " *TMN in Portugal*".

TMN in Portugal. TMN, our Portuguese mobile operating company, is the leading provider of mobile voice, data and Internet services in Portugal in terms of the number of activated mobile telephone cards connected to its network and by revenues, margins and profits.

Operating revenues from TMN amounted to €1,266.6 million in 2002, €1,171.9 million in 2001, and €994.3 million in 2000. Mobile services have undergone extraordinary growth in recent years in Portugal. At December 31, 2002, there were approximately 82.5 activated mobile telephone cards per 100 Portuguese inhabitants. This was more than the number of wireline main lines per 100 Portuguese inhabitants at December 31, 2002, which was 41.9.

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The table below provides statistical information relating to TMN.

	As of December 31,				
	1998	1999	2000	2001	2002
<i>TMN Portugal</i>					
Number of subscribers (thousands)	1,426	2,115	2,939	3,905	4,426
Subscribers growth per annum (%)	87	48	39	33	13
Number of subscribers per 100 inhabitants (including competitors' subscribers)	31	47	67	77	83
Estimated market share by number of subscribers %(1)	46.4	45.3	44.1	49.0	51.9
Churn rate %(2)	24.9	28.3	26.1	23.5	25.3
Number of employees	735	930	1,019	1,194	1,192

(1) Source: ANACOM and TMN.

(2) TMN defines the "churn rate" as the percentage of TMN mobile subscribers that end their use of TMN's mobile services either by terminating their service or by changing their mobile handset and card number without terminating their existing TMN service. The period after which a non-active, pre-paid mobile subscriber's service is terminated is either three months after the last call made or received or six months after the last recharge, depending upon the pre-paid service.

Services. TMN provides GSM mobile telephone services. GSM is a European and worldwide mobile telephone standard using digital technology. Through roaming agreements, TMN's subscribers can use GSM to make and receive mobile calls throughout Europe and in many other countries.

TMN provides GSM services in the 900 MHZ and 1800 MHZ band spectrums. TMN began to offer GSM 1800 services in May 1998 in addition to the GSM 900 service it already offered. TMN's strategy has been to use GSM 1800 services to offer an increased number of channels in high traffic density areas. Dual-band handsets, which select available channels from each frequency band, enable users to benefit from the wider range of available channels.

During 2000, 2001 and 2002, TMN continued to introduce new products and services, such as:

VPN (Virtual Private Network) services for corporate subscribers;

Direct Voice Interconnection (DVI), which provides interconnection of a mobile subscriber's telecommunications network to a TMN switch;

"TMN Regional", which provides discounts of 50% to fixed network numbers within the same fixed telephony billing zone;

"TMN Multi" and "TMN Familiar", which offer discount packages to groups;

"Pako", a prepaid card which has no monthly subscription, no obligatory charge and a bonus on calls received;

Hi-Pack product package, which allows customers to purchase a mobile handset with a 24-month contract at competitive prices and several upgrade products in exchange for older mobile handsets;

WAP services, including "Bolsa on-line" (providing share price information), together with sapo.pt;

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"MyTMN", personalized internet and data services which offer text messaging, WAP and voice-based services that can be customised by each subscriber;

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"TMN Empresas", which was launched in the third quarter of 2001 and provides services for corporate customers, such as marketing and technical assistance services, in cooperation with our pme.link.pt portal;

the first SMS InterWorking agreement, an interconnection agreement (February 2002);

"DataXpress", a wireless data compressed transmission service using GPRS technology;

opening of the second TMN Megastore, in Oporto, which sells products and services of TMN;

first public demonstration of mobile videotelephony service, using a UMTS network (May 2002);

corporate solutions to SOHO customers in partnership with pme.link;

MMS services, or multimedia messages, which combine picture and sound (May 2002);

GPRS roaming service, launched in partnership with Telefónica (April 2002);

"Spik" products, a mobile phone with a competitive package of minutes; and

"Roaming Zone", a roaming service package for post paid customers.

TMN is also developing services in wireline to mobile convergence, such as a voicemail service, which allows mobile telephone users to retrieve voicemail messages from their fixed-line telephones through mobile telephone handsets with PT Comunicações. TMN also offers a range of Internet-access and multimedia services, such as Internet access service through WAP mobile handsets. This service, available to every TMN subscriber, including users of all prepaid services, allows subscribers to access the Internet through their handsets. In August 2001, TMN launched the "MyTMN" platform, offering personalized Internet and data services, enriched with content and services supplied by new partners. MyTMN allows users to customize a wide range of WAP, SMS and voice-based services. WAP customers can access webmail, agenda, stock exchange information, location-based services, easy messaging, on-line tickets and chat services. TMN invoices its customers for the use of TMN services and remits to its partners a percentage of the total fees collected that corresponds to the content and services supplied by such partners.

MyTMN's new range of offering has introduced new services such as Logos & Ring Tones (also polyphonic), Multimedia Messaging (including the ability to send to customers of other operators), Java Games and My Message 4u (a service that allows customers to personalize the welcome message or other voice messages (with music, dedications or jokes). At MyTMN, customers can also create their own MMS Album, with holiday souvenirs, cards and similar items.

We expect data-service usage to grow considerably as customers become increasingly familiar with MyTMN, as service offering is further expanded and as access speed is increased through the introduction of GPRS. We also expect higher data speeds to improve performance and the attractiveness of the MyTMN package of products, which we expect will result in a higher contribution of data services to overall revenues in the future.

TMN introduced its GPRS system at the end of 2000 in Lisbon and Oporto and launched it at the beginning of October 2001 in all other areas of Portugal. See " *Network and Capital Investment*". GPRS provides higher speed data communications than GSM networks. TMN expects the introduction of GPRS to improve its existing WAP services. In addition, GPRS allows TMN to provide "always on" connection to Internet services. To use this service, subscribers must purchase new mobile handsets that are able to carry GPRS services. TMN's allocation of such handsets has been sufficient to meet demand during the initial roll out of its GPRS service. TMN had direct investment of €10.9 million in 2000, €11.7 million in 2001 and €5.5 million in 2002, in building out its GPRS system. TMN believes that introducing GPRS is an important step towards developing third generation mobile services.

At the end of 2000, the Portuguese government opened a tender for four licenses for third generation mobile services, also known as universal mobile telecommunications services or UMTS. TMN received one of these licenses and paid an up-front fee of €100 million. Licenses were also awarded to Oniway, a new entrant in the Portuguese mobile market, Vodafone Telecel and Optimus. However, subsequent to an agreement with the other three mobile operators in Portugal, including TMN, Oniway decided not to participate in the provision of third generation mobile services and as a result requested that the Portuguese government repeal the license granted to it in December 2000. The Portuguese government granted this request by ministerial order on January 13, 2003. The other three recipients of third generation licenses, including TMN, requested that the additional frequency that had been allocated to Oniway be reallocated to them. This request was granted by a special ministerial order in January 2003. See " *Regulation Portugal Third Generation Mobile Services Licenses*". Under the agreement entered into with Oniway referred to above, TMN, Vodafone and Optimus agreed to pay Oniway an amount of €33 million each for certain intangibles held by Oniway related to UMTS launch preparations upon the reallocation to them of the frequency that had been equally allocated to Oniway.

We expect the development of third generation services to require certain additional investments by TMN. TMN made direct investments of €12.4 million in 2001 and €38 million in 2002 in building out its third generation network. In addition, TMN paid spectrum fees in 2002, 2001 and 2000 of €29 million, €25 million and €19 million, respectively, for the use of its 900 MHz and 1800 MHz GSM network.

ANACOM reviewed the situation regarding the availability of handsets and related software for UMTS services during the third quarter of 2002 and has postponed the mandatory initiation of third generation services for all holders of UMTS licenses until December 31, 2003. We expect to be able to make a decision about the deployment of new services based on commercial grounds as well as on applicable ANACOM requirements.

Subscribers and Traffic. TMN is the market leader in mobile services in Portugal. At December 31, 2002, TMN had approximately 4.4 million subscribers, representing an increase of 13.3% from December 31, 2001. At December 31, 2002, TMN's subscribers represented 51.9% of the total mobile subscribers in Portugal. During 2001 and 2002, TMN also captured a greater proportion of the market increase in terms of net subscriber additions than its competitors, enabling it to maintain its position as the market leader. During 2002, TMN's share of new mobile subscribers (net additions) was 53.4%. Over the course of 2002, TMN's churn rate, which means the percentage of TMN mobile subscribers that ended their use of TMN's mobile services either by terminating their service or by changing their mobile handset and card number without terminating their existing TMN service, was 25.3%. TMN's churn rate was 23.5% in 2001.

In addition to the increase in the number of subscribers, mobile usage grew during 2002. TMN's voice traffic in terms of minutes grew by approximately 15.1% to 6.413 billion minutes in 2002, compared to 5.572 billion minutes in 2001. Average monthly usage per subscriber decreased 5.1% to 130.5 minutes in 2002, compared to 137.4 minutes in 2001. Traffic from data transmission, such as SMS and WAP services, increased by 22.5% and 18.5%, respectively, during 2002 in terms of number of calls. There was an average of 24.8 SMS messages per month per user in 2002, 4% less than the average of 25.9 SMS messages per month per user in 2001.

Prices and Revenue Breakdown. We believe that mobile services in Portugal are priced lower than the European average and are among the lowest in Europe. Mobile telephone charges are not regulated. Traffic charges, sales of handsets and connection and subscription fees represented approximately 87.4%, 9.6% and 3.0%, respectively, of TMN's revenues in 2002, and approximately 84.4%, 12.5% and 3.2%, respectively, of TMN's revenues in 2001. Since May 2003, monthly

subscription fees range from €9.50 to €38.00, excluding VAT. TMN no longer charges an initial connection fee. TMN currently has many different price plans for its mobile telephone services.

Products and Marketing. TMN offers a variety of innovative subscriber-oriented products. It was the first operator in the world to offer pre-paid services. TMN's prepaid and discount products have been popular. We estimate that at the end of 2002, approximately 83.6% of its

subscribers were using TMN's prepaid products. TMN has been expanding its subscriber base through increased advertising and the use of its own distribution network. TMN markets its services through more than 1,850 points of sale, including our group's and TMN's sales forces, Portugal Telecom retail shops, TMN shops, supermarket chains and independent dealers. PT Prime also markets TMN's services to corporate subscribers. TMN has been trying to encourage the use of mobile services more broadly in the middle and high end of the market and to increase subscriber retention in this market segment. By focusing on the business segment of the market, TMN experienced a 13.8% increase in the number of postpaid subscribers in 2002.

Network and Capital Investment. In recent years, TMN has made significant investments in base stations throughout Portugal for its GSM 900 and GSM 1800 services. As a result of its investments, TMN has a technologically advanced high capacity network that provides extensive coverage across Portugal. As of the end of 2002, TMN's digital network had 3,799 base stations, including 303 base stations added during 2002. These stations covered more than 95% of continental Portugal and 98% of the Portuguese population. The addition of the GSM 1800 band has substantially increased TMN's network capacity in heavily used areas. By the end of December 2002, TMN had installed GSM 1800 technology in 743 base stations. TMN has offered GPRS services, which allow for "always on" data access, such as an Internet connection through a mobile handset, on its mobile network since it introduced them at the end of 2000 in Lisbon and Oporto and October 2001 in all other areas of Portugal. TMN also is focusing on improving its indoor coverage in larger metropolitan areas. In 2002 TMN introduced MMS.

Roaming. Roaming agreements between operators allow their subscribers to make and receive voice calls automatically, send and receive data, or access other services when traveling outside the geographical coverage area of the home network, by using a visited network. As of the end of 2002, TMN had entered into roaming agreements with a total of 248 operators in 143 countries. Since November 2000, it has been possible for Telesp Celular subscribers to use TMN's network in Portugal and TMN's roaming partners' networks. At the same time, TMN's subscribers can use Telesp Celular's network in Brazil and TCP's Brazilian roaming partners' networks, in each case with a handset and mobile telephone card that is compatible with the network. In April 2002 TMN entered into a GPRS roaming agreement with Telefonica.

Equipment Sales. TMN sells mobile phones and related equipment in Portugal. Equipment sales generated operating revenues of €134 million in 2002, €164 million in 2001 and 153 million in 2000.

Joint Venture with Telefónica Móviles in Brazil. On January 23, 2001, we entered into a strategic agreement with Telefónica Móviles to create a mobile joint venture company in Brazil to aggregate all of our combined mobile assets in Brazil to the extent permitted under Brazilian law. The strategic agreement was approved by the European Commission on March 13, 2001. ANATEL, the Brazilian telecommunications regulator, advised us in May 2001 that the joint venture could be formed provided that neither we nor Telefónica Móviles could transfer to the mobile joint venture company more than 19.99% of the ordinary shares with voting rights of the mobile service companies controlled by us and Telefónica Móviles in Brazil. This limitation was applicable until such time as the mobile service companies to be contributed to the mobile joint venture company migrated from the SMC regime to the SMP regime. See " *Regulation Brazil Competition Issues.*" On December 10, 2002, ANATEL formally approved the migration of our Brazilian mobile subsidiaries from the SMC regime to the SMP

regime and the transfer of all of our direct and indirect interests in Brazilian mobile services companies to the mobile joint venture company.

On December 27, 2002, PT Móveis, which holds our interests in Brazilian mobile services companies, and Telefónica Móviles transferred their direct and indirect interests in Brazilian mobile services companies to the joint venture company, named Brasilcel. Portugal Telecom and Telefónica Móviles transferred to Brasilcel all their interests in:

TCP, which controls Telesp Celular (the band A operator in the state of São Paulo) and Global Telecom (the band B operator in the states of Paraná and Santa Catarina), was contributed by us and Telefónica Móviles;

Tele Sudeste Celular Participações, S.A., which controls Telerj Celular, S.A. (the band A operator in the state of Rio de Janeiro and Telest Celular, S.A. (the band A operator in the state of Espírito Santo), was contributed by Telefónica Móviles;

Tele Leste Celular Participações, S.A., which controls Telebahia Celular, S.A. (the band A operators in the state of Bahia) and Telerpipe Celular, S.A. (the band A operator in the state of Sergipe), was contributed by Telefónica Móviles; and

Celular CRT Participações, S.A., which controls CRT Celular, S.A. (the band A operator in the state of Rio Grande de Sul), was contributed by Telefónica Móviles (which had a controlling position) and by us.

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Brasilcel is the leading mobile company in Brazil, with approximately 13.7 million customers and a potential market of more than 94 million people. The joint venture operates in areas which provide more than 70% of Brazil's GDP and in its areas of operation it has an estimated market share of more than 60%. We believe that the joint venture will facilitate our ability to serve our Brazilian subscribers on a seamless basis throughout Brazil. We intend Brasilcel to develop and use its own overall brand. Brasilcel launched a new brand called Vivo in April 2003. We expect to benefit from synergies in various areas, including marketing, promotional activities, distribution networks, call center management, network management and operations, information technology, procurement and support functions, as well as the deployment of new mobile data services for business users. We believe that the joint venture will enable us to respond more effectively to increased competition from existing operators, such as OI, Telecom Americas, Telecom Italia Mobiles and Brasil Telecom, and from other mobile operators in the markets we serve.

We have described the arrangements by which we and Telefónica Móviles own and manage the joint venture and related issues below in " *Strategic Alliances Alliance with Telefónica*". We have described certain regulatory restrictions applicable to Brasilcel and its subsidiaries which result from their relationship with Telefónica, including the inability of Brasilcel and its subsidiaries to provide wireline long distance services in Brazil, below in " *Regulation Brazil SMP Regulation*". See also " *Item 3 Key Information Risk Factors The Conditions Applying to Brasilcel's Subsidiaries Under the New SMP Licensing Regime may Result in Reducing Our Revenues and Results of Operations*".

Acquisition of TCO

On April 25, 2003, TCP acquired 61.10% of the voting capital stock of Tele Centro Oeste Participações, S.A., or TCO, for approximately R\$1,506 million, corresponding to approximately R\$19.49 per each lot of 1,000 shares acquired. At the date hereof, TCP has paid R\$284.7 million of the total amount and the remaining will be paid in installments. TCO is an A Band operator providing cellular telecommunications services in the Federal District of Brazil, as well as in the Brazilian states of Goiás, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and Tocantins. The agreement also included the acquisition of TCO's B Band subsidiary NBT, which provides cellular telecommunications services in the Brazilian states of Amapá, Amazonas, Maranhão, Pará and Roraima.

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On May 25, 2003, TCP made a request to launch a tender offer for the voting shares of the remaining minority shareholders of TCO, as legally required by the acquisition of control of TCO. The request is currently being considered by CVM. The price per share to be offered will be 80% of the price paid to the controlling shareholders. After the acquisition and the tender offer, TCP expects to merge TCO shares and ADSs into TCP. With the acquisition of its participation in TCO, Brasilcel provides services to approximately 50% of the total Brazilian market, representing coverage of 86% of the Brazilian territory.

TCP and Telesp Celular

Telesp Celular Operating information	2000	2001	2002
Cellular lines in service at year-end (in thousands)	4,302	5,104	6,060
Customer growth during year	48.7%	18.6%	18.7%
Prepaid lines in service at year-end (in thousands)	2,698	3,735	4,634
Churn(1)	14%	20%	17%
Estimated population of authorization area at year-end (million)(2)	37.1	37.7	38.3
Estimated covered population at year-end (millions)(3)	36.4	36.7	37.2
Percentage of population covered(4)	98.1%	97.3%	97.1%
Penetration at year-end(5)	18.0%	21.0%	23.8%
TCP Financial information(6)			
Net operating revenues (in millions of Reais)	2,766.7	2,946.2	3,390.6
Net Income (loss)(in millions of Reais)	152.2	(1,113.6)	(1,140.8)
Total assets (in millions of Reais)	6,204.0	6,872.2	9,654.4

(1) Churn is the number of customers that leave us during the year, calculated as a percentage of the simple average of customers at the beginning and the end of the year.

(2)

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Projections based on estimates of the Instituto Brasileiro de Geografia e Estatística IBGE and Target 2002 "Brasil em Foco".

- (3) Number of people within the region that can access the cellular telecommunications signal.
- (4) Percentage of the population in the region that can access the cellular telecommunications signal.
- (5) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (6) Data taken from the consolidated financial statements prepared under Brazilian GAAP, which include the results of Global Telecom recorded by the equity method of accounting.

Telesp Celular is part of our mobile joint venture with Telefónica and is 100% owned by TCP. Telesp Celular is the leading mobile telephone operator in the Brazilian state of São Paulo and in Brazil. São Paulo has a population greater than 38 million people and is the most economically developed state in Brazil. The state of São Paulo contributes around 35% of Brazil's GDP. As of December 31, 2002, mobile penetration in the state of São Paulo was 23.8%, compared to 19.8% in the rest of Brazil. Telesp Celular's operating revenues were R\$3,390.6 million in 2002, R\$2,946.2 in 2001 and R\$2,766.7 million in 2000.

We initially invested in TCP in 1998. Currently TCP owns 100% of the ordinary and preferred shares of Telesp Celular. At the time of our initial investment in TCP, we also invested in Telecomunicações de São Paulo S.A. Telesp, also known as Telesp Fixa, the wireline operator in the state of São Paulo. In November 2000, after ANATEL'S approval we exchanged our interest in Telesp Fixa for Telefónica's interest in TCP. TCP completed a one-for-ten rights offering on November 7, 2000. TCP undertook this capital increase to prepare its financial condition to allow for future

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investments and raised R\$1,125 million in the capital increase. We subscribed for additional shares in the rights offering at a total price of approximately R\$1,322.9 million. In May 2001, we announced our intention to conduct a tender offer for all of the outstanding securities of TCP that we did not already own. We made our initial filing relating to the tender offer with the U.S. Securities and Exchange Commission and the Brazilian securities commission in July 2001. Due to conditions in the global capital markets, we withdrew our tender offer in September 2001.

On March 11, 2002, TCP announced its intention to undertake an overall capital increase of its common and preferred shares, including preferred shares underlying its ADSs. As part of this overall capital increase, TCP offered holders of its preferred shares rights to subscribe for new preferred shares, holders of its ADSs rights to subscribe for new ADSs and holders of its common shares rights to subscribe for new common shares. TCP successfully completed its rights offering in September 2002, which generated proceeds of R\$2,403 million.

Portugal Telecom subscribed to a total of 247,224 million common shares and 326,831 million preferred shares in the rights offering. As a result, as of September 2002, we owned 93.7% of TCP's common shares and 49.8% of TCP's preferred shares, representing an economic interest of 65.12%. In October 2002, in connection with the formation of the joint venture, we sold a 14.68% stake in TCP to Telefónica Móviles, reducing our economic interest in TCP to 50.44%. On December 27, 2002 we transferred the rest of our interest in TCP to Brasilcel. We now hold our interest in TCP, as well as our interest in the other mobile services companies that were transferred to Brasilcel, indirectly, on a 50/50 basis with Telefónica Móviles.

In February and July 2001, TCP acquired an 81.61% indirect economic interest in Global Telecom, through the acquisition of 49% of the voting shares and 100% of the non-voting shares of each of three holding companies that controlled Global Telecom. The total purchase price was R\$902.6 million. On December 11, 2002, after all of the TCP operators had switched over to the new SMP regulatory licensing regime, ANATEL approved TCP's acquisition of the remainder of the shares and, on December 27, 2002, TCP acquired the remaining 51% of the voting shares of the three holding companies that own Global Telecom for US\$82.0 million. TCP now owns 100% of the voting and non-voting shares of Global Telecom.

Services. Telesp Celular provides cellular telecommunications services using both digital and analog technologies. Its digital service is based on the CDMA standard. Telesp Celular started providing digital services in the São Paulo metropolitan area in November 1998. Telesp Celular also provides analog service using a technology standard called Advance Mobile Phone Service, or AMPS, in the frequency of 850 MHz. Telesp Celular provides ancillary services, including voicemail and voicemail notification, call forwarding, three-way calling, caller identification, short text messaging for digital network subscribers (Torpedo) and wireless Internet access (Waaap) under the wireless

application protocol, or WAP. Telesp Celular offers these services to both post-paid and prepaid customers.

In June 2000, Telesp Celular launched mobile Internet access using WAP, under the name "Waaap". Its CDMA subscribers can now access Internet pages on their cellular phone display. They can also send and receive e-mails, use search engines, play games and access the banking system and other Internet based services and applications. Through Telesp Celular's "Waaap" PAG service, its CDMA subscribers can also conduct secure micropayments, or small value payment transactions, through their WAP-enabled mobile handsets. Subscribers who subscribe to the Baby and Peg & Fale prepaid plans are now able to recharge their prepaid minutes directly through their handsets. The "Waaap" PAG service plans to offer subscribers the ability to purchase a wide variety of products and services, such as movie tickets and gasoline, from their WAP-enabled handsets. At December 31, 2002, more than 46% of Telesp Celular's total subscribers already had WAP-enabled handsets and more than 13% of these had already accessed "Waaap" at least once.

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In September 2001, Telesp Celular launched a line of products focused on providing mobile telephone solutions to small and medium-sized enterprises and large corporate subscribers called "Telesp Celular Empresas".

Telesp Celular began to offer 2.5G services using CDMA 1XRTT technology in December 2001, enabling it to provide high speed packet data service by increasing potential data transmission speeds from current Waaap circuit switched at 14.4 kb per second to packet switched at up to 144 kb per second. Telesp Celular's current commercial pilot program has an average speed of approximately 100 kb per second, ranging from a low of 60 kb per second to a high of 144 kb per second. Building on its 2.5G network, Telesp Celular offered three types of high speed data services: "Waaap Turbo," which provides access to existing Waaap services from 2.5G cellular phones and bills subscribers according to the amount of information transferred (Kbytes) rather than on a per minute basis; "Zaaap," which offers direct access to the Internet through either PCMCIA cards designed to connect compatible PDAs and laptops to 2.5G service or through 2.5G cellular phones by cable connection; and "Zaaap VPN," which offers corporate subscribers secure access to their intranet and office resources. Waaap Turbo, Zaaap and Zaaap VPN subscribers are billed monthly and their subscriptions include the transfer of a certain amount of megabytes for free. The names of these services have changed to reflect the launch of the new trademark Vivo in 2003.

Telesp Celular offers roaming services, through agreements with local cellular service providers throughout Brazil and other countries that allow its subscribers to make and receive calls while out of its concession areas. Telesp Celular provides reciprocal roaming services to subscribers of those cellular service providers while they are in its concession areas. See " *Roaming*".

Subscribers and Traffic. At the end of 2002, Telesp Celular had approximately 6.1 million subscribers. Approximately 64% of its subscribers were in metropolitan São Paulo, and 36% of them were elsewhere in the state. At the end of 2002, approximately 98% of Telesp Celular's subscribers used digital services, an increase of 4.2 percentage points compared to 2001. Telesp Celular's subscriber numbers have grown significantly in recent years. During 2002, its subscriber base increased by approximately 18.7% and during 2001 by 18.6%. This growth was supported by the launch of new products and services, including prepaid products and new messaging services, as well as the growth of the network's digital capacity, the improvement of activated mobile telephone information and subscriber care systems, marketing campaigns and promotions and the restructuring and expansion of the sales network.

In 2002, 2001 and 2000, Telesp Celular's churn rate was 17%, 20% and 14%, respectively.

There remains significant room for further growth of mobile services in the state of São Paulo, which had approximately 24 subscribers per 100 persons in the area at December 31, 2002, compared to approximately 21 subscribers per 100 persons at December 31, 2001. We expect the number of subscribers in the state of São Paulo to grow, perhaps significantly, over the next several years.

Marketing. During 2002, Telesp Celular continued to invest in the expansion of its subscriber base and in the increase of its penetration rate, building on the increased capacity made available by its intensive investment program during 2000, 2001 and 2002.

In 2001, Telesp Celular launched the prepaid service, "Peg & Fale Go1", which is directed to football fans in the state of São Paulo. Telesp Celular also launched the prepaid service "Baby MTV", which is directed to teenagers. The "Baby MTV" handsets have headphones for listening to the radio.

Telesp Celular kept its focus on profitable growth and customer value in 2002, with an emphasis on investment returns. It implemented a new model for service and client management (call center and marketing) on the basis of segmentation by client profitability in 2001, and in 2002 targeted increased loyalty and focused on customer retention. In 2002, Telesp Celular initiated a plan targeted at younger segments of the population and other plans designed to increase the use of its SMS service, known as

Coisa, which offers users a 50% discount on local calls between Telesp Celular handsets in its region from Monday through Friday, from 8 p.m. until 8 a.m. and during the weekends. Customers using this plan may also choose one Telesp Celular number, register the number, and obtain a 50% discount on local calls for any time of the day. In 2002, Telesp Celular developed several campaigns for prepaid clients, including the *Carrega Brasil* promotion during the World Cup.

Telesp Celular divides its market into business and individual subscribers. It promotes its services to large corporations through a major accounts program through which it identifies, contacts and supports corporate subscribers. It services its small and medium-sized enterprise customers through a direct sales force. It markets its services and provides after-sales service through a network of stores. In December 2002, the network included 2,345 points-of-sale stores, covering substantially all of the cities in its authorization areas. It operated 65 stores, with the remaining stores being operated by 2,280 independent distributors.

Telesp Celular's marketing efforts for Internet-based services have been primarily focused on increasing usage and number of subscribers to its Waaap services and applications. Its marketing and sales efforts have resulted in a more than 2.8 million subscribers with WAP enabled handsets. In addition, partnerships with leading Brazilian content and service providers and its open portal approach have promoted a steady use of Waaap services.

The names of the services will change to reflect the launch of the new Vivo trademark in 2003.

Network and Capital Expenditures. At December 31, 2002, Telesp Celular's mobile telecommunications network covered 76% of the municipalities, representing 97% of the population of its authorization areas. Its network provides both CDMA and AMPS services and included 51 mobile switches, 322 signal repeaters and 2,920 base stations in 2,244 sites as of year-end 2002. Telesp Celular is continuing to increase the capacity of its network and its coverage to improve its services and to meet demand from subscribers.

Prior to November 1998, Telesp Celular's network used only AMPS analog technology. After the privatization of Telesp Celular in 1998, it installed CDMA digital technology in the metropolitan area of São Paulo, and by December 2002, its network covered 76% municipalities, representing approximately 97% of the population of its concession areas.

The network is connected primarily using fiber-optic transmission capacity that Telesp Celular leases from Telesp Fixa, the wireline operator in the state of São Paulo. Telesp Celular maintains network administration centers in São Paulo that monitor the base stations, switching centers and all critical network operational parameters. Its principal suppliers of cellular telecommunications equipment include NEC, Nortel, Motorola, Lucent and Ericsson.

Telesp Celular made capital expenditures (including capitalized interest) of R\$327.2 million in 2002, R\$936.8 million in 2001 and R\$784.0 million in 2000.

Interconnection Charges. Telesp Celular earns revenues from calls that originate from another mobile or wireline service provider's networks connecting one of its customers. Telesp Celular charges the service providers from whose network the call originates a network usage charge for every minute that its network is used in connection with the call. Telesp Celular's average interconnection charges for 2000, 2001 and 2002 were R\$0.1964, R\$0.2407 and R\$0.2670 per minute net of value-added taxes, respectively. In February 2003, ANATEL authorized the increase of Telesp Celular's tariff per minute to R\$0.3296. Mobile operating companies, once authorized to increase the tariff, are now obligated to grant a 30% discount on certain tariffs for local calls during off peak hours originating, in the case of Telesp Celular, with Telesp Fixa.

Bill and Keep. Under the SMP system, usage of the network remuneration between SMP mobile operators will only be due if traffic carried in the same registration area between two networks, in a

given direction, exceeds 55% of the total traffic exchanged between them. In this case, only those calls which have surpassed the 55% threshold will be subject to payment for network usage. This rule is valid until June 30, 2005. Thereafter, SMP operators will adopt full Bill and Keep, by which no remuneration will be due for network usage among SMP networks, regardless of the amount of carried traffic.

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Roaming. Telesp Celular has agreements pertaining to automatic roaming with all cellular CDMA/TDMA service providers in Brazil and with some wireless service operators abroad. These contracts allow its subscribers to access the network of other cellular service providers when traveling outside its coverage area without having to change their handsets or mobile numbers. Telesp Celular provides reciprocal services to subscribers of other cellular service providers when they are within its coverage area. The agreements require the contracting parties to provide service to roaming subscribers on the same basis as they provide service to their own subscribers. Roaming charges are reconciled monthly.

Automatic roaming services are offered in most of the United States, Canada, Mexico, the Caribbean and Mercosul, providing coverage in more than 3,000 cities. In 2001, Telesp Celular signed a new roaming agreement with operators in Japan, Korea, China and New Zealand, allowing expansion of automatic roaming to Asia and Oceania. In over 100 countries in Europe, Asia, Africa and Oceania that use the GSM standard, Telesp Celular's subscribers have access to roaming using their own mobile numbers, although they must use GSM handsets supplied by Telesp Celular. Telesp Celular provides a similar service in Brazil for TMN cellular subscribers.

Equipment Sales. Telesp Celular sells dual-mode and tri-mode cellular handsets and PCMCIA boards through its own sales distribution channels. Although Telesp Celular still has some subscribers using analog service (approximately 2.4% of its total subscriber base at December 31, 2002), it has implemented a series of actions, such as providing discounts on digital handsets, discounts on monthly fees for digital services, digital handset rentals and free digital handsets to its high-value subscribers, to encourage analog subscribers to migrate to digital service. Net revenues from sales of handsets and accessories were R\$470.4 million in 2002, R\$467.5 million in 2001 and R\$790.2 million in 2000.

License. Telesp Celular provides mobile telecommunications services on a frequency range known as band A in two authorization areas, covering approximately 248,209 square kilometers or approximately 3.0% of Brazil's territory. The authorization areas have more than 38.3 million people, representing 22% of Brazil's population, and 63 municipalities with populations in excess of 100,000, including the largest city in Brazil, the City of São Paulo, with more than ten million people. In 2002, income per capita in the state of São Paulo was approximately R\$12,056 per annum, and the state generates approximately 35% of Brazil's GDP.

As from December 6, 2002, Telesp Celular operates in its authorization areas pursuant to SMP licences granted by ANATEL. Under the new SMP regime, Telesp Celular converted its former concessions to new SMP licenses. These SMP licenses have substantially the same terms and conditions as the other new SMP licenses issued under the new regime, although certain terms of Telesp Celular's former concessions, such as limits on prices charged to subscribers under its postpaid service plan (the Basic Plan), continue to apply despite conversion to SMP licences. Conversion to SMP licences offers Telesp Celular greater flexibility in setting its prices, particularly its interconnection fees, even though Telesp Celular is now limited by the price caps established in its former concession agreements until June 30, 2004.

By converting its concessions to SMP licences, Telesp Celular will be required to introduce carrier selection on its network to give its subscribers the choice to use another carrier for long distance and international calls. The introduction of carrier selection will increase the competitive pressures on Telesp Celular's business. In addition, because the SMP regime permits commercial negotiation of the

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interconnection rates it charges to wireline operators, Telesp Celular may be forced to reduce such rates in the future. Telesp Celular's SMP licences expire on the same date as the concessions were to have expired (August 2008). Telesp Celular has the same right to apply for renewal as other SMP license holders that migrate to the SMP regime from their existing concession.

Management. TCP's Board of Directors has eleven members, five elected by Portugal Telecom, five by Telefónica and one elected by minority shareholders, pursuant to Brazilian corporate law. Portugal Telecom elects the Chief Executive Officer and Telefónica elects the Chief Financial Officer.

Prior to 2002, Portugal Telecom received an annual management fee from TCP and expects to receive this year the annual fee in respect of 2002. With the establishment of Brasilcel, Portugal Telecom will no longer receive such an annual management fee from TCP. This management fee had a fixed component and a performance-related component. Under the performance-related element, Portugal Telecom received a higher fee if TCP's financial results and share price increased by more than a minimal amount. The management fee varied but was not permitted to exceed 2% of TCP's net operating revenues from its services.

Global Telecom

2000 2001 2002

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<i>Global Telecom</i>	2000	2001	2002
Cellular lines in service at year-end (in thousands)	463	862	1,177
Customer growth during year	282%	86%	36.5%
Prepaid lines in service at year-end (in thousands)	110	539	924
Churn(1)	16%	23%	20%
Estimated population of authorization area at year-end (millions)(2)	14.9	15.1	15.3
Estimated covered population at year-end (millions)(3)	8.9	10.6	11.0
Percentage of population covered(4)	60%	71%	74%
Penetration at year-end(5)	13%	17%	19%
Net operating revenues (in millions of <i>Reais</i>)(6)	246.7	425.9	512.2
Net Income (in millions of <i>Reais</i>)(6)	408.1	(856.1)	(771.1)
Total assets (in millions of <i>Reais</i>)(6)	1,752.4	2,632.8	2,383.6

- (1) Churn is the number of customers that leave Global Telecom during the year, calculated as a percentage of the simple average of customers at the beginning and the end of the year.
- (2) Projections based on estimates of the Instituto Brasileiro de Geografia e Estatística IBGE and Target 2002 "Brasil em Foco".
- (3) Number of people within the region that can access the cellular telecommunications signal.
- (4) Percentage of the population in the region that can access the cellular telecommunications signal.
- (5) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (6) Data taken from financial statements prepared under Brazilian GAAP.

Under the terms of Global Telecom's authorization from ANATEL, it operates in the states of Paraná and Santa Catarina. These two states have a combined population of approximately 15.3 million and together generate approximately 10% of Brazil's gross domestic product. The mobile phone penetration rate is approximately 19.4% in Paraná and Santa Catarina. As of December 31, 2002, Global Telecom's service area reached more than 74% of the urban population of those areas and Global Telecom had 1,177,000 subscribers, representing an estimated market share of 41% as compared to 862,000 subscribers as of December 31, 2001, representing an estimated market share of 35%. Global Telecom introduced pre-paid products in 2000 and made significant investments in 2001 and 2002 to expand the coverage of its network service, as well as to offer mobile data services with potential speeds of up to 14.4 kb per second.

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<i>Tele Sudeste Celular Participações</i>	2000	2001	2002
Cellular lines in service at year-end (in thousands)	2,503	3,028	3,455
Customer growth during year	35.2%	21.0%	14.1%
Prepaid lines in service at year-end (in thousands)	1,549.2	2,023.3	2,368.2
Churn(1)	33.3%	17.9%	18.2%
Estimated population of authorization area at year-end (millions)(2)	17.5	17.9	18.0
Estimated covered population at year-end (millions)(3)	15.8	15.3	15.8
Percentage of population covered(4)	90.5%	85.9%	87.4%
Penetration at year-end(5)	23.7%	27.7%	32.7%
Net operating revenues (in millions of <i>Reais</i>)(6)	1,528.6	1,703.3	1,847.6
Net Income (in millions of <i>Reais</i>)(6)	121.9	162.9	140.4

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<i>Tele Sudeste Celular Participações</i>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Total assets (in millions of <i>Reais</i>)(6)	2,696.2	2,690.6	2,812.1

- (1) Churn is the number of customers that leave Telerj Celular and Telest Celular, taken together, during the year, calculated as a percentage of the simple average of customers at the beginning and the end of the year.
- (2) Projections based on estimates of the Instituto Brasileiro de Geografia e Estatística IBGE and Target 2002 "Brasil em Foco".
- (3) Number of people within the region that can access the cellular telecommunications signal.
- (4) Percentage of the population in the region that can access the cellular telecommunications signal.
- (5) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (6) Data taken from financial statements prepared under Brazilian GAAP.

Tele Sudeste Celular Participações, or Tele Sudeste, holds 100% of Telerj Celular, the leading mobile telephone operator in the state of Rio de Janeiro and 100% of Telest Celular, the leading mobile operator in the state of Espírito Santo. These states have a combined population of approximately 18 million people and together contribute to around 13% of Brazil's GDP. As of December 31, 2002, mobile penetration in its authorization area was 32.7%, compared to 19.8% in the rest of Brazil. At December 31, 2002, Tele Sudeste had approximately 3.5 million cellular lines in service, of which approximately 2.4 million were prepaid. Tele Sudeste's consolidated operating revenues were R\$1,848 million in 2002, R\$1,703 in 2001 and R\$1,529 million in 2000.

<i>Tele Leste Celular Participações</i>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Cellular lines in service at year-end	674	822	973
Customer growth during year	25.6%	22.0%	18.3%
Prepaid lines in service at year-end	347.8	499.1	673.4
Churn(1)	22.1%	19.8%	25.5%
Estimated population of authorization area at year-end (million)(2)	14.8	15.1	15.1
Estimated covered population at year-end (million)(3)	9.1	9.3	9.5
Percentage of population covered(4)	62%	62%	63%
Penetration at year-end(5)	7.5%	8.9%	10.6%
Net operating revenues (in millions of <i>Reais</i>)(6)	332.6	386.3	431.4
Net Income (loss) (in millions of <i>Reais</i>)(6)	(9.5)	(6.0)	(5.1)
Total assets (in millions of <i>Reais</i>)(6)	914.5	861.5	958.0

- (1) Churn is the number of customers that leave Tele Leste Celular Participações during the year calculated as a percentage of the simple average of customers at the beginning and the end of the year.

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Projections based on estimates of the Instituto Brasileiro de Geografia e Estatística IBGE and Target 2002 "Brasil em Foco".

- (3) Number of people within the region that can access the cellular telecommunications signal.
- (4) Percentage of the population in the region that can access the cellular telecommunications signal.
- (5) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (6) Data taken from the financial statements prepared under Brazilian GAAP.

Tele Leste Celular Participações, or Tele Leste, holds 100% of Telebahia Celular, the leading mobile telephone operator in the state of Bahia and 100% of Telergipe Celular, the leading mobile operator in the state of Sergipe. These states have a combined population of approximately 1.5 million people and together contribute to around 5% of Brazil's GDP. As of December 31, 2002, mobile penetration in its authorization area was 10.6%, compared to 19.8% in the rest of Brazil. At December 31, 2002, Tele Leste had approximately 1.0 million cellular lines in service, of which approximately 0.7 million were prepaid. Tele Leste's operating revenues were R\$431 million in 2002, R\$386 million in 2001 and R\$332 million in 2000.

CRT Celular

	<u>2000</u>	<u>2001</u>	<u>2002</u>
Cellular lines in service at year-end (in thousands)	1,452	1,785	2,078
Customer growth during year	50.1%	22.9%	16.4%
Prepaid lines in service at year-end (in thousands)	889.2	1,206.3	1,466.4
Churn(1)	21%	17%	16%
Estimated population of authorization area at year-end (millions)(2)	9.8	10.0	10.1
Estimated covered population at year-end (millions)(3)	8.0	8.2	8.3
Percentage of population covered(4)	81%	82%	82%
Penetration at year-end(5)	21%	26%	31%
Net operating revenue (in millions of <i>Reais</i>)(6)	758.6	840.4	910.9
Net Income (in millions of <i>Reais</i>)(6)	60.0	102.9	147.6
Total assets (in millions of <i>Reais</i>)(6)	1,337.8	1,417.3	1,680.0

- (1) Churn is the number of customers that leave CRT Celular during the year, calculated as a percentage of the simple average of customers at the beginning and the end of the year.
- (2) Projections based on estimates of the Instituto Brasileiro de Geografia e Estatística IBGE and Target 2002 "Brasil em Foco".
- (3) Number of people within the region that can access the cellular telecommunication signal.
- (4) Percentage of the population in the region that can access the cellular telecommunication signal.
- (5) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (6) Data taken from financial statements prepared under Brazilian GAAP.

CRT Celular is the leading mobile telephone operator in the state of Rio Grande do Sul. The state of Rio Grande do Sul has a population of approximately 10 million people and contributes to around 10% of Brazil's GDP. As of December 31, 2002, mobile penetration in CRT Celular's authorization area was 31.2%, compared to 19.8% in the rest of Brazil. At December 31, 2002, CRT Celular had approximately 2.1 million cellular lines in service, of which approximately 1.5 million were prepaid. CRT Celular's operating revenues were R\$911 million in 2002, R\$840 million in 2001 and R\$758 million in 2000.

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Medi Telecom in Morocco. In August 1999, Medi Telecom, a consortium made up of Portugal Telecom, Telefónica Móviles and certain Moroccan entities, bid for and won a license to operate a GSM mobile network in Morocco. This was the second such license issued by the Moroccan government. The license fee was 9.0 billion Moroccan dirhams (€929 million). Medi Telecom entered into a €1 billion project financing facility. We initially held 34.5% of Medi Telecom, having invested approximately €166 million, but in January 2000 we sold 4% of our interest in compliance with a condition of the bid process for the same license. At the end of 2002, following a capital increase, Portugal Telecom raised its equity share to 31.34%, equal to Telefónica's position. Medi Telecom began operations at the end of March 2000. By the end of 2002, it had 1,600,470 subscribers, representing an estimated market share of approximately 41%. Approximately 93% of its activated mobile telephone cards are prepaid, a result of capitalizing on our experience in Portugal. We are managing the operations of Medi Telecom jointly with Telefónica Móviles.

Mascom Wireless in Botswana. We manage the operations of, and have a 50.01% interest in, Mascom Wireless, an international consortium that offers GSM services in Botswana. Mascom Wireless was the first operator of GSM services in Botswana and is currently the market leader with an estimated 71% market share as of December 2002. Mascom had approximately 278,000 subscribers, and it had gross operating revenues of €54 million for 2002, €53 million for 2001 and €48 million for 2000. We accounted for Mascom Wireless on an equity basis until the end of 1999, assuming an interest of 40%. Since January 1, 2000, we have fully consolidated its financial results.

Unitel in Angola. At the end of 2000, we acquired 25% of the share capital of Unitel, a GSM mobile operator in Angola. Unitel's other shareholders are Sonangol, which holds 25%, and local partners, which hold 50%, of the share capital of Unitel. We are the operational manager of the venture, which began operations in Luanda in April 2001. As of December 31, 2002, Unitel had 82,109 subscribers of which 99% were prepaid cards.

PT Multimedia

We provide multimedia services in Portugal through our subsidiary PT Multimedia and its subsidiaries. PT Multimedia's operating revenues were €640.3 million in 2002, €592.9 million in 2001 and €226.7 million in 2000.

Formation and Development. Portugal Telecom formed PT Multimedia in July 1999 and transferred to the new company certain of our cable and satellite pay-TV activities as well as our Internet-related activities focused on residential customers and the small-office and home-office and small and medium-sized enterprise markets, including:

our cable television pay-TV operations through cable and DTH satellite;

cable and direct-to-home satellite programming activities;

advertising sales;

the provision of Internet access; and

our minority stake in the leading Portuguese telephone directories business.

After an initial public offering of ordinary shares of PT Multimedia in November 1999, Portugal Telecom held 66.71% of PT Multimedia. PT Multimedia's shares are now traded publicly. During the course of 2002, we acquired 2.43% of PT Multimedia in the open market. As of December 31, 2002 Portugal Telecom held 56.48% of the ordinary shares of PT Multimedia.

In 2000, Portugal Telecom granted a shareholder loan to PT Multimedia, to enable PT Multimedia to acquire international investments in the multimedia business. PT Multimedia repaid the loan

through a capital increase in its ordinary share capital, and the new shares were issued to us in April 2001. PT Multimedia also issued further capital in August 2001 and December 2002.

In March 2000, PT Multimedia created PT Conteúdos to hold its interests in programming ventures, and PT Multimedia.com, or PTM.com, to which it transferred its Internet-related assets. See "*PTM.com*", above.

In April 2000, PT Multimedia acquired 60.05% of Lusomundo, a leading media and entertainment company in Portugal, through a tender offer on the Euronext Lisbon Stock Exchange. Pursuant to an agreement with the majority shareholders of Lusomundo, PT Multimedia contributed its interest in Lusomundo to ASLE-SGPS, S.A. in exchange for 42% of the share capital of ASLE. After the contribution, ASLE owned 99.9% of Lusomundo's voting share capital. On March 26, 2001, PT Multimedia acquired the remaining 58% of the share capital of ASLE after approval from the Portuguese competition authorities in January 2001, thereby increasing its ownership interest in Lusomundo to 99.9% of Lusomundo's share capital. Approval was given on condition that PT Multimedia ensures that content produced by and supplied to Lusomundo, in which it does not face significant present or future competition, will be made available to third parties in accordance with normal market practice and the policy of transparency and non-discrimination that applies to other members of the Portugal Telecom group.

As a result of the acquisition, PT Multimedia incurred a liability of €268.5 million payable to CINVESTES-SGPS, S.A. On June 20, 2001, in exchange for the contribution of such liability to Portugal Telecom, CINVESTES acquired 28.5 million of Portugal Telecom's ordinary shares at a price of €9.40 per share in connection with a share capital increase approved by Portugal Telecom's shareholders on February 5, 2001. PT Multimedia repaid the liability that it owed to Portugal Telecom with the proceeds from a rights issue completed in July 2001. See "*Lusomundo*" below.

In June 2000, PTM.com increased its share capital, issued new shares in a public offering to PT Multimedia's shareholders and was listed on the Euronext Lisbon Stock Exchange. On June 20, 2000, PT Multimedia sold approximately 7.5% of the share capital of PTM.com in a private placement to two strategic shareholders, Banco Espírito Santo and Caixa Geral de Depósitos, and to PPTV, a shareholder in its joint venture Sport TV.

In January 2001, PT Multimedia announced the launch of an exchange offer in Portugal to acquire all of the outstanding shares of PTM.com that it did not already hold in exchange for PT Multimedia shares. The exchange offer was approved by PT Multimedia's shareholders on September 19, 2001. PTM.com shareholders received one PT Multimedia share for every 3.4908 PTM.com shares tendered. After completion of the exchange offer on December 3, 2001 PT Multimedia held 98.76% of the share capital of PTM.com. Pursuant to a compulsory acquisition permitted by Portuguese law, PT Multimedia acquired the remaining 4,186,593 ordinary shares of PTM.com that it did not already own and delisted PTM.com's shares from the Euronext Lisbon Stock Exchange in March 2002.

On October 17, 2002, we entered into an agreement with PT Multimedia to acquire its 100% interest in PTM.com, its 24.75% interest in Páginas Amarelas and its 50 interest in Sportinveste Multimedia. These acquisitions took effect as of September 30, 2002 and were completed at an aggregate acquisition price of €199 million. In addition, we also acquired €401 million in shareholder loans that PT Multimedia had extended to PTMultimedia.com and Sportinveste Multimedia. This transaction reduced the net debt of PT Multimedia by €600 million to €139 million. As from October 1, 2002, PT Multimedia no longer fully consolidates the financial results of PTM.com.

Overview. PT Multimedia's businesses now consist of:

cable and satellite television through TV Cabo's subsidiaries and TV programming activities of PT Conteúdos' subsidiaries and joint ventures;

broadband internet access through cable modem provided by TV Cabo;

TV programming activities of PT Conteúdos' subsidiaries and joint ventures; and

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the provision of media and entertainment content and services, including cinema distribution and exhibition, national and regional newspapers and magazines and radio in Portugal by Lusomundo.

TV Cabo. PT Multimedia provides cable television and direct-to-home satellite television services through TV Cabo, its wholly owned subsidiary, and TV Cabo's subsidiaries. TV Cabo is also involved in advertising sales. In addition, it provides multimedia services, such as broadband cable Internet access and interactive digital television services, or IDTV.

Cable Television and Direct-to-Home Satellite Television Services. TV Cabo is the leading cable television operator in Portugal. Its cable television licenses cover approximately 77% of Portugal's population, comprising approximately 3.7 million homes. At December 31, 2002, TV Cabo's cable network passed, or provided potential access to, approximately 2.39 million homes, including 2.2 million residences. At December 31, 2002, approximately 47% of the residences TV Cabo passed were subscribers, compared with 45% at December 31, 2001. TV Cabo's cable television subscribers are charged an installation fee, an annual rental fee for set-top boxes and a monthly subscription fee for programming packages.

Since September 1998, TV Cabo has also distributed a direct-to-home, or DTH, satellite television service in Portugal. TV Cabo distributes its DTH satellite service using Hispasat Satellite broadcasting capabilities. TV Cabo's DTH satellite service is the only DTH digital multi-channel service specifically marketed in Portugal. TV Cabo's DTH satellite subscribers are charged an installation fee and a monthly subscription fee and are required to purchase a satellite dish and a digital set-top box. TV Cabo's DTH satellite service is mainly targeted at people whose homes are not passed by TV Cabo's cable television network.

Because it offers cable and DTH satellite services, TV Cabo can distribute programming and advertising across Portugal. As of December 31, 2002, TV Cabo had approximately 290,200 DTH satellite subscribers. The total number of TV Cabo's cable and satellite subscribers increased 13% during 2002 to approximately 1,308,000 from 1,160,000 at the end of 2001. At December 31, 2002,

approximately 70% of TV Cabo's cable and satellite subscribers subscribed to its premium channels, for which it charges additional fees.

Programming Content. As of December 31, 2002, TV Cabo offered over 40 basic channels to cable subscribers and more than 30 basic channels to DTH satellite subscribers in continental Portugal. Seven premium channels are presently available to cable and DTH subscribers. About half of the channels distributed by TV Cabo, including Telecine Premium and Telecine Gallery and Sport TV, consist principally of programming that is in Portuguese or that has been dubbed or subtitled in Portuguese. The rest of the channels are mainly in English, but also in other European languages such as Spanish, French and German.

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In March 2000, PT Multimedia (on behalf of PT Conteúdos) and TV Cabo established a strategic partnership with SIC, a major television operator in Portugal, to develop television content. This arrangement included the acquisition by SIC on September 4, 2000 of 60% of Lisboa TV, S.A., or Lisboa TV, the owner of a live news and information channel in Portugal, now known as "SIC Notícias", the production of two channels for TV Cabo's basic package and cross-promotion between SIC and TV Cabo. PT Conteúdos holds the other 40% of Lisboa TV.

Multimedia Service. In order to increase its revenues per subscriber, TV Cabo has been developing a set of multimedia services, comprising broadband Internet access and Interactive Digital Television. TV Cabo launched broadband Internet access through cable modems at the end of 1999. This was the first broadband internet access service launched in Portugal. TV Cabo had approximately 140,000 subscribers for its broadband Internet access product at the end of 2002. In June 2001, TV Cabo, in conjunction with Microsoft, launched its high-end interactive digital service, which uses set-top boxes manufactured by Octal TV, a company in which PT Multimedia holds a 20% interest. With the set-top box, subscribers have access to several IDTV services such as Pay Per View, Homebanking, Shopping, Games and Betting. In 2003, TV Cabo's plans to launch a low-end interactive digital service aiming to provide to subscribers a first digital experience.

Network. Between 1994 and year-end 2002, TV Cabo invested approximately €470 million, mainly in the development of a hybrid fiber-coaxial broadband distribution network. The network has a bandwidth of 750 MHz and is sufficient to permit gradual migration to digital signals. The current design of the network allows it to increase capacity without significant additional capital expenditure. TV Cabo has activated the two-way capacity of its bandwidth cable network which at the end of 2002 stands at 86% of houses passed by its network. This activation allowed it to introduce Internet access by cable at the end of 1999 and allowed it to launch its IDTV service in June 2001.

TV Cabo's television signals are transmitted through fiber optic cables owned by our fixed line business, PT Comunicações under a service agreement. In addition, TV Cabo has used PT Comunicações existing ducts, wherever possible, to build its network. Because TV Cabo was able to utilize those ducts, its cumulative 2002 capital expenditure per home passed, excluding last connection to the client, or cable drop, was approximately €84. As of December 31, 2002, TV Cabo's network reached approximately 2 million homes that have two-way capacity. The investment required to make the network capable of carrying two-way signals is also minimal.

Marketing. TV Cabo is pursuing an aggressive marketing campaigns. It is promoting its premium channels and highlighting the high level of Portuguese-language content on its channels the new digital services enabled by IDTV and its broadband internet access (NetCabo). TV Cabo markets its services through door-to-door selling, telemarketing and through Portugal Telecom shops, its own shops, supermarkets and other retail shops. We believe the alliance with SIC, Sport TV and other content producers has been contributing to the increased penetration of TV Cabo, as the agreement contemplates cross promotion between free and cable TV, and increased advertising initiatives.

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Strategic Alliance with Microsoft. In connection with Microsoft's investment in PT Multimedia, we entered into a strategic agreement with Microsoft providing, among other things, for cooperation in joint projects for the development and delivery of interactive video and data services, such as non-traditional telephone services, Internet, interactive video enhanced programming and wireless and other data services to both business and residential customers. See " *Our Businesses Strategic Alliances Alliance with Microsoft*", below.

Lusomundo. Lusomundo provides entertainment distribution services through Lusomundo Audiovisuais, cinema exhibition through Lusomundo Cinemas and production of news content through Lusomundo Media.

Lusomundo Audiovisuais. Lusomundo Audiovisuais has broadcast rights to over 3,000 feature films as of December 31, 2002. In Portugal, Lusomundo Audiovisuais also has the right to distribute:

Videogames: Sony Playstation;

Theatrical: UIP (Universal, Dreamworks and Paramount, BUENA Vista International (Touchstone, Walt Disney Pictures), Spyglass, Revolution Studios and Independent Producers; and

Video: Columbia, BVHE (Walt Disney), Paramount, Spyglass, Revolution Studios and Independent Producers.

Lusomundo Cinemas. Lusomundo Cinemas has cinemas with 130 screens in Portugal and 104 screens in Spain, as of December 31, 2002.

Lusomundo Media. Lusomundo Media is the owner of several newspapers and magazines in Portugal, such as:

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"Jornal de Notícias", one of Portugal's most popular daily newspapers with an average daily circulation of approximately 109,000 as of December 31, 2002;

"Diário de Notícias", one of Portugal's leading daily newspapers with an average daily circulation of approximately 54,000 as of December 31, 2002;

"24 Horas", a daily tabloid newspaper, and "Tal & Qual", a weekly tabloid newspaper;

regional newspapers, including "Açoreano Oriental", "Diário de Notícias da Madeira", "Jornal do Fundão" and "Jornal Tribuna de Macau"; and

6 magazine titles, including "Notícias Magazine", "Grande Reportagem", "Volta ao Mundo", "Evasões", "Playstation 2" and "National Geographic Magazine".

Lusomundo Media also provides radio content and programming and owns "TSF", Portugal's most popular news radio station. As of December 31, 2002, "TSF" had approximately 271,000 listeners on a daily basis and an approximately 20% share of the total radio advertising market in Portugal.

PT Conteúdos. PT Multimedia created PT Conteúdos to manage the Portuguese-language audiovisual programming activities previously managed by TV Cabo. After restrictions on cable operators engaging in any programming business were lifted in 1997, TV Cabo formed two joint ventures to develop programming channels in Portugal (Sport TV and Premium TV) and launched CNL, now known as Sic Notícias (Lisboa TV), a Lisbon-focused live news, information and entertainment channel in Portuguese. These ventures were aggregated under PT Conteúdos, which is 100% owned by PT Multimedia.

PT Conteúdos directly owns 46% of Premium TV, a partnership with Globo and SIC. Globo is Brazil's leading television network, and a leading producer of Portuguese programming. SIC is a major television operator in Portugal. PT Multimedia holds an additional 8% of Premium TV through

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Lusomundo. In June 1998, Premium TV launched two premium movie channels Telecine Premium and Telecine Gallery using the film libraries of Globo. Until May 2003, these channels were distributed via cable and satellite, through TV Cabo's platforms. Premium TV has also launched adult entertainment programming. In June 2003, PT Multimedia acquired the remaining 54% of the share capital of Premium TV held by Globo and SIC, and decided to replace Telecine Premium and Telecine Gallery by launching two premium movie channels (Lusomundo Premium and Lusomundo Galery) produced in-house using the film libraries of Lusomundo.

PT Conteúdos also owns 33.33% of Sport TV, a joint venture with Radiotevisão Portuguesa, S.A., the Portuguese state television operator, and PPTV-Publicidade de Portugal e Televisão, S.A. The latter is a subsidiary of Olivedesportos, a Portuguese sports marketing firm. This joint venture produces Sport TV, a premium sports channel, which is distributed by Portuguese cable and satellite operators in exchange for a per-subscriber fee. Sport TV holds a license to distribute most league matches of Portugal's leading football league and certain other European football leagues through 2004.

PT Conteúdos also holds PT Multimedia's 40% interest in Lisboa TV (the owner of the live news and information channel "SIC Notícias"). See "TV Cabo", above.

Additionally, PT Conteúdos holds 100% of TV Cabo Auidovisuais S.A., a company that is engaged in the wholesale business for content. From 2002 overwards this company will be responsible for negotiations with content producers of the acquisition of rights to carry pay TV channels and other content. It will resell that content to different distribution platforms including TV Cabo's pay TV and Internet platforms, as well as those of other operators.

Yellow Pages. Until October 2002, PT Multimedia held a 24.75% economic stake and 50% of the voting rights in the leading provider of yellow pages and white pages directories in Portugal, Páginas Amarelas. In October 2002, PT Multimedia sold its interest in Páginas Amarelas to us. See "PT Multimedia Formation and Development".

PT Multimedia.com. In March 2000, PT Multimedia formed PT Multimedia.com, in which it collected its Internet activities focused on the residential and small and medium-sized enterprise markets. In October 2002, PT Multimedia sold its interest in PT Multimedia.com to us. Therefore PT Multimedia no longer consolidates these companies in its financial statements as from October 2002 and we only recorded their results under "PT Multimedia" for the first three quarters of 2002. The contribution from the Internet activities in the fourth quarter of 2002 was recorded in our consolidated financial statements under "Other". See " *PTM.com Formation and Development*".

PT Ventures

PT Ventures, SGPS, S.A. (formerly Portugal Telecom Internacional, SGPS, S.A.), or PT Ventures, aggregates interests in telecommunications operators and service providers in China, Europe and certain African countries. We hold 100% of PT Ventures.

Investments in Africa. PT Ventures owns 40% of the share capital of Cabo Verde Telecom, which provides telecommunications fixed, mobile, data and Internet services to the Cabo Verde Islands, a Portuguese-speaking country off the coast of West Africa. PT Ventures manages and provides technical support to the company. Cabo Verde Telecom also uses GSM mobile technology.

In Mozambique, PT Ventures has a 50% stake in Teledata together with TDM the Mozambican incumbent that holds the other 50%. Teledata provides data communications and Internet services. Teledata holds an estimated market share of approximately 70%.

Investments in Asia. PT Ventures has a 25% interest in Companhia de Telecomunicações de Macau, or CTM, the exclusive provider of fixed line and a provider of mobile telephone services in Macau. Macau, an enclave situated near Hong Kong on the coast of the Guangzhou Province, China,

was a territory administered by the Portuguese government until December 1999 when its administration was transferred to the People's Republic of China. The other shareholders of CTM are Cable & Wireless plc and CITIC Pacific.

At December 31, 2002, CTM had 176,732 fixed line main lines in service. This figure represents approximately 40 fixed line main lines per 100 inhabitants. CTM's mobile telephone services are growing rapidly, with 211,307 activated mobile telephone cards at December 31, 2002 and 47 activated mobile telephone cards per 100 inhabitants. CTM uses GSM digital mobile technology. In December 1999, CTM entered into a new concession that will be valid until the end of December 2011.

PT Ventures holds a 35% interest in Macau Cable TV, a company that has a license to provide and provides cable television services in Macau. The other interests in Macau Cable TV are held by Macau and Chinese investors.

PT Ventures has interests in satellite broadcasting services and satellite television programming in the People's Republic of China. Together with local investors and companies representing the Chinese Ministry of Posts and Telecommunications, the Ministry of Aerospace Industry and Ministry of Defense, we have formed a joint venture, called Telesat, that provides satellite broadcast services. We have a 18.52% interest in Telesat. With a stake of 6.67%, we also participate in Cosmos with several local investors and investors representing Chinese state companies. Cosmos provides satellite television programming.

Investments in East Timor. PT Ventures holds a direct 75.16% interest in Telecomunicações Públicas de Timor, or TPT, the controlling consortium of Timor Telecom, the country's incumbent operator. Timor Telecom has a concession to provide telecommunication services in East Timor for a period of 15 years, from July 2002, renewable for 10 years. Other than Internet services, its right to provide all services is exclusive for the length of the concession period.

Investment in Central Europe and Eastern Europe. PT Ventures has a 44.62% interest in Hungaro DigiTel Kft, or HDT, a satellite telecommunications company.

Investment in Directories. PT Ventures holds 100% of Directel - Listas Telefónicas Internacionais, SGPS, S.A., or Directel, the holding company of a number of international directories companies in Africa and Asia. Directel operates in Kenya, Mozambique, Angola, Uganda, Cape Verde, Macao and Hong Kong.

Corporate Venture Capital. PT Ventures is also looking for corporate venture capital opportunities that have synergies with telecommunications services.

PT Sistemas de Informação, PT Inovação, PT Pro and PT Compras

As part of our reorganization, in December 1999, we created PT Sistemas de Informação, an information systems support unit to which we have transferred the data centers, information systems and information technology activities of our business units. PT Sistemas de Informação provides integrated information systems and information technology services to our business units, as well as to our existing and new customers. In 2002, we held 95% of the share capital of PT Sistemas de Informação and IBM held 5%, although in 2003, we acquired IBM's interest in PT Sistemas de Informação. PT Sistemas de Informação has subcontracted the information technology aspect of its services to DCSI-Dados, Computadores e Soluções Informáticas, or DCSI, an information technology company of IBM.

In October 2002, PT Sistemas de Informação acquired, from PT Prime SGPS and BES.com, their shares in the share capital of Megamédia, a company previously controlled by PT Prime SGPS and engaged in IT consulting and web-enabled solutions. Subsequently, PT Sistemas de Informação acquired the remaining share capital of Megamédia and in April 2003 this company was merged with

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PT Sistemas de Informação. This transaction was entered into to allow our IT consulting business to be developed using a single platform, taking advantages of synergies and economies of scale.

In July 1999 we created Portugal Telecom Inovação, S.A., or PT Inovação, to focus on research and development of innovative technological solutions for the developing market.

In December 2002, we created PT Serviços, S.A., or PT Pro, to aggregate all our back office activities in Portugal. PT Pro will take advantage of economies of scale and process alignments throughout our group to reduce costs in back office activities. PT Pro will also allow for a reduction of the execution risk of the financial reporting function of the Company through standardization of processes and application of best practices.

On May 2003 we created PT Compras, S.A., or PT Compras, and we transferred our newly created central purchasing unit to this company. PT Compras will optimize our purchasing function on an integrated basis. Taking advantage of scale and specialization, we expect PT Compras to increase pressure in reducing suppliers' prices and to improve the levels of quality and service. We believe that PT Compras will be a significant driver in creating competitive advantages for PT.

Strategic Alliances

We have summarized below our principal existing and planned alliances and joint ventures.

Alliance with Telefónica. On January 23, 2001, we entered into a strategic agreement with Telefónica to create a mobile joint venture company that would aggregate all our Brazilian mobile assets with the Brazilian assets of Telefónica Móviles, the mobile subsidiary of Telefónica, to the extent permitted under Brazilian law. On December 27, 2002, we and Telefónica transferred all of our respective interests in Brazilian mobile services companies to the joint venture, called Brasilcel, with its head office in the Netherlands. We hold our interest in Brasilcel through PT Móveis and Telefónica holds its interest through Telefónica Móviles. Our agreements governing the ownership and management of Brasilcel have been entered into by those entities. We have discussed the benefits we expect from the joint venture with Telefónica and the reasons for entering into it above under "*Joint Venture with Telefónica in Brazil*".

We have appointed the Chief Executive Officer and Telefónica has appointed the Chief Financial Officer of Brasilcel. We manage Brasilcel on an equal basis with Telefónica and appoint six of the twelve members of its board of directors, including the Vice-Chairman. Three of each party's six directors must be resident in the Netherlands. In the event that either our or Telefónica's economic and voting interest is diluted below 50%, but not lower than 40%, due to a capital increase, the diluted party can re-build its interest to 50% within 12 months from the date of dilution. During such period, Brasilcel would be managed on an equal basis. We can maintain our share ownership percentage by contributing with cash or liquid assets. Should the percentage of the share capital in Brasilcel that we or Telefónica hold fall below 40% and remain below 40% for six consecutive months thereafter, our respective numbers of directors on the board will be changed to reflect our proportional shareholdings and the diluted shareholder will lose its right to appoint the CEO or CFO, as applicable.

As long as both parties have equal voting rights, the decisions of the board of directors shall be made by mutual agreement of the parties and will accordingly require the vote of at least one director appointed by each party. The joint venture agreement specifies that important decisions will be made by the affirmative vote of at least seven members of the board of directors. If a deadlock over an important issue in the decision-making of Brasilcel cannot be resolved by the chairmen and CEOs of us and Telefónica, then the issue will be settled by reference to a committee of third party "wise persons". Alternatively, if the parties so agree, the interests contributed by the companies to Brasilcel will be

returned and any subsequent interests acquired by Brasilcel will be divided according to the agreement of the parties or by arbitration.

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Potential acquisitions of wireless and mobile telephone operators in Brazil may be pursued by Brasilcel or by us or Telefónica and subsequently contributed to Brasilcel. New acquisitions by Brasilcel require the approval of a majority of the board of directors of Brasilcel. If either we or Telefónica acquire a mobile operator in Brazil, the acquiring party must offer the right to a 50% participation in the acquisition to the other party.

In the event of a change of control of either us or Telefónica, the unaffected party shall have the right to sell the shares that it owns in Brasilcel to the affected party at a value determined pursuant to an independent appraisal. In addition, if we are diluted to below a 40% economic and voting interest in Brasilcel and fail to increase our interest to 40% within a six-month period, we will have the right to sell our interest in Brasilcel to Telefónica within one year from the expiration of the applicable six month period at a price to be determined by a third party.

If either party wishes or is required to transfer all or part of its equity interest in Brasilcel to a third party, the non-transferring party will have the right to purchase the equity interest on the same terms and conditions offered by the third party.

In 1997, we entered into a cooperation agreement with Telefónica. This agreement focused principally on cooperation in international investments, particularly in Latin America. In 1998 we acquired interests, together with Telefónica, in Brazil. See " *Mobile Businesses Joint Venture with Telefónica Móviles in Brazil.*" In 1999 we commenced operations with Telefónica in Morocco. See " *Mobile Businesses Medi Telecom in Morocco.*"

As part of our initial agreement with Telefónica, we acquired 1.0% of Telefónica's share capital and Telefónica acquired 3.5% of our share capital. We and Telefónica also gave each other a right of first refusal on any transfer of our respective interests. In addition, a member of our board who is an executive officer is serving on Telefónica's board as a non-executive director and two members of Telefónica's board who are executive officers are serving on our board as non-executive directors. Under the terms of our strategic agreement with Telefónica, we may acquire up to an additional 1.5% of Telefónica's share capital, and Telefónica may increase its ownership interest in our share capital up to 10%. Currently, Telefónica directly holds 3.74% of our share capital. Neither party controls the operations or management of the other.

As of December 31, 2002, Telesp Participações S.A. and Aliança Atlântica Holding B.V., which are affiliates of Telefónica, hold 0.64% and 0.42%, respectively, of our share capital.

Alliance with Banco Espírito Santo and Caixa Geral de Depósitos. In April 2000, we signed a strategic partnership agreement with the Banco Espírito Santo group, or BES, and Caixa Geral de Depósitos, or Caixa, to develop "new economy" initiatives. Pursuant to this agreement, BES increased its stake in Portugal Telecom to 6% of Portugal Telecom's share capital, and in August 2000 we acquired a stake in BES of 3% of its share capital. As of December 31, 2002, BES owned 9.32% of Portugal Telecom's share capital. In accordance with this arrangement, an executive officer of BES serves as a non-executive member of Portugal Telecom's board of directors. An executive member of Portugal Telecom's board of directors also serves as a non-executive member of the board of directors of BES.

Under this strategic partnership agreement, we launched various initiatives in business-to-consumer and business-to-business e-commerce and new mobile service areas in business-to consumer and e-finance, business-to-business and M-commerce and payment services.

Alliance with Microsoft. In March 1999, we formed a strategic partnership with Microsoft to develop jointly interactive video and data services. The partnership was formed to accelerate the deployment of new broadband technology and services for delivery to our customers in Portugal. The alliance provides for a wide range of joint initiatives, including the development of interactive services

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over the Internet, interactive digital television and wireless services. In connection with this alliance, Microsoft holds a 1.87% interest in PT Multimedia. See " *PT Multimedia.*"

Properties

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Our principal properties consist of buildings and telecommunications installations. These include various sizes of exchanges, transmission equipment, cable networks, base stations for mobile networks and equipment for radio communications. They are located throughout Portugal and internationally. We own our principal offices in Lisbon.

We own several office buildings in Portugal. Our main proprietary office space is located at the following addresses:

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

R. Gonçalves Cristóvão, n° 155, Porto, Portugal (15,116 square meters);

R. General Humberto Delgado, 342/368, Coimbra, Portugal (11,785 square meters);

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

Av. da Liberdade, 266 and R. Rodrigues Sampaio, 111, Lisboa, Portugal (10,057 square meters); and

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

We also have some leased offices, which are located at the following addresses:

Av. Álvaro Pais, 2, Lisboa, Portugal (31,800 square meters);

Parque da Ciência Oeiras, Lt 35, Taguspark, Portugal (27,800 square meters);

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

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

R. Entrecampos, 28, Lisboa, Portugal (7,120 square meters).

The cable television infrastructure that TV Cabo's regional subsidiaries have installed and operated may be subject to reversion or transfer to third parties without compensation when the authorizations granted expire or are terminated. See "*Regulation Portugal Summary of Our Concession and Existing Licenses*".

We have registered our important trademarks, such as "Portugal Telecom," "TV Cabo," "PT Prime," "TMN," "PT Multimedia," "PT Multimedia.com," "Telepac" and their related logos, in Portugal. We have also applied for a European Community trademark for "Portugal Telecom" and our logo. Telesp Celular has registered its important trademarks in Brazil. Trademarks registered in Brazil may be subject to less legal protection in Brazil than registered trademarks in Portugal or the United States. We do not own any registered patents or copyrights which are material to our business as a whole.

Competition

We now face substantial and increasing competition. The Portuguese telecommunications sector has been open to competition since January 1, 2000. We have competitors able to compete with us in each of our service areas. In response to the competition we are already experiencing and in anticipation of intensified competition, we are pursuing a range of strategic initiatives. Through these, we intend to reposition, modernize and prepare ourselves for the challenging new environment in which we operate.

Competition Facing PT Comunicações

Since January 1, 2000, we no longer have the exclusive right to provide domestic and international public switched fixed line telephone services or to install and operate the related telecommunications networks in Portugal.

Fixed-line Telephone Services. Our fixed-line telephone services business faces increasingly strong competition from new fixed-line operators as well as from mobile telephone service providers, including our own mobile service provider, TMN. The number of subscribers to mobile services in Portugal now outnumbers the number of wireline lines in Portugal. At the end of 2002, there were approximately 82.5 activated mobile telephone cards per 100 inhabitants in the Portuguese market. This growth comes as more residential subscribers add mobile lines for family members and as businesses add mobile cards for their employees. Vodafone Telecel and Optimus are already marketing their mobile services as an alternative to our wireline telephone services. We compete with them for market share. Mobile telephone services provided by TMN, Vodafone Telecel and Optimus have been growing strongly. Through TMN, we have benefited from the rapid growth of mobile services.

Vodafone and Optimus have major shareholders that can provide them with substantial resources. As well as strengthening their position in the mobile telephone market, this may enable them to compete directly and aggressively with our fixed-line telephone services. See "*Competition Facing our Mobile Business TMN in Portugal*". Optimus and Vodafone already offer direct access through fixed wireless access technology.

At December 31, 2002, according to ANACOM figures, PT Comunicações had an estimated 95% market share of lines. At December 31, 2002, according to ANACOM figures and our estimates, our wireline businesses (including both PT Comunicações and PT Prime) had an approximately 90% of total outgoing traffic, a decrease of 3 percentage points from December 31, 2001, and an estimated 91% market share of domestic outgoing traffic, a decrease of 3 percentage points from December 31, 2001.

The main competitors in the wireline voice market include Oni (owned by Electricidade de Portugal, Banco Comercial Português and Brisa Autoestradas Portugal), Novis (owned by Sonae and France Telecom), Jazztel, Vodafone Telecel and the international competitor Global One. Jazztel, Vodafone and Global One are offering services mainly to small and medium-sized enterprises and corporate segments. The cable operator Cabovisão has a triple-play offer of Internet, cable TV and voice services to the residential segment. Cabovisão has attracted some of our local customer market and may continue to do so. Jazztel is constructing fiber rings in Lisbon and Oporto. It holds a license to offer fixed wireless access local loop services. As Jazztel rolls out its service offering, we expect it to be a significant source of competition for the provision of wireline telephone services to small and medium-sized enterprises. Sonae, the leading Portuguese retail group and a major Portuguese enterprise, in joint venture with France Telecom, formed Novis, the operator for fixed communications, and the cellular operator Optimus. All of the new entrants have focused on providing their customers national and international services over their networks without direct interconnection. These customers must still connect to our competitors' services through our fixed lines.

The development of fixed wireless access local loop infrastructure represents a significant competitive challenge to our local loop infrastructure, because it provides an alternative to our local loop direct connections to customers. According to ANACOM, 8,600 fixed wireless access licenses were awarded to companies in Portugal as of December 31, 2002. The fixed wireless access local loop infrastructure that is being developed under these licenses is used to offer voice services in competition with our fixed-line telephone services.

Measures such as call-by-call selection (introduced on January 1, 2000) and carrier pre-selection (introduced on October 1, 2000), as well as number portability (introduced on July 1, 2001), make it

easier for our competitors to attract our customers to their services. At December 31, 2002, we estimate that there were approximately 275,000 lines in pre-selection.

We lose revenues from our international telephone services because we no longer have the exclusive right to provide fixed-line telephone services, and large telecommunications users lease lines through which they connect to networks outside Portugal. At December 31, 2002, according to ANACOM data and our estimates, our fixed-line business (including both PT Comunicações and PT Prime) had an estimated 76.7% market share of international traffic, an increase of 0.4 percentage points from December 31, 2001. In addition, we are losing revenues from our international telephone services as mobile operators establish direct international interconnections with mobile or fixed-line networks outside of Portugal, enabling them to offer international telephone services without using our network. We face indirect competition in international fixed-line telephone services from calling cards and rerouting of calls by other international operators. Together with falling international call prices worldwide, these factors put pressure on us to reduce international fixed-line telephone prices.

In response to full competition, we have been lowering the prices of our wireline telephone services. In 2002, however, we maintained the aggregate nominal prices of our regulated basket of services. Compared with 2001, because 2001 price change occurred in February, prices reduced by 1.9% for regional calls, 1.6% for domestic long distance and 0.4% for international calls on average. We believe our price structure is now competitive and that we are meeting the challenge of full competition.

The overall effect of full competition partly depends on the prices that other mobile and wireline network operators pay us to interconnect with our network. Portuguese law requires us to lease lines to our competitors. It also obliges us to interconnect our network with our competitors' networks or lines leased by them. Our interconnection rates are subject to regulatory review. See "*Regulation Pricing of Wireline Services Interconnection Prices*". If ANACOM intervenes in the future to set interconnection prices at low levels, we believe new entrants to the Portuguese market would have a competitive advantage. New entrants and resellers of lines leased from existing operators have made very rapid inroads into other EU telecommunications markets that have also opened up to full competition.

Wholesale. Mobile operators are establishing direct international interconnections with mobile or wireline operators outside Portugal, enabling them to offer international telephone services without using our network. This is reducing our wholesale revenues generated from connecting mobile operators in Portugal to operators abroad.

Our interconnection business faces more direct competition now that other operators may install and operate their own public wireline telephone networks. Mobile and wireline networks, which are our interconnection customers, can interconnect with these new networks rather than with ours. Other competitors may also establish local networks using other technologies such as local radio systems, fiber optic technologies and new mobile systems that may be used to complete calls which are currently made to our subscribers. Refer, the owner of the Portuguese national railway infrastructure, and Águas de Portugal, a Portuguese state holding company with interests in water distribution companies, have formed Netrail, a fiber optic network company.

Other infrastructure operators began leasing lines and satellite capacity when the market began to open in 1996 and 1997. Now, competitors may lease satellite-based networks, the infrastructure of public utilities and other infrastructures in full competition with our wholesale leased line business. As a result of growing competition in our leased line business, we have been reducing our prices substantially since the beginning of 1997.

We also face competition from other licensed service providers, such as Global One and Oni Solutions, in the provision of voice services to corporate networks and other closed groups of users.

Such service providers can use lines leased from us or their own networks. This market is now highly competitive. These customers tend to have large volumes of traffic, particularly international and long distance.

Competition Facing PT Prime and Tradecom

PT Prime faces significant competition from several operators. Its principal data communications and business solutions competitors include companies associated with Oni, Novis, Jazztel, Vodafone and other international operators, such as Global One, Colt, Equant and KPN Qwest. These companies compete with PT Prime in providing data communications, voice and Internet services to business customers.

Tradecom's Internet and business-to-business activities, which are aimed at the large-business market, face increasing competition in Portugal. For example, Electricidade de Portugal has entered into a partnership with a financial company (Banco Comercial Português), a technology company (Ariba) and an energy company (Galp Energia) to create ForumB2B. ForumB2B provides business-to-business e-commerce services in the Portuguese market and competes with Tradecom. In addition, Sonae has established a partnership with a leading Portuguese financial institution, Banco Português de Investimento, and with a Portuguese technology company, AITEC, to create Bizdirect. Bizdirect provides business-to-business e-commerce services in Portugal.

Our competitors may use satellite-based networks, the infrastructure of public network operators, leased lines and their own infrastructure to offer telecommunications services to customers. These are all alternatives to leasing lines from PT Prime for data communications. As a result of competition, PT Prime has reduced its prices for leased lines and focused on value-added solutions based on Internet Protocol Virtual Private Networks, or IP VPN, to establish managed internal voice and data transmission networks to out customers, as well as data center services.

Competition Facing PTM.com

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The Portuguese market for portal businesses, e-commerce and Internet access is highly competitive, relatively new and rapidly evolving. PTM.com compete with numerous providers of content and services over the Internet. These competitors include a wide variety of Portuguese and English language search engines, Internet portals, Internet service providers, applications service providers and sites maintained by government and educational institutions.

PTM.com is the leader in providing Internet access and in search engines and portal activities in Portugal. Our other competitors in Portugal include:

Portuguese-language content providers, including clix.pt, iol.pt, vizzavi.pt, publico.pt and others;

English-language Internet retrieval companies, search engines and Internet portals, such as Yahoo, Alta Vista, Excite, Infoseek and Lycos; and

ISPs, such as Clix (Sonae), Oni, IOL.

Competition Facing our Mobile Businesses

TMN in Portugal. TMN competes with Vodafone Telecel and Optimus, the two other mobile operators licensed to provide mobile telephone services in Portugal. According to figures from ANACOM, the Portuguese telecommunications regulator, at the end of 2002, in terms of the number of activated mobile telephone cards in the Portuguese market, TMN had a 51.9% market share.

Optimus' growth since it entered the market in September 1998 has been partly a result of the growth in the overall mobile market. TMN's market share was approximately 50.5% of the number of activated mobile telephone cards at year-end 1997, before Optimus began to offer services in 1998.

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Vodafone Telecel had approximately 49.5% of the market at that time. TMN's market share initially dropped when Optimus began to offer services. Since the end of 1998, however, TMN has made maintaining its market share a priority. As a result of competitive pricing strategies, quality of service, innovative services and technology and excellent subscriber care, it has sustained its market share of new mobile subscribers.

Price competition has increased appreciably since Optimus entered the Portuguese mobile telephone market in September 1998. Both TMN and Vodafone Telecel have lowered prices in response to price reductions by Optimus.

Vodafone Telecel and Optimus each have major shareholders that could provide them with substantial resources to compete aggressively against us in the Portuguese mobile telephone market. Vodafone Group plc, which was already Vodafone Telecel's controlling shareholder, has acquired the remainder of its share capital during 2002. Sonae (one of Portugal's largest groups with a leading position in the retail business in Portugal) and Orange (a subsidiary of France Telecom) are the major shareholders in Optimus. We expect Vodafone and France Telecom to use Vodafone Telecel and Optimus as vehicles to market their own services in the Portuguese market.

Competition is increasing in the mobile services sector in Portugal as TMN and its competitors develop new services. The Portuguese government awarded four licenses to provide third generation mobile services in December 2000. Each of TMN Vodafone Telecel and Optimus has received one of these licenses. The fourth license was awarded to Oniway, a subsidiary of Oni and a new entrant in the Portuguese mobile market. However, Oniway decided not to participate in the provision of third generation mobile services and as a result the Portuguese government repealed the license granted to Oniway by ministerial order on January 13, 2003. The other three recipients of third generation licenses, including TMN, requested that the additional frequency that had been allocated to the new entrant be reallocated to them. This request was granted by a special ministerial order in January 2003. See "*Mobile Businesses TMN in Portugal*" and "*Regulation Portugal Third Generation Mobile Services Licenses*".

Telesp Celular in Brazil. Telesp Celular competed with three mobile operators in the state of São Paulo in 2002: BCP Telecomunicações S.A., or BCP, (in the São Paulo metropolitan area), Tess in the rest of São Paulo state and TIM (since September 2002). BellSouth is a shareholder in BCP. Tess is controlled by Telecom Américas Ltd. (controlled by América Móvil S.A., a large Mexican telecommunications group). BCP and Tess began offering services in their respective areas of the state of São Paulo in 1998. In February 2002, TIM acquired the D band license for the entire state of São Paulo. In September 2002, TIM began operations in São Paulo using the GSM/GPRS technology.

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On December 10, 2002, Telesp Celular converted its concessions to new SMP licenses. The distribution of new SMP licenses is likely to increase the competitiveness of the mobile market in which Telesp Celular operates as well as in the other areas where Brasilcel operates.

Telesp Celular also competes with other wireless telecommunications services, such as digital trunking and paging services, which are widely used in Brazil. These competing wireless telecommunications services are generally less expensive than mobile telecommunications services.

Telesp Celular also competes for subscribers with wireline telephone service providers. Some existing and potential subscribers may shift to wireline services for a number of reasons, including price, if the availability of wireline services and the quality of the service improve. The main wireline service provider in São Paulo state is Telefônica, through Telesp Fixa. In April 1999, a license to provide wireline services in São Paulo state was also granted to Vésper S.A., that is controlled by Qualcomm and others shareholders.

Brasilcel's Other Operators in Brazil. As a result of the new SMP licensing regime, Tele Sudeste, Tele Leste, Global Telecom and Celular CRT face increasingly competitive environments. There has

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been a significant increase in the number of licensed operators and competitors in their authorization areas. These competitors are in some cases already providing wireless or wireline services in the same regions and other regions of Brazil and represent companies of substantial size and resources.

ANATEL auctioned nine new SMP licenses, three per region, operating under band C, band D and band E. An operator that was awarded a license in the SMP auction was also granted a license to operate long distance fixed telephony, both national and international, after December 31, 2001. The band C auction was canceled due to a lack of bidders. ANATEL is analyzing the best way to allocate the relevant frequency, and a new band C auction is not expected to take place. The band D auction was successfully completed on February 13, 2001. Telemar was awarded a band D license for Region I (North and East Region, including the states of Rio de Janeiro, Minas Gerais and the states in the Northeast and North of Brazil) and Telecom Italia Mobiles was awarded a band D license for Region II (Center and South Region, including the states of Rio Grande do Sul, Santa Catarina, Paraná and the states in the Center of Brazil) and Region III (São Paulo Region, including the metropolitan area of the city of São Paulo and the rest of the state of São Paulo). The initial band E auction was held on March 13, 2001. Telecom Italia Mobiles was awarded a band E license for Region I. The auction for band E licenses in Regions II and III was postponed due to a lack of bidders. However, on January 22, 2001, ANATEL published a new invitation to bid for band E licenses in Regions II and III, as well as for band D and E licenses in eight smaller regions, some of which cannot be operated by Telecom Italia Mobiles due to its ownership interests in mobile operators. This auction was scheduled to take place on March 12, 2002 but was canceled due to a lack of bidders. In November 2002 those remaining licenses were awarded to: Telecom Americas (three licenses, including a Band E license for the metropolitan area of São Paulo), Brasil Telecom (three licenses in the regions in which it already operated in wireline telecommunications, including the states of Paraná, Santa Catarina and Rio Grande do Sul) and Vesper (three licenses, including a Band E license for the country area of São Paulo).

Competition Facing TV Cabo

Certain cable television operators are authorized to provide services in Portugal in addition to TV Cabo. Portuguese cable television authorizations cover different regions. TV Cabo has control over nine cable authorizations covering 125 counties in seven regions in continental Portugal and the Madeira and Azores Islands. As of the end of 2002, TV Cabo's cable television licenses covered approximately 77% of Portugal's population (this does not include its DTH satellite coverage). TV Cabo's competitors operate principally in Portugal's major cities. TV Cabo's principal competitors include Cabovisão, which has control over six cable authorizations, Parfitel, which has control over at least five cable authorizations and TVTel, which has control over four cable authorizations. According to ANACOM figures, we estimate that at the end of 2002, TV Cabo's competitors had approximately 16% of the total number of subscribers in the pay-TV market.

We believe the first cable television operator in any region has a competitive advantage over other operators. TV Cabo began providing services in Portugal before its competitors. TV Cabo began to provide services in Lisbon and Oporto, Portugal's largest cities, in 1995. In addition, TV Cabo has completed building most of its planned cable network.

TV Cabo competes for advertising revenue with terrestrial television companies and other forms of media such as newspapers, magazines, radio, billboards and the Internet. It also competes with terrestrial television companies for the acquisition of programming to attract viewers. Such competition can increase program acquisition costs.

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In August 2001, the Portuguese government granted an authorization to Plataforma de Televisão Digital Portuguesa, S.A., or PTDP, to provide digital terrestrial television services. The Pereira Coutinho Group, through Sociedade Gestão e Concorrência, SGPS, S.A., or SGC, holds an 80%

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interest in PTDP, and the free-to-air TV channels Sociedade Independente de Comunicação, S.A., or SIC, and Radiotelevisão Portuguesa, S.A., or RTP, hold the remaining 20%. ANACOM instructed PTDP that it must begin operations before March 1, 2003. As PTDP has had difficulty complying with the instruction, ANACOM, with PTDP's agreement, has proposed to the Ministry of Economy that PTDP's authorization be revoked. By order of the Minister of Economy, dated March 25, 2003 (Ministerial order 6973/2003, published on April 9, 2003), the authorization was revoked. We are not aware of any immediate plan of the government to grant an authorization to any other entity to provide digital terrestrial television services in Portugal.

Competition Facing Lusomundo

Lusomundo Audiovisuais and Lusomundo Cinemas. In the five main segments of both these businesses (Film distribution, Cinema exhibition, Video distribution, Video games distribution and Distribution of rights for TV broadcasting), Lusomundo faces competition from various entities that differ from segment to segment.

Lusomundo Audiovisuais and Lusomundo Cinemas' main competitors by activity are;

Film distribution: Filmes Castello Lopes, LNK Filmes, Columbia Tristar Warner Filmes de Portugal, Atlanta Filmes and Sociedade Distribuidora Vitora Filmes;

Cinema exhibition: Socorama Sociedade Comercial de Cinemas, Medeia Filmes, New Lineo Cinemas de Portugal, UCI Cinemas United Cinemas international and AMC;

Video distribution: LNK Filmes, Ecovideo, Universal Home Video, Warner Home Video; Castello Lopes, Selecções Readers Digest and Planeta Agostini;

Video games distribution: Ecogames, Electronic Arts and Concentra;

Distribution of rights for TV broadcasting: Warner Television, Columbia Television, Fox Television, Paramount Television, Buena Vista International Television, Universal Television, LNK, Ecofilmes and Castello Lopes.

In all of the activities mentioned above, except in the distribution of rights for TV broadcasting, where the free-to-air TV stations are basically supplied by the international market, Lusomundo Audiovisuais and Lusomundo Cinemas are market leaders in Portugal.

Lusomundo Media. The Portuguese market for newspapers and magazines has moved towards consolidation among the main media groups and the disappearance of independent publications. Excluding sports newspapers, Portugal has one of the lowest readership rates in Europe for newspapers and magazines.

In terms of daily newspapers, "Jornal de Notícias" and "Diário de Notícias" have been dealing with more direct competition from "Público" (Sonae Group) and "Correio de Manhã" (Cofina Group).

The Portuguese magazine market has been particularly active in the last ten years. Lusomundo Media's current portfolio includes six magazines aimed at different audiences, as follows:

Segment	Magazine
News	"Grande Reportagem"

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Segment	Magazine
Travel	"Volta ao Mundo" "Evasões"
Information/technology	"Playstation2"
General interest	"National Geographic Magazine" "Notícias Magazine"

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With a per issue circulation in excess of 190,000 copies, "Notícias Magazine" (distributed on Sundays with Lusomundo's newspapers, "Diário de Notícias", "Jornal de Notícias" and "Diário de Notícias da Madeira") is an uncontested market leader.

Other significant magazine publishers in Portugal, apart from Lusomundo Media, are Impresa (in association with the Swiss media group Edipress), Impala and Cofina.

Regulation

The telecommunications industry has traditionally been heavily regulated in most countries of the world, including Portugal and Brazil. Over the last several years, both countries (Portugal beginning in 1991 and Brazil in 1998) have substantially privatized their state-held telecommunications operators and have been opening their telecommunications markets to competition. Portugal, a member of the European Union, opened its telecommunications market to full competition as of January 1, 2000. Portugal is pursuing further EU-led initiatives aimed at increasing the competitiveness of its market. Brazil is also in the process of introducing further measures designed to increase competition. In this section, we explain the main laws and regulations in Portugal and Brazil that affect our operating companies in these two countries.

Portugal

In the increasingly competitive Portuguese telecommunications market, the regulatory measures which most affect our operations, our revenues and our costs, concern:

restrictions on the changes we may make to the prices we charge for certain wireline services;

obligations to allow our competitors to interconnect with and use our wireline network;

certain wireline services that we are obliged to provide to the public under our "universal service obligation";

measures that are intended to make it easier for our customers to migrate to our competitors' services, including carrier pre-selection, number portability and unbundling of the local loop; and

the terms of our Concession and our licenses, including the new third generation mobile license that TMN received at the end of 2000.

Law 91/97 of August 1, 1997, known as Law 91 or the Basic Law of Telecommunications, provides the legislative framework and the basis for telecommunications regulation in Portugal. This law was enacted to implement the European Commission's legal framework for the opening of the telecommunications sector in the European Union to full competition. Law 91 provided for the opening of the Portuguese telecommunications market, including public switched wireline telephone services and related infrastructure to full competition, as of January 1, 2000. It also established the legislative framework for the transition to a fully competitive telecommunications sector in Portugal.

Law 91 requires the Portuguese government to ensure that a basic telecommunications network exists and basic telecommunications services are provided on a universal basis in Portugal. In addition, Decree Law 381-A/97, of December 30, 1997, provides that any entity can provide telecommunications networks and services if they obtain a license from or register with the Portuguese telecommunications regulator.

Our wireline business unit provides domestic and international public wireline voice telephone services in Portugal pursuant to a Concession granted in 1995. Portugal Telecom transferred this Concession to PT Comunicações. On December 11, 2002, we agreed to prepay the future rental payments due under the Concession in exchange for full ownership of the basic telecommunications network and to ensure that there will be no reversion of the assets related to the provision of

Concession services to the Portuguese government in 2025. On December 27, 2002, we acquired full ownership of the basic telecommunications network for €365 million, which included the 2002 Concession rental fee in the amount of €16.6 million. Our other subsidiaries in Portugal hold licenses to provide their services, including mobile telephony, data transmission and cable television. See "*Summary of Our Concession and Existing Licenses*", below.

Law 91, our Concession and Decree Law 458/99 of November 5, 1999, which implemented the EU universal service regulation, impose on us universal service obligations in Portugal. Currently, we are the only telecommunications Company in Portugal subject to these universal service obligations. See "*Universal Service Obligations*", below. Law 91 imposes on the operators of public telecommunications networks an obligation to permit the use of their networks by other network operators and service providers on terms and conditions that are determined competitively and without discrimination. It also prohibits unfair competitive acts and abuse of a dominant position by a network operator or service provider. Law 91/97 has been changed by Law 29/2002 of December 6 enabling the sale of the ownership of the basic network to PT Comunicações on December 27, 2002, resulting in basic network assets becoming owned by PT Comunicações. See "*Summary of Our Concession and Existing Licenses Our Wireline Concession*" and "*Item 8 Financial Information Legal Proceedings*". Law 91 also codified our right to use public rights-of-way free of municipal fees and taxes. Decree Law 458/99 (Universal Service) and Decree Law 415/98 of December 31, 1998, which implemented the EU Interconnection Directive in Portugal, address the pricing mechanism and the financing procedures regarding universal service obligations. According to our New Concession Agreement, PT Comunicações should be compensated for losses if the rights-of-way regime changes.

In February 2002, the European Union agreed upon a new regulatory framework for electronic communications networks and services, consisting of five directives governing procedures, authorizations, access, universal service obligations and data protection, and one decision on the availability and use of radio spectrum. Until Portugal has implemented the new EU framework for electronic communications networks and services, the existing decree laws 458/99 and 415/98, which implement existing EU directives and regulations on universal service obligations and interconnection, will continue to govern in Portugal. The new EU framework is expected to be introduced through new legislation enacted by the Portuguese Parliament and Government and implementing regulations by the Portuguese regulator, ANACOM, which are required by the new EU framework to be in force by July 25, 2003. The introduction of the new regulatory framework is currently being implemented by the Government. The new EU directives will change the current regulatory framework applicable to us. The new EU directives and recommendations, which adopt competition law principles such as market dominance for the designation of significant market power and the definitions of relevant product and geographic markets which may be subject to "ex ante" regulation will result in significant changes and refinements to the current regulatory regime applicable to us in Portugal.

Under the new regulatory regime, regulatory obligations can be imposed on operators having significant market power in any one of 18 relevant retail and wholesale markets identified by the European Commission. Since we are active in many of these markets, the new regulatory regime could result in an increase in the regulatory measures affecting our businesses and operations. In addition, certain other aspects of the current regulatory scheme, such as the basis upon which we and other operators in Portugal can use public rights of way, may be subject to further review and changes. Overall, however, we believe that the new framework will permit an increasingly flexible approach to regulation as competition develops in Portugal. Until the implementation of the new EU regulatory regime at a national Portuguese level, the measures adopted under the current regulatory regime will still apply to us.

Regulatory Institutions

ANACOM. The Autoridade Nacional das Comunicações, or ANACOM, created in January 2001 (formerly The Instituto das Comunicações de Portugal, or ICP), is the Portuguese telecommunications regulator. Since it commenced operations in 1989, it has been closely involved in developing the telecommunications regulatory framework in Portugal. It advises the Portuguese government on telecommunications policy and legislation and monitors compliance with concessions, licenses and permits granted to telecommunications providers in Portugal.

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ANACOM is accountable to the Ministry of Economy. The Ministry of Economy retains basic responsibility for telecommunications policy in Portugal. Together with the Ministry of Finance, it has ultimate responsibility for monitoring our compliance with our Concession. It also has certain supervisory powers with respect to our activities. The Portuguese government delegated a significant number of those powers and functions to ANACOM in our Concession.

Over the past several years the Portuguese government has substantially increased the autonomy of ANACOM and allowed it to become a more effective and independent regulatory body. ANACOM acts on complaints against us by our competitors, our customers and other interested parties. It can impose fines on us if we do not meet our obligations under our Concession, including our obligations to supply public switched wireline telephone services, leased lines and other services to our competitors on a timely basis. ANACOM has from, time to time, addressed complaints against us by our competitors. However, such complaints have been resolved in a manner that has not had a material adverse effect on our businesses or operations. ANACOM's decisions are subject to possible reconsideration and can be submitted for judicial review.

EC Commission. Most of the EU competition rules have the force of law in all EU member states and therefore apply to us in Portugal. The current priority of the EC Commission is to ensure that EU member states fully and correctly implement EU requirements in national law. The EC Commission routinely monitors the status of EU member states in implementing EU directives.

The Directorate-General for Competition of the EC Commission is responsible for considering, on its own initiative as well as in response to complaints by interested parties, potential claims that our business activities or Portuguese government regulations are inconsistent with the key provisions of the Treaty of Amsterdam, also known as the EC Treaty, relating to competition in the EU. Article 81 of the treaty prohibits agreements or coordinated action between competitors that may affect trade between EU member states and have as their objective or effect the prevention, restriction or distortion of competition within the EU. Article 82 of the treaty prohibits any abuse of a market-dominating position within the EU, or a substantial part of the EU, that may affect trade between EU member states. The Directorate-General for Competition enforces these rules in cooperation with the national competition authorities. In addition, national courts have jurisdiction over violations of EU competition law. There are currently no material complaints relating to our activities or the regulatory framework of the Portuguese government pending before the Directorate-General for Competition.

We understand that at the end of 2001 the Directorate-General for Competition and the Directorate-General for Information Society of the European Commission requested information from the Portuguese government regarding the telecommunications rights-of-way regime in Portugal, which provides PT Comunicações with the exclusive right to use public rights-of-way free of municipalities' fees and taxes. Since we have not been party to the communications between the Directorates-General and the Portuguese government, we are unable to assess the potential outcome and implications, if any, for us, of such communications.

Autoridade da Concorrência. Our activities are also overseen by Autoridade da Concorrência (formerly Direcção Geral do Comércio e da Concorrência, or DGCC), the new agency with responsibility for enforcement of Portuguese competition law. This agency shares responsibility with

ANACOM for overseeing our compliance with the pricing convention, which we describe below, including pricing schemes. It is also responsible for considering complaints relating to our business practices or other business arrangements. There are currently no material complaints relating to our activities pending before this agency. We expect the Autoridade da Concorrência to take a more active role in matters relating to pricing and to the determination of which companies have "significant market power" and the regulatory implications for such companies.

Pricing of Wireline Services

On September 10, 1997, we, ANACOM and the DGCC entered into a pricing convention. The pricing convention established price caps on our prices for wireline telephone services over the three-year period from January 1, 1998 through December 31, 2000. The pricing convention covered only the prices for our wireline telephone services, *i.e.*, installation charges and line rental fees, and prices for domestic and international telephone calls and public payphones. The prices for our public switched wireline telephone services under the pricing convention had to comply with the principles of cost orientation, non-discrimination and transparency.

Decree Law 458/99 requires that ANACOM, DGCC and the provider or providers of the universal service in Portugal enter into a new pricing convention that governs only prices for services that we provide under universal service obligations. We are currently the only universal service provider in Portugal. See "*Universal Service Obligations*", below. On December 30, 2002, we, ANACOM and the DGCC entered into a new pricing convention pursuant to article 11 of Decree Law 458/99. The new pricing convention establishes the price regime applicable to the

following universal services provided by PT Comunicações: (i) wireline services for subscribers, including traffic and subscription to analog lines within Portugal; and (ii) wireline services for public pay telephone calls made within Portugal, as well as making telephone directory and information services available. In addition, the new pricing convention governs certain obligations of PT Comunicações to provide services to retirees, low income pensioners, low consumption residential users and customers with special needs.

Under the new pricing convention, the prices of universal services will be adjusted based on actual costs, and the prices charged must comply with transparency and non-discrimination principles and ensure that all users have access to such services. As a result, PT Comunicações must maintain a system of cost accounting, which will enable it to monitor the costs of the services it provides, and it must publicize current prices. For wireline subscribers, the new pricing regime means that the weighted average variation of the prices they pay for domestic services will not exceed 2.75 p.p. for 2003. PT Comunicações is also obligated under the new pricing convention to make available an optional pricing plan for the benefit of residential customers with low consumption.

Other Requirements. The regulatory framework requires PT Comunicações to submit periodic reports on quality of service and comply with the specified indicators. Penalties may occur in case we do not achieve such indicators. The new pricing convention allows us to discount our prices for wireline telephone services so long as such discounts are offered on a transparent and non-discriminatory basis. In addition, we must offer economy service options to retired pensioners whose household income is less than the national minimum salary level established by the Portuguese government. We must also provide itemized billing records, white page directories and certain other facilities to certain specified categories of subscribers free of charge.

Interconnection Prices. Decree Law 415/98 of December 31, 1998, which implemented the EU Interconnection Directive, sets out a general framework for interconnection. We submitted our reference interconnection offer for the year 2003, which was published on April 8, 2003, to ANACOM. See "*Interconnection*", below. We also submitted our reference Internet access offer to ANACOM. See "*Interconnection Internet Access*", below.

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Prices for Leased Lines. Prices for our leased lines are not subject to the pricing convention. The principles of cost-orientation, non-discrimination and transparency apply to our leased line prices, because ANACOM determined in August 2000 that we have significant market power in the provision of leased lines.

Universal Service Obligations

As we mentioned above under "*Pricing of Wireline Services*," our new pricing convention only regulates the prices of services offered under our universal service obligations. These services are all wireline telephone services, public payphones, national directories and information services.

The EU Interconnection Directive sets out the rules for costing and financing of universal service in a competitive environment. The EU allows EU member states to decide which operators have an obligation to provide universal service. It also describes how these states may allocate any unfair burden that may arise as a result of the universal service obligation. However, it does limit the services that are eligible for any support payments made to the universal service provider and it requires an incumbent telecommunications operator to justify any amounts payable by other operators to meet its net costs of meeting the universal service.

Law 91, our Concession and Decree Law 458/99 of November 5, 1999 impose on us universal service obligations in Portugal. These obligations include providing connection to the public telephone network at a wireline location. They also include providing access to public switched wireline telephone services, including enabling users to make and receive local, national and international telephone calls, facsimile communications and data communications. They also include providing public pay telephones, making directories available and at least one telephone directory enquiry service covering all public voice telephone subscribers' numbers.

Decree Law 415/98, which implemented the EU Interconnection Directive in Portugal, and Decree Law 458/99, which implemented the EU universal service regulation in Portugal, addressed the pricing mechanism and the financing procedures regarding the universal service obligations, as well as those who must contribute to its cost. Law 91 requires that operators of public telecommunications networks and providers of voice services must contribute to the costs of our universal service obligation. Decree-Law 415/98 and Decree Law 458/99 require us to disclose to ANACOM our negative margins involved in meeting the universal service obligations. ANACOM will establish and publish the criteria for contributions to the cost of universal service. It will also determine, on an annual basis, the amounts and timing of contributions by other operators and service providers. Decree Law 458/99 also required that we, ANACOM and the DGCC enter into a new pricing convention governing the prices of services provided pursuant to the universal service obligation. As discussed above, we entered into a new pricing convention on December 30, 2002. See "*Pricing of Wireline Services*".

Interconnection

The EU Interconnection Directive establishes the general conditions for interconnection among telecommunications operators in competitive markets. It guarantees the rights of new entrants to obtain interconnection from telecommunications operators with significant market power. An operator is presumed to have significant market power if it has more than a 25% share of the relevant market.

In August 2000, ANACOM declared PT Comunicações to have significant market power in the following markets:

provision of interconnection;

provision of wireline telephone networks and/or services; and

provision of leased lines.

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ANACOM has declared our Portuguese mobile services subsidiary, TMN, to have significant market power in the provision of mobile networks and mobile telephone services. ANACOM also declared TMN's competitor, Vodafone Telecel, to have significant market power in these markets.

Internet Access. On February 21, 2001, ANACOM issued an administrative decision instructing PT Comunicações to submit a reference Internet access offer proposal changing the connection of ISPs to its wireline network from a model based on revenue sharing to one based on call origination charges and establishing maximum prices that PT Comunicações is permitted to charge ISPs for Internet access service. This administrative decision instructed PT Comunicações to implement the new billing regime by May 31, 2001. PT Comunicações published its reference Internet access offer on March 1, 2001, and since that time has modified how it accounts for revenues attributable to the interconnection of ISPs to its wireline network. We believe that PT Comunicações is in full compliance with ANACOM's administrative decision.

Under the new billing regime, two different types of billing arrangements with ISPs are possible. Under the first method of billing, PT Comunicações is required to collect revenues on behalf of ISPs from customers that use its wireline network to connect to the Internet, at a price established by the ISPs. The ISPs pay to PT Comunicações a call origination charge and the cost to PT Comunicações of invoicing customers for their minutes of usage at rates set by the ISP, if PT Comunicações is requested to invoice customers on behalf of the ISPs. PT Comunicações remits the revenues that it receives from customers to the ISPs and collects those charges that it is owed by the ISPs. When an ISP does not request that PT Comunicações invoice its customers, PT Comunicações only collects the call origination charge from the ISP. Under the second method of billing, PT Comunicações charges the ISPs a wholesale flat rate. In turn, the ISP bills its own customers for the ISP services. As discussed below in "*Item 8 Financial Information Legal Proceedings*," PT Comunicações has submitted a claim to the Lisbon administrative court requesting relief from the recent ANACOM administrative act and contesting the legality of such act.

The Interconnection Framework. The EU Interconnection Directive requires that interconnection services be made available in a non-discriminatory manner. It also requires that operators with significant market power in the provision of wireline telephone network services or of leased lines make interconnection available by publishing a reference interconnection offer which includes interconnection price lists. Interconnection prices must be cost-based and supported by transparent accounting systems. The EU Interconnection Directive encourages commercial negotiations among operators but requires national regulatory authorities to establish mechanisms for effective dispute resolution.

Through Decree Law 415/98, the EU Interconnection Directive was implemented in Portugal. ANACOM established the basic framework for interconnection agreements. This framework is based on Law 91/97, Decree Law 415/98 and various obligations included in our Concession. All telecommunications companies with significant market power in the provision of wireline telephone networks or services, leased lines or mobile telephone networks or services must:

make interconnection access to their networks available to other network operators;

not discriminate between interconnection customers; and

provide to those requesting interconnection the information and technical specifications necessary for them to interconnect their networks.

In addition, telecommunications companies with significant market power in the provision of wireline telephone networks or services and leased lines must:

offer interconnection prices that are transparent and cost-oriented and do not discriminate between interconnection customers;

establish a reference interconnection offer; and

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maintain a separate accounting system for interconnection activities.

None of the mobile operators in Portugal has been declared by ANACOM to have significant market power in the national market for interconnection, nor is any mobile operator in Portugal subject to the full interconnection regime. According to Decree-Law 415/98, telecommunications companies providing mobile telephone networks and/or services with significant market power in the national market for interconnection are required to offer interconnection prices that are transparent and cost-oriented and do not discriminate between customers. They are also required to maintain a separate accounting system for interconnection activities.

The last version of the reference interconnection offer for our wireline network in 2003, which was published on April 8, 2003, sets out the overall set of services that our PT Comunicações business unit provides to other operators. It also sets forth terms and conditions, including prices, which our PT Comunicações business unit uses as a basis for providing interconnection services when requested by other operators.

Pursuant to Decree-Law 415/98, ANACOM is entitled to review and modify our proposed interconnection rates and arrangements in our reference interconnection offer. ANACOM has established in Portugal an overall interconnection framework based on cost and consistent with the EU legal framework for both wireline and mobile services. We expect that convergence of interconnection rates and practices in Portugal with those in the EU will occur in a step-by-step process over the next several years.

The EC Commission generally monitors interconnection rates and practices in the EU. Through its competition directorate, the EC Commission may become involved in complaints with respect to interconnection arrangements and practices brought by new entrants against incumbent telecommunications operators. Although the EC Commission often defers to initiatives undertaken by national regulatory agencies with respect to interconnection-related matters, there can be no assurance that the EC Commission will not further investigate or become actively involved in matters concerning the establishment of interconnection arrangements in Portugal on its own initiative or in response to a complaint by another telecommunications operator.

ANACOM determined that from October 1, 2000, the ownership of fixed to mobile traffic would shift from mobile operators to wireline operators. See "*Item 5 Operating and Financial Review and Prospects Overview Changing Composition of Our Operating Revenues*".

Number Portability and Carrier Selection

An amendment in September 1998 to the EU Interconnection Directive required member states to introduce number portability among telecommunications operators in most EU countries by January 1, 2000. Where implemented, number portability allows a subscriber at a specific location to change service providers without having to change telephone number. The Portuguese government adopted Decree Law 415/98, which requires us to provide number portability by a date to be set by the government member responsible for telecommunications. PT Comunicações introduced number portability for wireline services on July 1, 2001. Number portability for mobile services was introduced in January 2002.

As required by ANACOM, our wireline business has been offering call-by-call carrier selection since January 1, 2000. Call-by-call carrier selection enables customers to select the carrier of their calls by dialing a code connecting them to the selected carrier. ANACOM has required call-by-call carrier selection to be offered by us for long distance and international calls since January 1, 2000. We have been offering it for local and regional calls since January 1, 2001 and for fixed-to-mobile calls since October 1, 2000.

The September 1998 amendment to the EU Interconnection Directive also required EU member states to provide that, at a minimum, all wireline network operators with significant market power offer carrier pre-selection. In Portugal, however, this obligation applies to all operators and service providers regardless of their market power. Carrier pre-selection allows customers to select the carrier that will be their default carrier. They then do not need to dial any code to connect to their selected carrier when they make their calls. ANACOM introduced interim carrier pre-selection using auto dialers on July 1, 2000 and full carrier pre-selection has been available throughout Portugal since October 15, 2000.

ANACOM also introduced call-by-call carrier selection for mobile operators, including TMN, on March 31, 2000. Following this introduction, mobile operators are required to offer call-by-call carrier selection for international calls only.

Unbundling of the Local Loop

On December 18, 2000, the EC Commission approved a regulation requiring wireline network operators to make the local loop between their customers and the local switches on their networks available to competitors. This allows such competitors to connect their networks to the copper "local loop" and use it to provide their services directly to those customers without having to rely upon the network operator's relationship with the customers. According to the regulation, we are required to maintain a reference offer for unbundled access to our local loops and related facilities and to meet reasonable requests for unbundled access to our local loops and related facilities under transparent, fair and non-discriminatory conditions. Prices charged must be cost-oriented. ANACOM has announced that unbundling of the local loop should be available in Portugal in accordance with the terms of the EC regulation. Our PT Comunicações wholesale unit published its last version of the reference offer for unbundled access to our local loops on April 4, 2003. The reference offer is in accordance with terms established by ANACOM.

PT Comunicações has made available to its competitors all of the local switches for remote and physical co-location where technical and space conditions are available, 14 of which are co-located.

Internet and Related Services

Various regulatory developments may affect our Internet businesses. Portugal has adopted Decree Law 290-D/99 of August 2, 1999 regarding digital signatures, which established a legal framework for electronic documents and digital signatures. This framework is a key component for developing e-commerce business. Portugal is expected to enact further measures pursuant to the EU Electronic Signature Directive, adopted in December 1999. The EU Electronic Commerce Directive, which was implemented in January 2002, further promotes the free movement of electronically provided services and commerce within the EU. For example, it requires EU member states to absolve information carriers and host-services providers from liability for the content of information transmitted over the Internet. Such provisions provide us with legal protection that is important in carrying out our business. The 1995 EU Data Protection Directive, which was implemented in Portugal in 1998, places restrictions on the use by Internet companies of personal data stored on their networks. It is not possible at this time to ascertain the burden that data protection schemes or other self-regulation and content-monitoring requirements may impose on our Internet business.

EU Cable Television Directive

The EC Commission issued a directive on June 23, 1999 that requires member states to enact legislation directing incumbent telecommunications operators to separate their cable television and telecommunications operations into distinct legal entities. The EC Commission has indicated that further actions to reduce the potential anti-competitive effects of the joint provision of cable television

and telephone infrastructures will be justified in specific cases. We believe, however, that steps already taken to operate our cable television business in Portugal through PT Multimedia, a separate legal entity that has independent shareholders, satisfy the requirements of the directive implemented in Portugal.

Licensing Framework

The EU Licensing Directive prohibits any limitation in the number of new entrants in telecommunications markets, except as required to ensure an efficient use of radio frequencies. It gives priority to general authorizations as opposed to licensing of particular activities; however, it

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permits national regulatory authorities to decide when licenses should be required for particular activities.

The Portuguese government approved Decree Law 381-A/97 of December 30, 1997, which implements the EU Licensing Directive. This decree law requires a separate license to:

provide public wireline telephone services;

establish and/or provide public telecommunications networks;

establish networks or provide services which require the granting of frequencies; or

conduct operations in which the operator is subject to universal service obligations, interconnection obligations or duties that derive from having significant market power.

Summary of Our Concession and Existing Licenses

Our Concession is for the installation, management and operation of the infrastructure that forms part of the basic telecommunications network in Portugal (as discussed below) and the terrestrial broadcasting network in Portugal, and it permits us to provide public switched wireline telephone, packet switched data (the rights to which were transferred to our subsidiary PT Prime) on X.25 mode, leased lines and telex and telegraphy services in Portugal. We also provide mobile telephone services, cable television and data communications services under licenses granted to our subsidiaries by the Portuguese government. The subsidiaries holding the licenses are subject to separate financial reporting and other requirements.

Our Wireline Concession. The Portuguese government granted Portugal Telecom a Concession on March 20, 1995. The Concession had an initial term of 30 years, expiring in 2025, and could be renewed for successive minimum periods of 15 years by agreement between us and the Portuguese government. As part of the reorganization of our businesses, Portugal Telecom transferred the Concession to its subsidiary PT Comunicações. The Council of Ministers approved this transfer in a Decree Law that came into effect upon publication in the Portuguese Official Journal on September 9, 2000. The Concession confers rights with respect to provision of transmission infrastructure and leased circuit services as well as wireline telephone, telex and telegraphy services in Portugal.

The Concession granted to us the right to install, manage and operate the infrastructure that forms part of the basic telecommunications network and the terrestrial broadcasting network. Some of our assets that are part of the basic telecommunications network (as defined in Portuguese legislation) were treated as being within the "public domain" under the terms of the Concession. During the term of the Concession, we were permitted to receive economic benefits from the use of public domain assets as if we owned them completely. However, such public domain assets would have reverted to the Portuguese government without compensation when the Concession expired.

On December 11, 2002, we agreed to prepay the future rental payments due under the Concession in exchange for full ownership of the basic telecommunications network and to ensure that there will be no reversion of the assets related to the provision of Concession services to the government in 2025. On December 27, 2002, PT acquired full ownership of the basic telecommunications network for €

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365 million, which included the 2002 Concession fee in the amount of €16.6 million. As a result of this acquisition, the terms of the Concession have been modified so that PT Comunicações no longer is obligated to pay a concession fee to the Portuguese government and ownership of the network and assets related to the Concession will not revert back to the Portuguese government in 2025.

The Portuguese government retains the ability to suspend or terminate our rights under the Concession. In cases of serious non-performance by us of our obligations under the Concession, the Portuguese government may, on a provisional basis, take over the development and operation of services authorized under the Concession. The Concession may also be terminated in cases of "severe, continual or insoluble" failure to perform our obligations. We believe that we have the resources to fulfill all our obligations under the Concession.

In addition, after 2010 the Portuguese government may revoke the Concession upon at least one year's notice if it deems such action to be justified in the public interest. In that event, we have the right to compensation in an amount equal to the value of the assets which constitute the

infrastructure of the basic telecommunications network, including other of our assets included in our infrastructure development plan, net of depreciation and revaluation. This compensation would be payable prorated over the remaining term of the Concession. We would also be entitled to additional compensation equaling our annual average net profits for the five years prior to notification of revocation multiplied by the number of years remaining before the Concession expires. See "*Item 3 Risk Factors The Portuguese Government Could Terminate Our Concession and Licenses*".

Our modified Concession provides that we are exempt from all taxes, fees and charges with respect to the usage of public rights-of-way for our telecommunications infrastructure. Further, Law 91/97 codified our right to use the public rights-of-way for our telecommunications infrastructure. Law 91/97 provides that we are exempt from municipal taxes and rights-of-way and other fees with respect to access to and installation and use of our telecommunications network in connection with our obligations under the Concession. Our exemption from municipal taxes prior to the enactment of Law 91/97 is being challenged in the Portuguese courts by the Municipality of Oporto. In case the legal situation for rights-of-way changes and PT Comunicações has to pay for these rights, our Concession provides that PT Comunicações should be compensated up to 2025, when the Concession expires. See "*Item 8 Legal Proceedings Claims for Municipal Taxes and Fees*".

Under the former terms of the Concession, we have to pay the Portuguese government a fee of up to 1% of our operating revenues from the services provided under the Concession, after certain deductions. This concession fee for 2000 and 2001 amounted to €21.48 million and €13.20 million, respectively. The fee for 2001 includes an adjustment of the fee for 2000 that amounted to a €4.04 million reduction as a result of the acquisition of the basic telecommunications network, the terms of the Concession have been modified so that PT Comunicações no longer is obligated to pay a concession fee to the Portuguese government, which in 2002 amounted to €16.6 million and was included in the amount paid for the acquisition of the ownership of the basic telecommunications network property. The Concession also requires us to supply telecommunications services free of charge to certain Portuguese state officials, including the President of the Republic, the President of the Parliament, the Prime Minister and the President of the Supreme Court. In 2000, 2001 and 2002 the value of such services was approximately €0.3 million, €0.2 million and €0.1 million, respectively.

We have to provide special telephone prices to certain eligible retired and pensioner Portuguese citizens. The costs of providing these special prices are directly reimbursed by the Portuguese government. In addition, we maintained in the new pricing convention the offering of supplementary discounts to certain retired and pensioner Portuguese citizens without reimbursement from the Portuguese government. The cost of such discounts was approximately €13.6 million in 2001 and €12.6 million in 2002.

Under the Concession, we have to establish objectives for the development of our infrastructure and service offerings. This includes indicators of the quality of services to be complied with us. These objectives must be defined by ANACOM.

The Concession imposes a universal service obligation on us. See "*Universal Service Obligations*", above.

The Ministry of Finance is responsible for monitoring financial issues with respect to the Concession. The Ministry of Economy is responsible for all other issues under the Concession. ANACOM is authorized to monitor and assess penalties up to a maximum of €500,000 if we fail to fulfill our obligations under the Concession or other obligations imposed by law. Disputes concerning the application and interpretation of the Concession are dealt with by arbitration.

Marconi Subconcession. We used to provide our international telecommunications services through Marconi under a subconcession from PT Comunicações. On 31 December, 2002, Marconi was merged with PT Comunicações. The subconcession has been terminated and all the Marconi services are now provided by PT Comunicações.

PT Prime's Data Licenses and Registrations. PT Prime holds:

a renewable, non-exclusive license, valid until 2015, to provide wireline services;

a renewable, non-exclusive license, valid until 2015, to be a "Public Telecommunications Networks" operator; and

due to our reorganization, all the former Telepac licenses, such as a data communications license, valid until 2010.

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PT Prime's data communications license authorizes it to provide X.25/X.32 synchronous services and X.28 asynchronous services and other switched and non-switched data communications services, including frame relay and virtual private networks for data communications. The license also authorizes PT Prime to provide value added services such as electronic data interchange and videotext services. In addition, the license authorizes the company to construct certain networks infrastructure in connection with licensed services. In February 1997, ANACOM granted PT Prime's predecessor a license to provide data communications services using satellite infrastructure, which was valid for 15 years. With respect to packet switched data, the data communications license is valid for 30 years and renewable by right thereafter for 15-year periods, unless PT Comunicações' Concession is terminated earlier. The license is valid for 15 years for other data transmission services. Under Decree Law 381-A/97 of December 30, 1997, and in accordance with the EU licensing regime, companies are not required to have a license to provide data communications services and Internet access. Instead, it is sufficient to register their intended services with ANACOM under its service registration scheme.

In April 1997, ANACOM granted a license (now held by PT Prime) to our Telepac subsidiary to provide data communications services using satellite infrastructure. Licenses have also been granted to other providers of data communications and Internet access services, including companies associated with major international telecommunications providers.

In April 1997, ANACOM also granted our Telepac subsidiary a license (now held by PT Prime) to offer voice services to corporate networks and other closed groups of users. This licence is valid for 15 years. Other providers of data communications services have also been issued licenses to provide such voice services, including Global One and Oni-Solutions Infocomunicações, S.A.

TMN's Mobile Service Licenses. Mobile telephone service licenses are valid for 15 years and are issued by ANACOM under Decree Law 381-A/97. These licenses authorize the installation of base stations, base station controllers and control switching centers and require the licensee to construct

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networks capable of reaching at least 75% of Portugal's population within a specified period of time. Charges for the provision of mobile telephone services are not subject to regulation.

Through TMN, we hold a renewable, non-exclusive license to provide traditional and GSM digital mobile telephone services throughout Portugal. This license is valid until 2007 and may be renewed thereafter by authorization of the Portuguese telecommunications regulator. TMN terminated the provision of traditional analog mobile services, after being authorized by the Portuguese regulator, in 1999. Two other operators hold licenses to provide GSM digital mobile telephone services on substantially the same terms as those applicable to us. Vodafone Telecel was awarded its license in 1991. Main Road was awarded a license in 1997 and began operations through Optimus in September 1998. In addition to GSM 900 services, all three mobile service operators have been authorized since April 1998 to provide GSM 1800 services in Portugal on substantially similar terms and conditions.

We are required to comply with a number of mobile telephone service criteria. These include satisfying minimum quality standards regarding blocked call rates, network effectiveness and servicing time, and providing certain services. We are also required to provide ANACOM with monthly information about our mobile telephone operations, including the number of customers, number and average duration of calls and quarterly information about the development of infrastructure.

TMN held a national license to provide paging services covering all of continental Portugal. It also held a license to provide paging services in the Azores and Madeira Islands. These licenses were valid until 2007 and are renewable thereafter by agreement. TMN terminated the provision of paging services in July 2002, after giving notice to the Portuguese telecommunications regulator and to paging customers.

ANACOM has also granted nationwide licenses to two operators for the provision of dispatch services: Radiomóvel and Repart. TMN sold its participation in Radiomóvel in 2001.

Third Generation Mobile Services Licenses. In 2000, ANACOM conducted a tender for four licenses for universal mobile telecommunications services, known as UMTS. UMTS services are the European version of the globally accepted technical standards for "third generation" mobile communications. UMTS constitutes a significant advance over the "second generation" digital GSM mobile services currently provided. The "first generation" services were traditional analog mobile services. The broadband capacity of the frequency spectrum to be allocated under the UMTS licenses will enable operators to supply video and Internet content to mobile handsets.

The UMTS licenses were issued by ANACOM at the end of 2000. The licenses cover all of Portugal and are valid for 15 years. The Ministry of Economy, under direction from ANACOM, has postponed the mandatory initiation of third generation services by license holders from January 1, 2003 to December 31, 2003. The license fee was €100 million per license. TMN and the other two main mobile operators in

Portugal were each awarded one of these licenses at the end of 2000.

One of the licenses for third generation services was awarded to Oniway, a new entrant in the Portuguese mobile market. However, Oniway decided not to participate in the provision of third generation mobile services and as a result requested that the Portuguese government repeal the license granted to it in January 2001. The Portuguese government granted this request by ministerial order on January 13, 2003. The other three recipients of third generation licenses, including TMN, requested that the additional frequency that had been allocated to Oniway be reallocated to them. This request was granted by a special ministerial order in January 2003.

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The tender was for 2x15MHz of paired spectrum in the 1920-1980 MHz / 2110-2170 MHz bands and 5 MHz of non-paired spectrum in the 1900-1920 MHz band for each of the licences. License holders are required to offer their services to:

at least 50% of the Portuguese population at the launch;

65% by the end of the third year; and

77% by the end of the fifth year.

To ensure a competitive market develops in the new services, license holders are limited in the amounts of share capital that they and their shareholders may hold of any other license holder. Neither a license holder nor a shareholder of a license holder may hold, directly or indirectly, more than 10% of the share capital of another license holder.

TV Cabo's Cable Television Authorizations. Cable television authorizations are issued upon proposal by the member of government responsible for telecommunications at ANACOM and are valid for 15 years. These authorizations permit the construction of the main cable distribution centers as well as cable distribution networks. They also contain quality of service standards and, in most cases, obligations to construct networks capable of reaching 80% of the population of the authorized area. The remaining 20% of the population may request connection at an extra charge. The charges for the provision of cable television services are not subject to regulation.

Although not public domain assets and not subject to the Concession, the cable television infrastructure that TV Cabo has installed and operates may be subject to reversion or transfer to third parties without compensation. Under the terms of Decree Law 241/97 of September 18, 1997, infrastructure installed on the property of a governmental authority will become part of such authority's property when authorizations granted to cable television operators expire or terminate. Infrastructure installed on the property of a telecommunications operator, including us, will revert to such operator. Also, unless otherwise agreed, infrastructure installed on other property will revert to the property owner.

TV Cabo holds a total of nine renewable, non-exclusive authorizations to provide cable television services in 125 counties in seven regions in continental Portugal and the Madeira and Azores Islands. These licenses are renewable by agreement. Currently, certain other operators are also authorized to provide cable television services in Portugal. See "*Competition Competition Facing TV Cabo*".

Under Portuguese law, advertising on TV Cabo's stations is generally restricted on the same terms as broadcast TV. These restrictions include a ban on alcohol advertisements before 10 p.m. and a complete ban on tobacco advertisements. Advertising on premium channels cannot take up more than 10% of air-time, and advertising on basic channels cannot take up more than 15% of air-time.

Portuguese law currently permits television operators to produce and broadcast their own television programming if they have national coverage. In addition, Portuguese legislation permits the use of two-way signaling capability over cable television networks. The ability to transmit and receive signals allows the introduction of pay-per-view, home shopping and similar products in Portugal.

In 1997, the Portuguese government decided to allow competition in the provision of infrastructure to telecommunications services that are already open to competition. As a result, cable operators can hold a public network operator license under Decree Law 381-A/97 and Decree Law 290-A/99 and cable networks may be used to provide infrastructure to providers of already liberalized services.

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Brazil

General. Our Brazilian mobile businesses, the services they provide and the prices they charge are subject to regulation under the General Telecommunications Law and various administrative enactments, which regulate the services provided by Brazilian telecommunications operators.

ANATEL is the agency that regulates telecommunications under the General Telecommunications Law and the July 2001 Regulamento da Agência Nacional de Telecomunicações, known as the ANATEL Decree. ANATEL is financially autonomous, and administratively independent of the federal government. ANATEL maintains a close relationship to the Ministry of Communications. Any regulation proposed by ANATEL is subject to a period of public comment, which may include public hearings. ANATEL's actions may be challenged in the Brazilian courts under Brazilian administrative law. On November 25, 1998, ANATEL enacted "Resolution 73 Regulation of Telecommunication Services," which regulates in detail the new comprehensive framework for the provision of telecommunications services in Brazil established by the General Telecommunications Law.

Concessions and Authorizations. Prior to January 2000, ANATEL had only authorized two mobile service providers in each of the ten franchise areas under A Band and B Band. A Band and B Band mobile service providers, including Brasilcel's operating subsidiaries, were granted concessions pursuant to the *Lei Mínima*, or the Minimum Law. Each concession is a specific grant of authority to supply cellular telecommunications services, subject to certain requirements contained in the applicable list of obligations appended to each concession. If a mobile service provider wishes to offer any telecommunications service other than those authorized by its concession, it may apply to ANATEL for an authorization to offer such other services.

In accordance with the General Telecommunications Law, a concession relates to the provision of telecommunication services under the public regime, as determined by the public administration. A concession may only be granted upon a prior auction bidding process. As a result, regulatory provisions are inserted in the relevant concession agreements and the concessionaire is subject to public service principles of continuity, changeability and equal treatment of customers. Also, the government authority is entitled to direct and control the performance of the services, to apply penalties and to declare the expiration of the concession and the return of assets of the concessionaire to the government authority upon termination of the concession. Another distinctive feature is the right of the concessionaire to maintain an economic and financial balance of the concession agreement. The concession is granted for a determinate period of time and is generally renewable once.

An authorization is a permission granted by the public administration under the private regime, which may or not be granted upon a prior auction bidding process, to the extent that the authorized party complies with the objective and subjective conditions deemed necessary for the exploitation of the relevant type of telecommunication service in the private regime. The authorization is granted for an indeterminate period of time. Under the authorization, the government will not guarantee the economic and financial balance, as it was guaranteed under the concession.

SMP Regulation. In November 2000, ANATEL adopted certain regulations for the issuance of new licenses, known as authorizations, to provide wireless communication services through SMP rules to compete with the then existing cellular operators in the various regions of Brazil. These regulations divided Brazil into three main regions covering the same geographic area as the concessions for the fixed-line telecommunications services. ANATEL organized auctions for three new licenses for each of those regions. The new licenses provided that the new services would be operated in the 1,800 MHz radio frequency bands, and they were denominated C Band, D Band and E Band. These new licenses were auctioned by ANATEL and awarded during the first quarter of 2001 and at the end of 2002.

Under these new licenses: services were to be provided using the 1,800MHz frequency; each operator would be able to provide domestic and international long distance services in its licensed area;

existing cellular service providers, as long as they do not have partnerships with fixed-line operators, as well as new entrants into the Brazilian telecommunications market could have bid for C Band, D Band and E Band licenses. However, fixed-line operators, their controlling shareholders and affiliated cellular providers may only bid for D Band and E Band licenses; a cellular operator, or its respective controlling shareholders, cannot have geographical overlap between licenses; and current A Band and B Band cellular service providers could apply for an extra frequency range.

Pursuant to the SMP services regulation each of the three main regions is divided into registration areas, or tariff areas.

Brasilcel's operating subsidiaries all held concessions prior to the introduction of the SMP regime. Subsequent to its introduction, they have migrated to the new SMP regime and their concessions have been converted into authorizations to use the radio frequency spectrum in their respective bands and provide services in the regions in which they operate. See " *Our Business Joint Venture with Telefónica Móviles in Brazil*". In order to migrate our services to the SMP regime, Telesp Celular and other operators owned by Brasilcel were required to comply with several technical and operational conditions, including, among others, the adoption of a carrier selection code for long distance calls originating from their networks.

Under the General Telecommunications Law, all mobile telecommunications service providers must provide interconnection upon the request of any other mobile or fixed-line telecommunications service provider. The terms and conditions of the interconnection are freely negotiated between wireless and fixed-line operators, subject to a price cap and compliance with regulations established by ANATEL relating to the traffic capacity and interconnection infrastructure that must be made available to requesting parties. If a service provider offers any party an interconnection tariff below the price cap, it must offer the same tariff to any other requesting party on a nondiscriminatory basis. If the parties cannot reach an agreement on the terms of interconnection, including with respect to the interconnection tariff, ANATEL will act as the final arbiter. Because ANATEL considers Telesp Celular and the other operators owned by Brasilcel to be affiliated with Telefónica, which already provides wireline long distance services in the state of São Paulo and was awarded a license to provide these services nationwide, ANATEL will not award a wireline long distance license to Telesp Celular or the other operators owned by Brasilcel. Though Brasilcel, through its operating subsidiaries, has requested that ANATEL revise the current SMP regime, there can be no assurance it will do so. Under the SMP regime, our operations will receive revenues from interconnection fees paid to us by wireline long distance operators due to long distance traffic originating and terminating on our network. However, there is no assurance that the interconnection fees that we receive from wireline long distance operators will compensate for the revenues that Telesp Celular and the other operators owned by Brasilcel would have received from our customers for directly providing long distance services to them. As a result, our overall revenues might decrease significantly.

The SMP regime may change the interconnection fees that other operators currently pay to Brasilcel's operators as a result of traffic originating on other networks and terminating on the mobile networks of Brasilcel's operators. The SMP regime permits commercial negotiation of the interconnection rates Brasilcel's operators charge other operators for the use of the network. Wireline operators have indicated that they may force such rates to be reduced.

The authorizations consist of two licenses – one to provide mobile telecommunications services, and another to use the frequency spectrum for a period of 15 years. The frequency license is renewable for a second 15-year period upon the payment of an additional license fee.

Potential Benefits Relating to the SMP System. According to the General Telecommunications Law and Decree No. 2056/96, control of a concessionaire can only be transferred after five years from the date of the privatization in the case of A Band concessionaires, or the commencement of services in the case of B Band concessionaires. On the other hand, under the SMP system, the authorization or control of the authorized party can be transferred through merger or incorporation of the relevant cellular mobile service provider, whether they are providing services under the A Band or the B Band.

Obligations of Telecommunications Companies. As telecommunications service providers, Telesp Celular and the other operators owned by Brasilcel are subject to regulations concerning quality of service and network expansion, as established in their authorizations and their original concession arguments.

Any breach by the companies of telecommunications legislation or of any obligation set forth in their authorizations may result in a fine of up to R\$50 million.

Our Brazilian mobile businesses' authorizations impose obligations to meet quality of service standards, such as: the system's ability to make and receive calls, call failure rates, the network's capacity to handle peak periods, failed interconnection of calls and customer complaints. ANATEL published the method for collecting these quality service standards on April 23, 2003 (ANATEL Resolution No. 335/03).

Interconnection. Under the General Telecommunications Law, telecommunications service providers are classified as providers of either collective or restricted services. All cellular operators, including SMP service providers, are classified by ANATEL as collective service providers. All providers of collective services are required to provide interconnection upon request to any other collective service provider. The terms and conditions of interconnection are freely negotiated between parties, subject to price caps and other rules established by ANATEL. Providers must enter into interconnection agreements, regarding, among other things, tariffs, commercial conditions and technical issues, with all requesting parties on a non-discriminatory basis.

Interconnection agreements must be approved by ANATEL and may be rejected if they are contrary to the principles of free competition and the applicable regulations. If the parties cannot agree upon the terms and conditions of interconnection, ANATEL may determine terms and conditions by arbitration.

Under the SMP system, usage of the network remuneration between SMP mobile operators will only be due if traffic carried in the same registration area between two networks, in a given direction, exceeds 55% of the total traffic exchanged between them. In this case, only those calls which have surpassed the 55% threshold will be subject to payment for network usage. This rule is valid until June 30, 2005. Thereafter, SMP operators will adopt full "Bill and Keep", by which no remuneration will be due for network usage among SMP networks, regardless of the amount of carried traffic.

Rate Regulation. Authorizations continue to provide for a price-cap mechanism to set and adjust rates on an annual basis. The cap is a maximum weighted average price for a package of services. The package consists of the services in its Basic Plan, including activation fees, monthly subscription fees, and certain roaming charges, which are charged for the use of mobile services under the SMP regime. The price cap set in the concession agreement has been revised annually to reflect the rate of inflation as measured by the IGP-DI. However, mobile operators are able to freely set the rates for alternative service plans.

The initial price cap agreed to by ANATEL and Brasilcel's operating subsidiaries in their authorizations had been based on the previously existing or bidding prices, and was adjusted annually on the basis of a formula contained in their authorizations. The price cap has been revised to reflect the rate of inflation as measured by the IGP-DI. The weighted average price for the entire package of

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services may not exceed the price cap, but the price for individual services within the package may be increased.

Other telecommunications companies that interconnect with and use Brasilcel's operating subsidiaries networks must pay certain fees, primarily an interconnection fee. The interconnection fee is a flat fee charged per minute of use. The interconnection fee charged by A Band and B Band service providers is still subject to a price cap stipulated by ANATEL. The price cap for the interconnection fee varies from company to company, on the basis of the underlying cost characteristics of each company's network. B Band service providers are subject to price caps established during the auction process for their licenses. There are no price caps on competitors in other Bands.

Competition Issues. ANATEL is required to consult with the Brazilian competition authority, Conselho Administrativo de Direito Económico, or CADE, in carrying out certain of its responsibilities, including those related to the review of acquisitions and joint venture agreements entered into by telecommunications operators. In turn, CADE does not exercise its responsibilities without initially seeking the views of ANATEL and would not intervene with respect to any proposed acquisition or agreement affecting competition in the telecommunications sector without first seeking the views of ANATEL. Telecommunications operators must concurrently seek review from ANATEL and CADE of acquisitions and joint venture agreements.

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ITEM 5 OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion in conjunction with our audited consolidated financial statements and the accompanying notes included elsewhere in this report. Our audited consolidated financial statements have been prepared in accordance with Portuguese GAAP, which differs in significant respects from U.S. GAAP. For a discussion of the principal differences between Portuguese GAAP and U.S. GAAP as they relate to us, see " *Portuguese GAAP Compared with U.S. GAAP*" below and Notes 38, 39 and 40 to our audited consolidated financial statements. All statements of income and cash flow data presented below for the years ended December 31, 2000, 2001 and 2002, and all balance sheet data as of December 31, 2000 and 2001, reflect the full consolidation of TCP's results of operations with our financial results. However, as a result of the transfer of our interest in TCP to Brasilcel on December 27, 2002 and our acquisition of a 50% ownership interest in Brasilcel as of that date, our consolidated balance sheet as of December 31, 2002 proportionally consolidates the financial results of Brasilcel.

Overview

Our Business Reorganization and Revenue Reporting Categories

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Portugal Telecom, SGPS, S.A. is a group holding company. We also created new subsidiaries to operate as our business units. Our business operations are conducted by our subsidiaries. During 2002, our business structure was as follows:

PT Comunicações Fixed Line
Business Unit

Offering fixed line telephone services for retail and wholesale customers, including leased lines, interconnection and transmission of TV and radio signals for broadcasters, as well as sales of telecommunications equipment in Portugal.

PT Prime Data and Business
Solutions Unit

Offering data and business solutions to corporate customers through its subsidiaries and other companies in which it holds an ownership interest:

PT Prime in Portugal and Primesys in Brazil provide data communications, network and systems outsourcing through integrated solutions; and

Tradecom is developing business-to-business e-commerce platforms in Portugal, Brazil and countries in the Mercosul region.

Mobile Business Unit

Offering mobile services, such as voice, data and Internet-related services, through its subsidiaries and other mobile companies in which it holds a direct or indirect ownership interest:

TMN in Portugal;

Telesp Celular, which operates in the Brazilian state of São Paulo(1);

Global Telecom, which operates in the Brazilian states of Paraná and Santa Catarina(1)(2);

Celular CRT, which operates in the Brazilian state of Rio Grande do Sul(1)(2);

Medi Telecom in Morocco(2);

Mascom Wireless in Botswana; and

Unitel in Angola(2).

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PT Multimedia Multimedia Business
Unit

Offering multimedia and Internet-related services for the residential and small and medium-sized enterprise market through its subsidiaries and participations:

TV Cabo provides cable, broadband Internet and satellite television services in Portugal;

Lusomundo, a leading Portuguese media and entertainment content and service provider;

PTM.com provides Internet access and applications, portal and content services and e-commerce in Portugal and Brazil(3);

PT Conteúdos is engaged in creating Portuguese language audiovisual programming content; and a minority interest in Páginas Amarelas, the leading provider of yellow and white pages directories in Portugal.

PT Prime Data and Business
Solutions Unit

Offering data and business solutions to corporate customers through its subsidiaries and other companies in which it holds an ownership interest:

PT Prime in Portugal and Primesys in Brazil provide data communications, network and systems outsourcing through integrated solutions(4); and

Tradecom is developing business-to-business e-commerce platforms in Portugal, Brazil and countries in the Mercosul region.

Support companies, certain
international investments & other
holdings

Other subsidiaries and investments, including research and development, information and support systems subsidiaries (PT Inovação and PT Sistemas de Informação) and investments in operators in Brazil, Macau and mainland China and certain countries in Africa (PT Ventures).

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- (1) During the year ended December 31, 2002, we offered mobile services in the Brazilian market through Telesp Celular, Global Telecom and Celular CRT. On December 27, 2002, PT's interest in these subsidiaries was transferred to Brasilcel in exchange for a 50% interest in Brasilcel. See *"Item 4 Information on the Company Our Businesses Mobile Businesses Joint Venture with Telefónica Móviles in Brazil"*.
- (2) We accounted for these investments during 2002 using the equity method.
- (3) The investments in PTM.com and in Páginas Amarelas were transferred directly to Portugal Telecom in October 2002 during the restructuring process of PT Multimedia. As a result, PT Multimedia's financial results only include nine months of the financial results of PTM.com and Páginas Amarelas.

Our mobile operations are in Portugal, Brazil, Morocco, Botswana and Angola. For financial reporting purposes, for the year ended December 31, 2002, we classified:

our mobile operations in Portugal under "Mobile Business in Portugal (TMN)";

our mobile operations in Brazil under "Mobile Business in Brazil (TCP)"; and

our mobile operations outside Portugal and Brazil under "Other Businesses".

We discuss and analyze our financial condition and results of operations in this section according to the classification used for the year ended December 31, 2002. This classification does not reflect our joint venture transaction on December 27, 2002, pursuant to which we and Telefónica transferred our interests in mobile operators in Brazil to Brasilcel and each of us acquired 50% of Brasilcel. Our classification in future reporting and discussion and analysis will, however, reflect the new joint venture. See *" Consolidation Treatment of TCP and Brasilcel"* below and *"Item 4 Information on the Company Our Businesses Business Units"*.

We are in the process of reorganizing our business reporting structure. In October 2002, we transferred our interest in PT Multimedia.com from PT Multimedia to PT Comunicações and the 2002 results of PT Multimedia reflect nine months' of these transferred subsidiaries' results. In future periods, we intend to report our results according to the following classification:

Wireline Business in Portugal, including PT Comunicações, PT Prime and PTM.com;

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Mobile Business in Portugal, including TMN;

Multimedia Business in Portugal, including PT Multimedia;

Mobile Business in Brazil, including our 50% interest in Brasilcel; and

Other Businesses, including our fixed line and mobile operations in countries other than Portugal and Brazil, support companies, certain international investments and other holdings.

Consolidation Treatment of TCP and Brasilcel

From July 1, 1998 until the end of 1999, under Portuguese GAAP, we proportionately consolidated the financial results of TCP with our consolidated financial results. This means that we included them in our group's consolidated financial statements in proportion to our economic interest in Telesp Celular at the end of a given reporting period. As a result of our increase in ownership in 2000, from approximately 35.58% to 85.06% of the voting securities of TCP, from January 1, 2000, we fully consolidated the financial results of TCP in our consolidated financial results. This change of consolidation treatment of TCP resulted in significant differences between our results for periods prior to and after

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January 1, 2000, which we discussed in our annual reports on Form 20-F for the years ended December 31, 2000 and 2001.

On December 27, 2002, we transferred our interest in TCP to our mobile joint venture with Telefónica Móviles in Brazil, named Brasilcel. We now hold a 50% interest in Brasilcel, which now holds directly the following investments:

the controlling interest in TCP (which holds 100% of Telesp Celular and, since December 27, 2002, 100% of Global Telecom) and a minority interest in Celular CRT Participações (which holds 100% of CRT Celular) which we used to hold; and

the controlling interest in Tele Sudeste Celular Participações (which has 100% of the mobile operators in the Brazilian states of Rio de Janeiro and Espírito Santo), Tele Leste Celular Participações (which holds 100% in the mobile operators in the Brazilian states of Bahia and Sergipe) and Celular CRT Participações, which Telefónica Móviles used to hold.

Since the transaction occurred at the end of the year, our statement of income and cash flow data for the year ended December 31, 2002 continues to fully consolidate the financial results of TCP. However, in future years, we will proportionally consolidate the financial results of Brasilcel in our consolidated financial results. Since the transaction occurred on December 27, 2002, our consolidated balance sheet at December 31, 2002 proportionately consolidates 50% of the assets and liabilities of Brasilcel rather than fully consolidating those of TCP.

Changing Composition of Our Operating Revenues

The composition of our operating revenues, excluding the change in our accounting treatment of fixed-to-mobile traffic, has been changing in recent years. See " *Accounting for Fixed-to-Mobile Traffic*". Mobile services, data and business solutions and multimedia services such as Cable TV and Internet services have been growing rapidly in Portugal. Revenues from fixed line telephone services, particularly voice services, account for a decreasing share of our total operating revenues. The decrease in our fixed line telephone services revenues since 1998 reflects the migration of users from fixed line voice services to mobile voice services in Portugal, as well as price reductions. We expect these changes in the composition of our revenues to continue.

The provision of public fixed line telephone services accounted for 27.1% of total operating revenues in 2002, 29.9% in 2001 and 29.9% in 2000. The proportion of our total operating revenues derived from the provision of mobile telephone services in Portugal and Brazil accounted, on a combined basis, for 44.5% in 2002, 44.9% in 2001 and 51.3% in 2000. The trends above are affected by

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the devaluation of the Brazilian Real, since a substantial part of our mobile telephone operations are in Brazil. Had the Brazilian Real not declined in value relative to the Euro, revenues from mobile telephone services would have represented a higher proportion and revenues from public fixed line telephone services would have represented a lower proportion of our total operating revenues in these periods. Other significant businesses currently include our fixed line wholesale services, our data and business solutions and our multimedia businesses. The proportion of our operating revenues attributable to our fixed line wholesale services business accounted for 4.8% in 2002, 4.7% in 2001 and 4.2% in 2000. The proportion of our total operating revenues attributable to our data and business solutions represented 4.7% in 2002, 3.8% in 2001 and 3.4% in 2000. The proportion of our total operating revenues attributable to our multimedia businesses represented 11.5% in 2002, 10.3% in 2001 and 4.4% in 2000.

Changes in the Portuguese telecommunications market are causing changes to the split of revenues among business units within our group. As mobile services in Portugal are increasingly utilized as a substitute for fixed line services, these revenues migrate from PT Comunicações to our mobile business in Portugal (as well as to other mobile operators, as appropriate). On the other hand, the rise in mobile services and competition from other fixed line service providers in Portugal has meant a corresponding rise in the revenues of PT Comunicações' wholesale business from its leased lines and interconnection agreements.

Internet Interconnection Charges

On February 21, 2001, ANACOM issued an administrative act instructing PT Comunicações to submit a reference Internet access offer proposal changing its billing structure for the interconnection of ISPs to its fixed line network from a model based on revenue sharing to one based on call origination charges and establishing maximum prices that PT Comunicações is permitted to charge ISPs, for Internet interconnection service. This administrative decision instructed PT Comunicações to implement the new billing regime by May 31, 2001. PT Comunicações published its reference Internet access offer on March 1, 2001 and, since that time, has modified how it accounts for revenues

attributable to the interconnection of ISPs to its fixed line network. We believe that PT Comunicações is in full compliance with ANACOM's administrative decision.

Under the new billing regime, two different types of billing arrangements with ISPs are possible. Under the first method of billing, PT Comunicações is required to collect revenues from customers who use its fixed line network to connect to the Internet on behalf of ISPs, at a price established by the ISPs. The ISPs pay a call origination charge and the cost to PT Comunicações of invoicing customers for their minutes of usage at rates set by the ISPs, if PT Comunicações is requested to invoice customers on behalf of the ISPs, to PT Comunicações. PT Comunicações remits the revenues it receives from customers to the ISPs and collects those charges that it is owed by the ISPs. When an ISP does not request that PT Comunicações invoice its customers, PT Comunicações collects only the call origination charge from the ISP. Under the second method of billing, PT Comunicações charges the ISPs a wholesale flat rate. In turn, each ISP bills its own customers for the ISP services.

Prior to the introduction of this new billing regime, PT Comunicações established the rates for Internet interconnection and collected the revenues for such interconnection from customers who used its fixed line network to connect to the Internet. PT Comunicações retained 65% of all such revenues received and remitted 35% to the ISPs.

Within the Portugal Telecom group, the new accounting regime reduces revenues collected by PT Comunicações from the provision of Internet interconnection service. However, to the extent the Portugal Telecom group provides services through our ISP Telepac, this change results in an increase in revenues collected by Telepac. This new accounting regime reduces our revenues on a consolidated basis.

We are currently contesting the legality of the ANACOM administrative decision that governs the new Internet interconnection billing regime. If PT Comunicações is successful in its initial claim, it plans to request compensation for any losses suffered in connection with the implementation of its reference Internet access offer of March 1, 2001. See "*Item 8 Financial Information Legal Proceedings*".

Cost Reduction Program

Our principal costs include employee costs (including wages and salaries, post retirement benefits and work force reduction program costs), costs of telecommunications (principally accounting rate payments to other international telecommunications operators), costs of products sold, other general and administrative costs and depreciation and amortization. Since our formation in 1994, we have focused on consolidating operations, identifying administrative duplication and generally improving the efficiency of our operations.

In 2002, we reduced our workforce in Portugal by 929 employees (including 754 employees resulting from the disposal of our investment in Deltapress). See "*Item 6 Directors, Senior Management and Employees Employees*". We expect these workforce changes to reduce labor costs and increase productivity. Workforce reductions in our fixed line telephone services will continue to be a significant part of our cost management in 2003. We believe that the productivity of our fixed line telephone service unit is commensurate with European standards generally. We believe that there is potential for further efficiency gains as a result of the continued implementation of the current cost reduction programs and network modernization, as well as management's continuous efforts to identify other areas to improve our efficiency.

Competition and Pricing

Changes in the competitive environment in Portugal have led to a significant reshaping of our domestic businesses, a process that we expect will continue in coming years.

We face substantial and increasing competition. In the past we experienced limited or no competition in our principal business areas, except in our mobile business unit. Since January 1, 2000, the telecommunications sector in Portugal has been open to full competition.

Our wireline telephone services face increasingly strong competition from mobile operators and other providers of wireline services. This resulted in decreases in revenues in wireline telephone services in 2002, 2001 and 2000. The market for mobile telephone services provided by TMN, our mobile subsidiary in Portugal, and by TMN's competitors, Vodafone and Optimus, has been growing at a fast pace. By the end of 2002, there were already approximately 82.5% activated mobile telephone cards per 100 inhabitants in the Portuguese market, more than the number of wireline main lines. This growth comes as more residential subscribers of wireline services add additional mobile phones for family members and as businesses add additional mobile telephones for their employees.

One of the principal ways that mobile operators compete with our wireline telephone and mobile services is through pricing. From January 1, 1999, mobile operators have been allowed to establish direct international interconnections with mobile and wireline networks abroad

and to by-pass our wireline network. Since then, Optimus, Vodafone and TMN have launched strong marketing campaigns for their international telephone services. Pricing competition is also increasing for domestic calls. See "Item 4 Information On The Company Competition".

The effect of full competition on our business depends partly on the prices that mobile and wireline network operators pay us for interconnection with our network. Since January 1, 2000, other companies may offer public wireline telephone services, and Portuguese law requires us to lease lines to our competitors and allow competitors to interconnect to our network. Our interconnection prices are subject to regulatory review and must be based on the cost of providing the service.

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Our reference offer for local loop unbundling was approved by ANACOM and published on July 16, 2001. PT Comunicações has made available to its competitors all of the local switches for remote and physical co-location, where technical and space conditions are available, 14 of which are co-located. Our competitors are now able to gain access to our network's local loops, giving them direct access to our customers. In addition, following the liberalization of wireline telephone services in 2000, steps have been taken towards full liberalization of the market since the first quarter of 2001. On January 1, 2001, carrier pre-selection was introduced for local and regional calls. Number portability for wireline services was implemented on July 1, 2001. These changes to the wireline telephone services market have intensified competitive pressures on our wireline telephone services business, including pricing. See "Item 4 Information on the Company Regulation".

Market and Economic Developments in Brazil

A material portion of our business, prospects, financial condition and results of operations is dependent on general economic conditions in Brazil. Since 1998, we have made significant investments in telecommunications operators such as TCP and in December 2002 we and Telefónica transferred our investments in Brazilian mobile operators to a 50/50 joint venture, Brasilcel, the largest provider of mobile telecommunications in the Brazilian market. The following significant factors have the potential

to impact negatively our investments in Brazil, including Brasilcel, and our results of operations in Brazil, including Brasilcel's:

general economic conditions in Brazil and in other Latin American countries;

the devaluation of the Real, which could negatively affect the stability of the Brazilian economy;

changes in the Brazilian government's economic policy, including changes in the exchange control policy; and

high rates of inflation, as well as governmental measures put in place to combat inflation.

In December 2001, we recorded a provision for impairment amounting to €500 million. This provision included an estimated impairment of our investment in TCP amounting to €1,500 million, net of the estimated tax effect of €1,000 million resulting from the corporate restructuring of our mobile businesses, which was in progress at that date. During the fourth quarter of 2002, this provision was used to offset the impairment in the investment in TCP amounting to €1,141 million, following the contribution of this investment to Brasilcel. See Note 18 c) to our audited consolidated financial statements.

Critical Accounting Policies under Portuguese GAAP

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with Portuguese GAAP. Our reported financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie preparation of the financial statements. We base our estimates on historical experience and on various other assumptions, the results of which form the basis for judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our consolidated financial statements.

Accounting for long-lived assets. Fixed assets and intangible assets other than goodwill are recorded at their acquisition cost or revalued amount in the case of certain fixed assets. When such assets are acquired in a business combination, purchase accounting requires judgment in determining the estimated fair value of the assets at the date of the acquisition and their useful lives over which the costs of acquiring these

assets are charged to the income statement.

Other intangible assets and plant, property and equipment are depreciated when, due to events and circumstances arising in the period, impairments are identified. The determination of such impairments involves the use of estimates, which include but are not limited to the cause, the timing and the amount of the impairment. Among impairment indicators, Portugal Telecom typically considers obsolescence, physical damage, significant changes in their usage, performance below forecast, decreasing revenues and other external indicators. When impairment is deemed necessary in the light of those indicators, the recoverable value of the assets is estimated by Portugal Telecom's management. The recoverable value is the higher of the realizable value and the value in use. Impairment tests are performed by group of assets by comparing the recoverable value and the carrying value (when an impairment charge appears necessary, the amount recorded is equal to the difference between the carrying value and the recoverable value).

For assets destined to be kept and used, the recoverable value is most often determined on the basis of the value in use, representing the value of expected future economic advantages from its use and disposal. It is assessed notably by reference to discounted future cash flows determined using economic assumptions and forecast operating conditions used by the management of Portugal Telecom or by reference to the cost of replacement taking into account asset ageing or cost of technology. For assets destined to be divested, the recoverable value is determined on the basis of the realizable value, and this is assessed on the basis of market value.

Goodwill. The determination of goodwill is dependent on the allocation of the purchase price to the tangible and intangible assets acquired and the liabilities assumed. Such an allocation is based on management's judgment. The useful lives assigned to different goodwill are estimates based on management's assumptions and defined objectives at the time of the acquisition. As of December 31, 2002, the net book value of goodwill recorded in the Company's balance sheet is approximately €2,211.3 million.

The recoverable value of goodwill is subject to review annually and when events or circumstances occur indicating that an impairment may exist. Such events or circumstances include significant adverse changes, other than temporary, in the business environment, or in assumptions or expectations considered at the time of the acquisition.

The necessity to record impairments is assessed by comparison of the carrying value of the investments and the corresponding fair value, which is estimated based on the discounted future cash flows determined using economic assumptions and forecast operating conditions used by Portugal Telecom's management.

These estimates, as well as the use of certain valuation methods, are the basis for the evaluation of the value of goodwill and therefore the amount of any impairment.

Deferred taxes. As of December 31, 2002, Portugal Telecom recorded deferred tax assets amounting to approximately €1,294.0 million, net of valuation allowances and deferred tax liabilities. This balance consists primarily of (i) temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes and (ii) tax losses carried forward mainly related to the parent company. The realization of deferred tax assets is reviewed by Portugal Telecom's management using each entity's tax results forecast based on budgets and strategic plans. Valuation allowances are considered in respect of deferred tax assets to the extent that the recovery of the related taxes is not considered probable. If Portugal Telecom's management were to consider that certain deferred tax assets for which allowances had been made were to be realized, a previously recorded valuation allowance would be fully or partially reversed.

Provisions for other risks and changes. Provisions are recorded when, at the end of the period, there is an obligation of Portugal Telecom to a third party which is probable or certain to create an outflow of resources to the third party, without at least equivalent return expected from the third party.

This obligation may be legal, regulatory or contractual in nature. It may also be derived from the practice of Portugal Telecom or from public commitments having created a legitimate expectation for such third parties that Portugal Telecom will assume certain responsibilities.

To estimate the expenditure that Portugal Telecom is likely to bear to settle its obligation, Portugal Telecom's management takes into consideration all of the available information at the closing date for its consolidated financial statements. If no reliable estimate of the amount

can be made, no provision is recorded; information is then presented in the notes to the financial statements.

Contingencies, representing an obligation which is neither probable nor certain at the time of drawing up the financial statements, or a probable obligation for which the cash outflow is not probable, are not recorded. Information about them is presented in the notes to the financial statements.

Because of the inherent uncertainties in the foregoing evaluation process, actual losses may be different from the original estimated amount provisioned at closing date.

Revenue and expense recognition from telecommunications services. Revenues from telecommunications services are recognized when earned. Billings for these services are made on a monthly basis throughout the month. Operating revenues are reported on a gross basis, with the compensation paid to other telecommunications operators being accounted for as operating expenses in the same period the revenue is earned. Unbilled revenues from the billing cycle are estimated based on the minutes of usage of the period and the prior month's pattern of traffic revenues, and are accrued at the end of the month.

Unbilled expenses related with telecommunication costs incurred during the period are also estimated based on the traffic information regarding the usage of other operators' networks during the period and the prior month's pattern of telecommunications costs.

Differences between estimated and actual unbilled revenues and expenses, which are recognized in the following period, may impact our results of operations in the period that such differences are recorded.

Provision for doubtful accounts. The provision for doubtful accounts receivable is stated at the estimated amount necessary to cover potential risks in the collection of overdue accounts receivable balances. A determination of the amount of provisions required is made after careful analysis of the evolution of accounts receivable balances and our knowledge of our customers' financial situation. The required provisions may change in the future due to changes in economic conditions and our knowledge of specific issues. Future possible changes in recorded provisions would impact our results of operations in the period that such changes are recorded.

Results of Operations

Our operating results reflect the changing patterns in our business described above in " *Overview*". The key changes over the course of 2000, 2001 and 2002 include:

increasing revenues from new high-growth services such as mobile services and multimedia services, such as cable and satellite television, as well as data and business solutions;

decreasing wireline telephone service revenues, excluding the impact of the change of ownership of fixed-to-mobile traffic from mobile operators;

increasing wireline wholesale revenues from interconnection and leased lines; and

a high level of work-force reduction program costs in 2000 and 2001, as we focus on increasing the efficiency of our wireline telephone services businesses.

The following tables set forth the operating revenues of each of our major business lines, as well as our major operating costs and expenses for the years ended December 31, 2000, 2001 and 2002.

Year Ended December 31,							
2000		2001			2002		
EUR Millions	% of Operating Revenues	EUR Millions	% of Operating Revenues	% Increase of Item	EUR Millions	% of Operating Revenues	% Increase of Item

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Year Ended December 31,

Operating Revenues								
Fixed-line Businesses								
(PT Comunicações)	1,956.4	38.02%	2,184.6	38.15%	11.66%	1,983.1	35.53%	(9.22%)
Fixed-line Telephone Services	1,541.2	29.95%	1,712.8	29.91%	11.14%	1,512.1	27.09%	(11.72%)
Wholesale(1)	218.1	4.24%	268.1	4.68%	22.93%	269.2	4.82%	0.45%
Directories	131.7	2.56%	136.8	2.39%	3.82%	139.1	2.49%	1.68%
Sales	39.0	0.76%	33.7	0.59%	(13.47%)	26.0	0.47%	(22.85%)
Other Revenues	26.5	0.51%	33.3	0.58%	25.65%	36.6	0.66%	9.91%
Data and Business Solutions								
(PT Prime)	176.8	3.44%	215.9	3.77%	22.09%	264.9	4.75%	22.70%
in Portugal:								
Data Communications	69.4	1.35%	82.1	1.43%	18.24%	92.3	1.65%	12.42%
Leased Lines	52.3	1.02%	44.7	0.78%	(14.38%)	57.0	1.02%	27.52%
Outsourcing and Net Solutions	12.0	0.23%	15.9	0.28%	32.32%	13.2	0.24%	(16.98%)
Internet Business to Business	8.7	0.17%	13.1	0.23%	51.04%	15.5	0.28%	18.3%
Sales	8.9	0.17%	8.8	0.15%	(1.65%)	6.4	0.12%	(27.27%)
Other	25.5	0.50%	51.3	0.90%	100.88%	47.9	0.86%	(6.63%)
in Brazil:								
Data Communications		n.a.		n.a.	n.a.	32.6	0.58%	n.a.
Mobile Business in Portugal								
(TMN)	994.3	19.32%	1,171.9	20.46%	17.86%	1,266.6	22.69%	8.08%
Services	842.4	16.37%	1,007.9	17.60%	19.65%	1,132.7	20.29%	12.38%
Sales	151.9	2.95%	164.0	2.86%	7.95%	133.9	2.40%	(18.35%)
Mobile Business in Brazil								
(TCP)	1,643.8	31.94%	1,401.2	24.47%	(14.76%)	1,217.6	21.81%	(13.10%)
Services	1,175.9	22.85%	1,178.7	20.58%	0.24%	1,048.6	18.79%	(11.04%)
Sales	467.9	9.09%	222.5	3.88%	(52.46%)	169.0	3.02%	(24.04%)
Multimedia Businesses								
(PT Multimedia)	226.7	4.40%	592.9	10.35%	161.55%	640.3	11.47%	7.99%
Services	220.2	4.28%	428.2	7.48%	94.45%	492.7	8.83%	15.06%
Sales	6.5	0.13%	164.7	2.88%	2,447.06%	147.6	2.64%	(10.38%)
Other	148.3	2.88%	160.1	2.80%	8.01%	209.5	3.75%	30.86%
Services	137.8	2.68%	140.3	2.45%	1.83%	200.3	3.60%	42.84%
Sales	10.5	0.20%	19.8	0.35%	89.21%	9.2	0.15%	(54.04%)
Total Operating Revenues	5,146.2	100.00%	5,726.6	100.00%	11.28%	5,582.0	100.00%	(2.53%)

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Operating costs and expenses

Wages and salaries	578.1	11.23%	668.6	11.68%	15.65%	694.8	12.45%	3.92%
Post retirement benefits	103.4	2.01%	140.7	2.46%	35.99%	183.2	3.28%	30.21%
Costs of telecommunications	470.7	9.15%	715.1	12.49%	51.93%	622.9	11.16%	(12.89%)
Depreciation and amortization	1,021.5	19.85%	956.2	16.70%	(6.39%)	962.8	17.25%	0.69%
Costs of products sold	658.0	12.79%	619.8	10.82%	(5.81%)	462.7	8.29%	(25.35%)
Other general and administrative	847.0	16.46%	997.1	17.41%	17.73%	923.9	16.55%	(7.35%)
Provisions for doubtful receivables, inventories and other	188.6	3.66%	130.7	2.28%	(30.69%)	132.8	2.38%	1.61%

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Other	342.1	6.65%	330.5	5.77%	(3.40%)	332.2	5.95%	0.51%
Total operating costs and expenses	4,209.5	81.80%	4,558.8	79.61%	8.30%	4,315.3	77.31%	(5.34%)
Operating income	936.8	18.20%	1,167.8	20.39%	24.66%	1,266.7	22.69%	8.47%
Other expenses, net(1)	423.8	8.23%	1,063.5	18.57%	150.96%	543.9	9.74%	(48.88%)
Work Force Reduction Program								
Costs	252.7	4.91%	183.9	3.21%	(27.24%)	53.7	0.96%	(70.80%)
Extraordinary items(2)	(496.4)	(9.65%)	281.1	4.91%	(156.62%)	15.6	0.27%	(94.45%)
Income before income taxes	756.7	14.70%	(360.7)	(6.30%)	(147.67%)	653.5	11.71%	281.18%
Consolidated net income before minority interests(3)	498.1	9.68%	(535.3)	(9.35%)	(207.47%)	316.4	5.67%	159.13%
Consolidated net income	540.3	10.50%	(192.6)	(3.36%)	(135.65%)	391.1	7.0%	303.06%

- (1) Other expenses, net in 2002 basically includes: (i) interest expenses, net amounting to €197 million; (ii) net foreign currency exchange gains amounting to €87.8 million; (iii) goodwill amortization amounting to €142.9 million; and (iv) equity losses in affiliated companies (mainly Global Telecom and Medi Telecom) amounting to €160.9 million.
- (2) In 2000, extraordinary items include basically: (i) a gain from the share capital increase of 5.8% of PT Multimedia (€483.1 million); (ii) a gain from the sale to strategic partners of 7.5% of the share capital of PTM.com (€176.5 million); (iii) a negative adjustment resulting from the share capital increase of PT Multimedia subscribed to by us (€172.9 million); (iv) a loss at PT Multimedia resulting from the difference between the acquisition value of Zip.Net, S.A. and the value attributable to the contribution in kind for the share capital increase of PTM.com on its incorporation (€336.1 million); (v) the capital gains resulting from the sale of 7.26% of CRT (fixed) (€52.0 million) and from the sale of our stake in Telesp Fixa (€285 million) included in the swap with Telefónica where this investment was exchanged for Telefónica's stake in TCP; and (vi) costs amounting to €35.0 million relating to the transfer of the negative currency translation adjustments related to the investment in CRT (fixed) and Telesp Fixa sold during 2000. In 2001, extraordinary items include basically: (i) a €199.5 million capital gain as a result of the sale of 15.76% of the share capital of PTM.com; (ii) the extraordinary amortization of goodwill of Global Telecom amounting to €132.6 million; (iii) a capital gain of approximately R\$90 million (€43.7 million) as a result of the non-monetary transaction involving the exchange of the investment in Zip.Net, S.A. for 17.9% of UOL; and (iv) the recording of a provision for an estimated impairment, amounting to €500.0 million, of Portugal Telecom's investment in TCP. In 2002, extraordinary items include basically: (i) €50.9 million related with a provision to adjust assets and liabilities in TMN; and (ii) €35.6 million gained as a result of the disposal of certain investments in Telefónica and Deltapress.
- (3) Loss (income) applicable to minority interests in our financial statements for 2000, 2001 and 2002 include basically the minority interests in TCP and PT Multimedia. In 2000, this item included the minority interest in a gain on the sale of 7.5% of the share capital of PTM.com, and a minority interest in the loss resulting from the difference between the acquisition value of Zip.Net, S.A. and the value attributable to the contribution in kind for the share capital increase of PTM.com on its incorporation. In 2001, this item included the minority interest in a gain on the disposal of the investment in Zip.Net, S.A. in the non-monetary transaction with UOL. In 2002, losses applicable to minority interests included the share of minority shareholders in the losses of TCP (€23 million) and PT Multimedia (€61 million).

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Operating Revenues

Our operating revenues decreased to €5,582.0 million in 2002 from €5,726.6 million in 2001, a decrease of 2.5%, primarily as a result of a reduction in operating revenues from our fixed-line businesses in Portugal (a reduction of €201.5 million) and, due to devaluation of the Brazilian Real, a

reduction in revenues recognized at a consolidated level from our mobile business in Brazil (a reduction of €183.6 million). These results were achieved in the context of the change in the ownership of Internet traffic described above and a devaluation of the Brazilian Real (R\$) of 24.5% in 2002.

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Fixed-line Business Unit (PT Comunicações). Operating revenues from our fixed-line businesses decreased by 9.2% to €1,983.1 million in 2002 from €2,184.6 million in 2001. This decrease was due to the general slow down in economic conditions and the continued substitution of mobile telephone usage in place of wireline telephone services that result in lower traffic volumes, to increased levels of competition and to the regulatory change in the ownership of Internet access traffic. Excluding the effect of the change in the ownership of Internet access traffic, PT Comunicações' operating revenues would have decreased by 3.6% over 2001 instead of 9.2%.

Fixed-line telephone services. Operating revenues from domestic and international fixed-line telephone services decreased by 11.7% to €1,512.1 million in 2002 from €1,712.8 million in 2001. The reduction was mainly due to the regulatory change of the way we account for fixed-to-mobile traffic required by regulation. See " *Overview Internet Interconnection Charges*", above. Had we not changed the way we account for fixed-to-mobile traffic, operating revenues from fixed-line telephone services would have decreased by 9.2% instead of 11.7%.

Operating revenues from international telephone services increased by 4.7% to €220.3 million in 2002 from €210.5 million in 2001. This increase was due to the stabilization of market share and in spite of reductions in our weighted average international call prices of 0.4% in nominal terms and reductions of 4.2% in the accounting rates for incoming calls in 2002 compared with 2001.

Wholesale. Operating revenues from wholesale services increased by 0.45% to €269.3 million in 2002 from €268.1 million in 2001. This increase was a result of higher demand from new operators with the liberalization of the fixed telephony market and new services as well as quality improvements and competitive pricing. Revenues from interconnection traffic increased by 10.3%. This was offset by a 9.1% reduction in revenues from leased lines provided by our wholesale business to €107.0 million in 2002 from €117.7 million in 2001. See " *Changing Composition of Our Operating Revenues*" above and " *Item 4 Information on the Company Our Businesses PT Comunicações Wholesale Services*".

Directories. Operating revenues from directories increased by 1.7% to €139.1 million in 2002 from €136.8 million in 2001. This increase primarily reflected the growth of Internet directories revenues and the directories reorganization in 2001 with the spin off of regional directories.

Data and Business Solutions (PT Prime). Operating revenues from data and business solutions increased by 22.7% to €264.9 million in 2002 from €215.9 million in 2001. This increase was mainly due to the consolidation of Primesys (a Brazilian data communications company) as from July 1, 2002 which generated additional revenues of €32.6 million.

The operating revenues from data communications services in Portugal increased by 12.4% to €92.3 million in 2002 from €82.1 million in 2001. This increase in revenues resulted basically from the increase in the number of customers provided with direct access to transmission services resulting from the new strategic partnership pursuant to which PT Prime Portugal operates and manages SIBS' network, and also from the growth in the number of corporate Internet subscribers and the expansion in Internet and broadband services.

Revenues from leased lines increased by 27.5% to €57.0 million due an increase in leased line capacity to end-users of 10.7% during the period.

The revenues of data communications and leased lines continue to have a major impact on this business representing 56.4% of total PT Prime's revenues, 2.3% less than the previous year (58.7%). This change in the composition of PT Prime's revenues resulted mainly from the development of corporate web, broadband services and outsourcing and net solutions, and also from the consolidation

of Primesys in the second half of 2002. See " *Item 4 Information on the Company Our Businesses PT Prime*".

Mobile Business in Portugal (TMN). Operating revenues from mobile business in Portugal increased by 8.1% to €1,266.6 million in 2002 from €1,171.9 million in 2001. This increase reflects the 13.3% increase in the number of TMN's activated mobile telephone cards in 2002, as well as a 15.1% increase in total traffic. There was a 5.1% decrease in average minutes per month per subscriber in 2002 compared with 2001 mainly due to the higher level of penetration and the strong increase of the customer base in the fourth quarter of 2002. We estimate that TMN's revenues per activated mobile telephone card decreased by 9.8% in 2002 to an average of approximately €27.1 per month compared to €30 per month 2001. Revenues from sales of handsets decreased due to the high level of market penetration. See " *Item 4 Information on the Company Our Businesses Mobile Businesses TMN in Portugal*".

Mobile Business in Brazil (TCP). Operating revenues from mobile business in Brazil decreased to €1,217.6 million in 2002 from €1,401.2 million in 2001. This 13.1% reduction was mainly due to the 24.5% devaluation of the Brazilian Real during the period and to lower sales of equipment. Notwithstanding the challenging economic environment in Brazil, the average revenue per user remained at R\$44 per month, the same as it was in 2001. The number of prepaid subscribers rose by 4.2% in 2002 compared to 2001. See " *Item 4 Information on the*

Company Our Businesses Mobile Businesses Joint Venture with Telefónica Móviles in Brazil TCP and Telesp Celular".

Multimedia Businesses (PT Multimedia). Operating revenues from our multimedia businesses increased by 8.0% to €640.3 million in 2002 from €592.9 million in 2001, despite the desconsolidation of PTM.com after its sale to PT in September 2002. This increase was largely due to the increase in the number of subscribers and in the number of subscribers using TV Cabo's premium channels (particularly satellite TV subscribers), as a result of which operating revenues from pay TV services rose by 30.9% to €364 million in 2002 from €278 million in 2001. Average monthly revenue per pay TV subscriber increased by 11.6% to €21.6 in 2002 from €19.0 in 2001. In addition, Lusomundo's revenues amounted to €256.0 million, a 2.1% increase over last year, excluding Deltapress from the comparison, since PT Multimedia's interest in Deltapress was exchanged for a minority interest in VASP. Deltapress was not consolidated in PT Multimedia's results in 2002. See "Item 4 Information on the Company Our Businesses PT Multimedia".

Other Businesses. Operating revenues from our other businesses included in our consolidated financial results increased by 30.9% to €209.5 million in 2002 from €160.1 million in 2001. The increase was mainly the result of the increase in the operating revenues of Mobitel (€10 million) and from the fourth quarter revenues of PTM.com (€40 million) which were included in Other Businesses.

Operating Costs and Expenses

Our operating costs and expenses decreased to €4,315.3 million in 2002 from €4,558.8 million in 2001, a decrease of 5.3%. The reduction in total operating costs and expenses was primarily due to a decrease in costs of telecommunications, costs of products sold, other general and administrative expenses, maintenance and repairs costs, and marketing and publicity expenses.

Wages and salaries. Wages and salaries, including employee benefits and social charges, were €694.8 million in 2002, compared to €668.6 million in 2001. This 3.9% increase was primarily due to the in-sourcing of staff from franchised shops of Telesp Celular and the consolidation of PrimeSys in the second half of 2002.

Post-retirement benefits. Costs of post-retirement benefits increased by 30.2% to €183.2 million in 2002 from €140.7 million in 2001. The change resulted primarily from higher charges resulting from the

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amortization of actuarial losses deferred in previous years due to lower returns generated by the pension funds compared with the 6% return assumed in the actuarial studies. These actuarial losses are amortized over the expected working life of our active employees which are covered by these benefits (currently 16 years). Post-retirement benefits costs do not include curtailment costs related to our work force reduction program. These are treated as an extraordinary item and not as operating costs and expenses and so are not included in our operating income. See "Work Force Reduction Program Costs" and "Liquidity and Capital Resources Post-Retirement Benefits".

Costs of telecommunications. Costs of telecommunications dropped to €622.9 million in 2002 from €715.1 million in 2001, representing a decrease of 12.9%. The reduction resulted mainly from the effect at PT Comunicações of lower traffic volumes and the change in the ownership of Internet access traffic as of October 2001, as well as the effect of the devaluation of the Brazilian Real in our mobile business in Brazil. See "Item 4 Information on the Company Our Businesses PT Comunicações Fixed Line Telephone Services International Traffic".

Depreciation and amortization. Depreciation and amortization increased by 0.7% to €962.8 million in 2002 from €956.2 million in 2001.

Costs of products sold. The costs of products sold amounted to €462.7 million in 2002, compared to €619.8 million in 2001 and represented 8.3% of consolidated operating revenues in 2002, compared to 10.8% in 2001. This reduction is the result of the lower sales of terminal equipment. Lower costs of products sold also reflect reduced subsidization of handset sales in our mobile businesses.

Other general and administrative expenses. Other general and administrative expenses include specialized work and subcontracts and various other administrative expenses. Other general and administrative expenses declined to €923.9 million in 2002 from €997.1 million in 2001, a reduction of 7.3%. The decrease was primarily a result of cost reduction programs implemented broadly across the Company.

Provisions for doubtful receivables, inventories and other. Provisions for doubtful receivables, inventories and other increased to €132.8 million in 2002 from €130.7 million in 2001. This increase of 1.6% is primarily the result of a major level of provisions for bad debts as a consequence of more challenging economic conditions.

Operating Income

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Our operating income increased to €1,266.7 million in 2002 from €1,167.8 million in 2001, an increase of 8.5%. Excluding the devaluation of the Brazilian Real, operating income would have been €1,355.8 million, representing an increase of 16.1% over 2001. The increase was primarily due to the increase in operating income from our mobile business in Portugal (an increase of €55.9 million or 14.3%), and our mobile business in Brazil (an increase of €99.2 million or 56.1%). These increases were partially offset by a decrease in operating income in our fixed-line businesses, our data and business solutions business and our multimedia businesses.

Operating margins (operating income as a percentage of total operating revenues) were approximately 22.7% in 2002, compared with 20.4% in 2001.

Other Expenses, Net

Other expenses/income, which decreased by 48.9% to €543.9 million in 2002 from €1,063.5 million in 2001, primarily includes our net financial charges, including net interest and related expenses, goodwill amortization, equity in earnings of affiliated companies, foreign exchange gains or losses and other financial gains and costs.

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Net financial charges decreased from €300 million in 2001 to €197 million in 2002, as a result of the €1,000 million reduction in net debt during the year and the reduction in the average cost of debt from 6% in 2001 to 5.5% in 2002.

Goodwill amortization decreased by 7.5% during 2002 to €143 million. This decrease was mainly due to lower amortization of TCP's goodwill as compared to the prior year (€28 million), as a result of the impairment charge recorded at the end of 2001 in connection with our investment in TCP. The lower TCP's goodwill amortization was partially offset by higher amortization of PTM.com's goodwill (€9 million, following the buy-out of minorities by PT Multimedia) and of Primesys' goodwill (€7 million, following the completion of the acquisition of 100% of its share capital).

Equity in losses of affiliated companies amounted to €160.9 million in 2002, as compared with €381.3 million in 2001. This improvement was primarily due to a significant reduction in our proportion of the losses of Medi Telecom (€56 million in 2002 compared with €66 million in 2001) and Global Telecom (€89 million in 2002 compared with €311 million in 2001). The significant improvement in the net income of Global Telecom resulted from better operating performance and the positive impact of the restructuring of its balance sheet completed by TCP following its rights issue in September 2002. See "Item 4 Information on the Company Our Businesses Mobile Businesses".

Net foreign exchange gains amounted to €88 million in 2002, as compared with currency exchange losses amounting to €119 million in 2001. These gains are a result of our efforts to neutralize our US dollar exposure and relate basically to the unwinding of certain derivative instruments.

Net other financial expenses amounted to €112 million in 2002, as compared to €144 million in 2001. In 2002 this caption includes the recording of a provision for equity swaps with PT's own shares amounting to €43 million.

Work Force Reduction Program Costs

Work force reduction program costs decreased by 70.8% to €53.7 million in 2002 from €183.9 million in 2001, as a result of a temporary slowdown during 2002 in the Work Force Reduction Program in the wireline businesses through pre and early retirement arrangements, mutual agreements and suspended contracts. "Item 6 Directors, Senior Management and Employees Employees Work Force Reductions".

Extraordinary Items

Extraordinary items were a net loss of €15.6 million in 2002 as compared with a net loss of €281.1 million in 2001. In 2002, extraordinary items included principally the following:

€50.9 million charge related to a provision for adjustment of TMN's assets and liabilities; and

gains on the disposal of interests in Telefónica (€30.5 million) and Deltapress (€5.0 million).

Income Taxation

Income taxes rose by 93% to €337.1 million in 2002 from €174.9 million in 2001. The effective tax rate in 2002 was 51.6%. This effective tax rate resulted from the significant items included in income before taxes that are not subject to taxation, principally the equity accounting in losses of affiliated companies (€160.9 million in 2002) and goodwill amortization (€142.9 million in 2002). Excluding the aforementioned items, net income before taxes in 2002 would have been €957.3 million resulting in an effective tax rate of 35% close the nominal tax rate in Portugal of 33%.

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Minority Interests

The losses applicable to minority interest in 2002 relate basically to the share of minority shareholders in the losses of TCP (€23 million) and PT Multimedia (€61 million).

Net Income

Our net income increased to € 391.1 million in 2002 from a net loss of €192.6 million in 2001. This increase was primarily due to the recognition of a provision for impairment of our financial investment in TCP (€500 million) during 2001.

Earnings per ordinary and A share in 2002 increased to €0.31 from a negative amount of €0.15 in 2001 on the basis of 1,254,285,000 shares issued.

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000**Operating Revenues**

Our operating revenues increased to €5,726.6 million in 2001 from €5,146.3 million in 2000, an increase of 11.28%, primarily as a result of growth in operating revenues from our multimedia businesses (€366.2 million), our fixed line business in Portugal (€228.2 million) and our mobile business in Portugal (€177.6 million). These results were achieved against a devaluation of the Brazilian Real of 19.6% in 2001.

Fixed Line Business Unit (PT Comunicações). Operating revenues from fixed line businesses increased by 11.7% to €2,184.6 million in 2001 from €1,956.4 million in 2000. This increase was due to the change of ownership of fixed-to-mobile traffic from mobile operators to fixed line operators in the fourth quarter of 2000. The increase was partially offset by market share losses, price reductions for fixed line telephone services, the negative impact of the change in the Internet access traffic regime and the substitution of mobile telephone usage in place of fixed line telephone services.

Fixed line telephone services. Operating revenues from domestic and international fixed line telephone services increased by 11.1% to €1,712.8 million in 2001 from €1,541.2 million in 2000. The increase was mainly due to the change for the way we account for fixed-to-mobile traffic. Had we not changed the way we account for fixed-to-mobile traffic, PT Comunicações' operating revenues would have decreased by 3.0% due to loss of market share and reduction in tariffs.

Operating revenues from international telephone services decreased by 5.7% to €210.5 million in 2001 from €223.2 million in 2000. This decrease was due to market share losses, reductions in our weighted average international call prices of 10.2% in nominal terms and reductions of 0.5% in the accounting rates for incoming calls in 2001 compared with 2000.

Wholesale. Operating revenues from wholesale services increased by 8.6% to €268.1 million in 2001 from €246.8 million in 2000. This increase was a result of higher demand from new operators with the liberalization of the fixed telephony market and new services as well as quality and competitive pricing. In particular, revenues from leased lines provided by our wholesale business increased by 12.7% to €117.7 million in 2001 from €104.4 million to other operators in 2000. These increases were partially offset by an average leased line price reduction of approximately 1.9% and average reductions in call termination prices of 28%, in each case in nominal terms, in 2001 compared with 2000. As a result of the change in the way we account for fixed-to-mobile traffic from October 1, 2000, revenues from this traffic are no longer recorded as wholesale services. See " *Changing Composition of Our Operating Revenues*" above and " *Item 4 Information on the Company Our Businesses PT Comunicações Wholesale Services*".

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Directories. Operating revenues from directories increased by 3.82% to €136.8 million in 2001 from €131.7 million in 2000. This increase primarily reflected the growth of Internet directories revenues and the directories reorganization in 2001 with the spin off of regional directories.

Fixed line Sales and Other Revenues. Operating revenues from fixed line sales and other supplementary fixed line business activities increased by 2.3% to €67.0 million in 2001 from €65.5 million in 2000.

Data and Business Solutions (PT Prime). Operating revenues from data and business solutions increased by 22.1% to €215.9 million in 2001 from €176.8 million in 2000. This increase was mainly due to a 18.2% increase in operating revenues from data communications services to €82.1 million in 2001 from €69.4 million in 2000. The increase in data communications revenues was due, in part, to the increase in the number of customers provided with direct accesses to transmission services resulting from the new strategic partnership pursuant to which PT Prime operates and manages SIBS' network. The increase in data and business solutions operating revenues was also the result of growth in the number of corporate Internet subscribers and the expansion in Internet and broadband services. Despite a 23% increase in the number of lines leased to the ultimate customer (measured by capacity leased, counted in 64Kbps equivalent units) since December 31, 2000, revenues from leased lines decreased by 14.4% to €44.7 million due to substitution from more advanced data services, broadband and web services and to price reductions. See "Item 4 Information on the Company Our Businesses PT Prime".

The revenues of data communications and leased lines continue to have a major impact on this business representing 58.8% of total PT Prime revenues, 10% less than the previous year (68.8%). This change in the composition of PT Prime's revenues resulted mainly from the development of corporate web, broadband services and outsourcing and net solutions.

Mobile Business in Portugal (TMN). Operating revenues from mobile business in Portugal increased by 17.9% to €1,171.9 million in 2001 from €994.3 million in 2000. Excluding the impact of the change in the accounting treatment of fixed to mobile traffic, operating revenues from TMN's revenues would have been €1,382.5 million, representing an increase of 31.8% from 2000 (€1,049.0 million). This increase reflects the 33% increase in the number of TMN's activated mobile telephone cards in 2001, as well as a 39% increase in total traffic and a 0.5% decrease in average minutes per month per subscriber in 2001 compared with 2000. The availability of WAP services and short message services, or SMS, among other things, contributed to increased usage of TMN's services. We estimate that TMN's revenues per activated mobile telephone card decreased by 2.7% in 2001 to an average of approximately €30.1 per month compared to €30.9 per month in 2000. Revenues from sales of handsets increased due to the increased number of activated mobile telephone cards. See "Item 4 Information on the Company Our Businesses Mobile Businesses TMN in Portugal".

Mobile Business in Brazil (TCP). Operating revenues from mobile business in Brazil decreased to €1,401.2 million in 2001 from €1,643.8 million in 2000. This 14.8% decrease was mainly due to deterioration of the Real by 19.6% during the period, lower sales of equipment and a 15.4% drop in average revenue per user to R\$44 compared with R\$52 in 2000. The number of prepaid subscribers grew significantly by 38.4% in 2001 compared to 2000. See "Item 4 Information on the Company Our Businesses Joint Venture with Telefónica Móviles in Brazil TCP and Telesp Celular".

Multimedia Businesses (PT Multimedia). Operating revenues from our multimedia businesses increased by 161.6% to €592.9 million in 2001 from €226.7 million in 2000. This increase was largely a result of the full consolidation of Lusomundo's revenues (€290.6 million) and the increase in cable television revenue (€71.5 million). As a result of the increase in the number of subscribers and in the number of subscribers using TV Cabo's premium channels (particularly satellite TV subscribers), operating revenues from pay TV services increased by 39.2% to €260.2 million in 2001 from €

187.0 million in 2000. Average monthly revenue per pay TV subscriber increased 10.3% to €19.3 in 2001 from €17.5 in 2000. This increase in operating revenues of our multimedia businesses' was partially off-set by a 10.4% decrease in operating revenues from Internet activities to €14.5 million in 2001 from €16.2 million in 2000. Despite our focus on penetration growth, our customer base was not yet sufficient in 2001 to produce positive operating income. See "Item 4 Information on the Company Our Businesses PT Multimedia".

Other Businesses. Operating revenues from our other businesses included in our consolidated financial results increased by 8.0% to €160.1 million in 2001 from €148.3 million in 2000. The increase was mainly the result of the increase in the operating revenues of Mascom and Cabo Verde Telecom.

Operating Costs and Expenses

Our operating costs and expenses increased to €4,558.8 million in 2001 from €4,209.5 million in 2000, an increase of 8.3%. If we had continued proportionately to consolidate TCP, our operating costs and expenses would have been €3,842.5 million in 2001 and €3,372.5 million in 2000. The increase in total operating costs and expenses was primarily due to increases in costs of telecommunications, other general and administrative expenses, wages and salaries and post retirement benefits.

Wages and salaries. Wages and salaries, including employee benefits and social charges, were €668.6 million in 2001, compared to €578.1 million in 2000. This 15.6% increase was primarily due to the full consolidation of Lusomundo and PT Sistemas de Informação, which accounted for €55.9 million and €15.4 million additional costs, respectively. Had we continued proportionate consolidation of our investment in TCP, our cost of wages and salaries would have been €633.4 million in 2001 and €538.9 million in 2000.

Post-retirement benefits. Costs of post-retirement benefits increased by 35.9% to €140.7 million in 2001 compared with €103.4 million in 2000. The change resulted primarily from the low financial return of the assets pension funds and the increase in the interest cost. Post-retirement benefits costs do not include curtailment costs related to our work force reduction program. These are treated as an extraordinary item and not as operating costs and expenses and so are not included in our operating income. See " *Work Force Reduction Program Costs*" and " *Liquidity and Capital Resources Post-Retirement Benefits*".

Costs of telecommunications. Costs of telecommunications increased to €715.1 million in 2001 from €470.7 million in 2000, representing an increase of 51.9%. The increase resulted mainly from expenses incurred by PT Comunicações as a result of the change of ownership of fixed-to-mobile traffic from mobile operators to wireline operators (€128 million) in 2001 and growth in mobile-to-mobile traffic to other mobile operators (€87 million). This expense is largely offset by revenues resulting from such change in ownership and from the growth in traffic from mobile operators, including TMN, to other international telecommunications operators. Costs of telecommunications consist primarily of accounting-rate payments to these operators and interconnection costs to interconnect with other mobile operators. Increasing international calls by TMN's mobile and PT Comunicações' wireline customers resulted in increased payments for those calls by TMN and PT Comunicações to these operators. Additionally, other mobile operators in Portugal use our international wireline network for international connection from time to time, so increasing international calling by their subscribers also increases our costs of telecommunications. These calls also result in corresponding increasing wholesale interconnection revenues for our wireline business. See " *Item 4 Information on the Company Our Businesses PT Comunicações Fixed Line Telephone Services International Traffic*".

Depreciation and amortization. Depreciation and amortization decreased by 6.4% to €956.2 million in 2001 from €1,021.5 million in 2000. This reduction resulted from the change in the amortization criteria for the assets acquired in the year 2001, which were amortized as from the month of its

acquisition, while in 2000, a full-year amortization was recorded (see Note 2 to our audited consolidated financial statements). The decrease was partially offset by the full consolidation of Lusomundo (€13.5 million) and the growth of TMN (€32.5 million) due to the high level of investment in this business.

Cost of products sold. The cost of products sold amounted to €619.8 million in 2001 compared to €658.0 million in 2000 and represented 10.8% of consolidated operating revenues in 2001, compared to 12.8% in 2000. This decrease is the result of the decrease in the number of the mobile handsets sold by TCP, partially offset by the full consolidation of Lusomundo (€71 million) and the increase in the number of handsets sold by TMN. If we had continued to consolidate proportionately TCP, the cost of products sold would have increased by 8.5% to €462 million in 2001 from €426 million in 2000, and represented 9.4% of consolidated operating revenues (10.2% in 2001).

Other general and administrative. Other general and administrative expenses include specialized work and subcontracts and various other administrative expenses. Other general and administrative expenses increased to €997.1 million in 2001 from €847 million in 2000, an increase of 17.7%. The increase was primarily due to an increase in specialized work and subcontracts related to the full consolidation of Lusomundo (€50.7 million) and PT Sistemas Informação (€20.6 million).

Provisions for doubtful receivables, inventories and other. Provisions for doubtful receivables, inventories and other decreased to €130.7 million in 2001 from €188.6 million in 2000. This reduction of 30.7% is primarily the result of a minor level of provisions for doubtful receivables based on the assessment of the estimated risks in the collection of accounts receivable for PT Comunicações. The results of the assessment were due to the limited maturity of the accounts receivable and to the agreements with various entities and external entities to receive at medium term.

Operating Income

Our operating income increased to €1,167.8 million in 2001 from €936.8 million in 2000, an increase of 24.7%. Excluding the devaluation of the Brazilian Real, consolidating operating income would have been €1,211.0 million, representing an increase of 29.3% over 2000. The increase was primarily due to the increase in operating income from our mobile business in Portugal (an increase of €132.6 million or 51.0%), our wireline business (an increase of €82.8 million or 14.5%) and our multimedia businesses (an increase of €66.7 million or 71.4%). The increase was partially offset by a decrease in operating income of our data and business solutions business and our mobile business in Brazil (due mainly to the 19.6% devaluation of the Brazilian Real).

Consolidated operating margins (operating income as a percentage of total operating revenues) were approximately 20.4% in 2001, compared with 18.2% for 2000.

Other Expenses, Net

Other expenses/income, which increased by 151.0% to €1,063.5 million in 2001 from €423.8 million in 2000, primarily includes our net financial charges, including net interest and related expenses, goodwill amortization, equity in earnings of affiliated companies, foreign exchange gains or losses and other financial gains and costs. The increase in these costs was primarily due to interest costs from indebtedness relating to our investments and the amortization of goodwill relating to our increased ownership interest in TCP. This increase is also a result of non-cash losses arising from the recognition of exchange rate losses relating to our derivative instruments used to hedge currency risks.

Equity in earnings of affiliated companies amounted to a loss of €381.3 million in 2001, as compared with a loss of €43.3 million in 2000. This 780.6% increase in loss was primarily due to our proportion of the losses of Medi Telecom (€7.0 million) and Global Telecom (€128.2 million). See "Item 4 Information on the Company Our Businesses Mobile Businesses".

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Work Force Reduction Program Costs

Work force reduction program costs decreased by 27.2% to €183.9 million in 2001, from €252.7 million in 2000 reflecting the advanced stage of the Work Force Reduction Program in the wireline businesses through pre and early retirement arrangements, mutual agreements and suspended contracts. "Item 6 Directors, Senior Management and Employees Employees Work Force Reductions".

Extraordinary Items

Extraordinary items decreased to a net loss of €281.1 million in 2001 from a net gain of €496.4 million in 2000. In 2001, extraordinary items included principally the following:

€199.5 million and €112.3 million gains obtained on disposals of investments in PTM.com and Telefónica, respectively;

€132.6 million loss due to an extraordinary amortization of Global Telecom goodwill; and

€500.0 million loss due to the recording of an estimated provision for impairment of Portugal Telecom's financial investments in TCP.

Income Taxation

Income taxes decreased by 32.5% to €174.6 million in 2001 from €258.6 million in 2000. The effective tax rate in 2001 was a negative rate of 48.4%. This effective tax rate resulted from the significant items included in income before taxes that were not subject to taxation, principally the recognition of a provision for impairment of our financial investment in TCP, tax losses in certain companies of the group, principally related to our losses with respect to Global Telecom, and goodwill amortization.

Net Income

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Our net income/loss decreased to a net loss of €192.6 million in 2001 from a net income of €540.3 million for 2000. This decrease was primarily due to the recognition of a provision for impairment of our financial investment in TCP (€500.0 million), the negative contribution of new and start-up companies (€251.4 million), €132.6 million loss due to an extraordinary amortization of the goodwill of Global Telecom and the non-cash losses of €94.2 million resulting from the recognition of the exchange losses relating to derivative instruments, offset by a €125.8 million increase in the net income of our fixed-line business and a €100.4 million increase in the net income of our mobile business in Portugal.

Earnings per ordinary and A share in 2001 decreased by 135.6% to a negative amount of €0.15 from a positive amount of €0.43 in 2000 on the basis of 1,254,285,000 shares issued.

Liquidity and Capital Resources

Overview

Sources of Cash Flow. During 2002, 2001 and 2000, we financed our operations and acquisitions principally from cash generated from operations, equity financings and debt financings.

Working Capital. As of December 31, 2002, working capital was negative €119.3 million on the basis of proportional consolidation of Brasilcel. On the basis of full consolidation of TCP, working

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capital was €91 million in 2002 and negative €38 million in 2001 representing an investment in working capital during the period of €129 million.

	2002	2002(1)	2001
Cash and cash equivalents	2.276,5	1.790,6	1.291,5
Current assets operational(a)	1.503,9	1.614,1	1.608,7
Accounts receivable trade(2)	1.011,3	995,6	1.105,2
Accounts receivable others(3)	220,1	370,9	258,4
Inventories	149,8	127,2	132,0
Deferred costs and other current assets	122,7	120,4	113,1
Current assets non-operational	1.070,6	1.051,2	727,9
Accounts receivable others	238,9	238,9	133,1
Deferred costs and other current assets	11,7	8,5	5,2
Deferred taxes	820,0	803,8	589,6
Total current assets	4.851,0	4.445,9	3.628,1
Short term debt	1.094,4	1.176,1	1.319,3
Current liabilities operational(b)	1.623,2	1.522,8	1.646,5
Accounts payable trade(2)	658,8	587,0	546,7
Accounts payable others(4)	454,3	412,9	600,5
Deferred income	439,6	452,4	422,0
Taxes payable	70,5	70,5	77,3
Current liabilities non operational	240,4	246,7	274,2
Deferred income	195,6	201,9	154,5
Taxes payable	0,6	0,6	76,3
Deferred taxes	44,2	44,2	43,4

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	2002	2002(1)	2001
	<u>2.958,0</u>	<u>2.945,6</u>	<u>3.240,0</u>
Total current liabilities			
Working Capital(a) -(b)	(119,3)	91,3	(37,8)
Investment in Working Capital	n.a	129,1	74,1

- (1) Pro-forma considering the full consolidation of the assets and liabilities of Telesp Celular Participações and excluding the proportional consolidation of 50% of the assets and liabilities of Brasilcel.
- (2) The decrease in these captions resulted basically from the decrease in the book value of the assets and liabilities of TCP due to the devaluation of the Brazilian Real.
- (3) The increase in these captions resulted from payments made by TCP on account of Global Telecom which were due as of December 31, 2002.
- (4) The decrease in this caption resulted basically from the reduction in capital expenditures during 2002.

We believe that cash generated from operations and bank facilities are sufficient to meet present working capital needs. Our cash and short term investments totaled €2,276.5 million at December 31, 2002, an increase of 76.3% over December 31, 2001. This increase was basically attributable to a strong growth in operating cash flow during the year and also to the proportional consolidation of Brasilcel which implied that 50% of certain floating rate notes issued by TCP and subscribed for by us, amounting to €766 million, are now recorded as short term investments in our balance sheet (the remaining 50% are cancelled in the proportional consolidation). Previously these notes were totally considered as intra-group loans and were cancelled in consolidation.

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Investments. During 2002, we made investments in the Brazilian mobile telecommunication sector of €232 million in connection with the refinancing of Global Telecom and the acquisition by TCP of the remaining stake in Global Telecom. We made total investments in 2002, including capital expenditures, of €1,453.6 million, a decrease of 62.1% over 2001. During 2002, we made an investment of €348 million relating to the acquisition of the ownership of the basic network in Portugal by PT Comunicações. We made total investments in 2001 of €3,836.7 million, an increase of 4.7% over 2000. See "Item 4 Information on the Company Our Businesses".

Cash from Operating Activities

Cash flows from operating activities include collections from clients, payments to suppliers, payments to personnel and other collections and payments relating to operating activities. All of our cash flows from operating activities result from operations conducted by our subsidiaries and not by Portugal Telecom, SGPS, S.A. The operations of our subsidiaries are described in relation to each business line in "Item 4 Information on the Company Our Businesses".

None of our subsidiaries is subject to economic or legal restrictions on transferring funds to us in the form of cash dividends, loans or advances that would materially affect our ability to meet our cash obligations. Our joint venture in Brazil contains provisions relating to important decisions, including the declaration and/or payment of dividends or other distributions by Brasilcel. Such decisions must be made by a majority of the board of directors of Brasilcel. Telefónica and we each appoint six of the twelve board members. Accordingly, it will effectively be necessary for Telefónica and us to agree to transfer funds from Brasilcel and its subsidiaries to us if we wish to do so. See "Item 4 Information on the Company Strategic Alliances Alliance with Telefónica".

2002. Net cash generated from operating activities increased by 41.8% to €2,092.3 million for 2002 from €1,475.4 million for 2001. The increase was due mainly to increased collections from customers (€6,521.8 million in 2002 compared with €6,192.1 million in 2001) and to decreased payments to suppliers (€2,940.5 million in 2002 compared with €3,166.1 million in 2001). These changes were partially offset by increased payments to employees (€763.8 million in 2002 compared with €714.0 million in 2001). The growth in collections from customers was

due to increased numbers of subscribers for our mobile business and increases in cellular traffic in Portugal. The decrease in payments to suppliers was basically due to extended payment terms adopted by PT during 2002 and also to certain cost control measures adopted by our group during 2002.

2001. Net cash generated from operating activities increased by 8.7% to €1,475.4 million for 2001 from €1,357.6 million for 2000. The increase was due mainly to increased collections from customers (€6,192.1 million in 2001 compared with €5,483.8 million in 2000). This increase was partially offset by increased payments to suppliers (€3,166.1 million in 2001 compared with €2,757.3 million in 2000) and increased other payments relating to operating activities (€507.5 million in 2001 compared with €424.1 million in 2000). The growth in payments to suppliers and collections from customers is due to increased numbers of subscribers for our mobile business and increases in cellular traffic in Portugal.

Cash for Investing Activities

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

2002. Net cash used for investing activities decreased by 60.0% to €1,009.6 million in 2002 from €2,528.5 million in 2001. The decrease was due to higher cash receipts from financial investments (€1,311.6 million in 2002 compared with €432.1 million in 2001) as a result of the payment by Global Telecom of intra-group loans granted in previous years totalling €917 million, a decrease in payments resulting from financial investments (€321.3 million in 2002 compared with €1,690.1 million in 2001) as

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a result of the acquisition of Global Telecom in 2001 and loans granted to Global Telecom in 2001, and a decrease in payments resulting from acquisitions of fixed assets (€856.0 million in 2002 compared with €1,211.4 million in 2001) reflecting the reduction in capital expenditures during 2002. The decreases in cash used for investing activities were partially offset by increases in payments resulting from acquisitions of intangible assets (€358.6 million in 2002 compared with €24.6 million in 2001) resulting from the acquisition of the ownership of the basic network by PT Comunicações amounting to €348 million.

2001. Net cash used for investing activities increased by 7.9% to €2,528.5 million in 2001 from €2,343.2 million in 2000. The increase was due to lower cash receipts from financial investments (€432.2 million in 2001 compared with €1,035.4 million in 2000), partially offset by decreases in payments resulting from financial investments (€1,690.1 million in 2001 compared with €1,915.4 million in 2000).

Cash from Financing Activities

Cash flows from financing activities include borrowings and repayments of debt and payments of dividends to shareholders.

2002. Net cash used for financing activities was €486.0 million in 2002 compared with a net cash inflow from financing activities in 2001 of €1,839.9 million. This evolution resulted mainly from the fact that in 2001 the loans obtained exceeded the loans repaid by €2,229 million, whereas in 2002 loans repaid exceeded loans obtained by €16 million, and also from the increase in dividends paid from €38 million in 2001 to €129 million in 2002.

2001. Net cash flow from financing activities increased by 62.7% to €1,839.9 million in 2001 from €1,131.0 million in 2000. The increase was mainly due to the issuance of convertible bonds amounting to €550 million in December 2001.

Indebtedness

Our total consolidated indebtedness was €6,313.5 million at December 31, 2002, 6.4% less than at December 31, 2001. Our total consolidated indebtedness was €6,747.6 million at December 31, 2001 compared with total indebtedness of €4,204.2 million at the end of 2000.

Our net indebtedness was €4,037.0 million at December 31, 2002, 26.0% less than at December 31, 2001. Our net indebtedness was €5,456.1 million at December 31, 2001 compared with €3,731.9 million at the end of 2000.

Changes in Structure and Amount of Indebtedness. The decrease in our net indebtedness at December 31, 2002 from December 31, 2001 was principally the result of strong growth in operating cash flow, sound financial management, the effect of entering into and proportionately consolidating the Brasilcel joint venture, and the positive exchange translation effect of US dollar and Real denominated debt. The level of our net indebtedness increased by 46.2% at December 31, 2001 from December 31, 2000, principally as a result of the acquisition

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of Global Telecom (a company for which we accounted pursuant to the equity method on those dates) by TCP, the refinancing by Portugal Telecom of Global Telecom's debt of €810 million and the full consolidation of Lusomundo's debt. See " *Debt Instruments, Sales of Equity and Repayment and Refinancing of Indebtedness*".

In addition to the decrease in our group's net indebtedness in the year ended December 31, 2002, the composition of our group's indebtedness also changed over that period, with medium- and long-term loans increasing from 80.4% to 82.7% of our total indebtedness. Short-term indebtedness decreased from 19.6% of our total indebtedness to 17.3% of our total indebtedness. See " *Debt Instruments, Sales of Equity and Repayment and Refinancing of Indebtedness*".

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In the table below, we have presented the composition of our consolidated indebtedness as of December 31, 2001 and 2002. We fully consolidated TCP's assets and liabilities at December 31, 2001 but instead proportionately consolidated Brasilcel's assets and liabilities at December 31, 2002 (which include those of TCP). For illustrative purposes, the table below also includes information on our consolidated indebtedness as if we had fully consolidated TCP's indebtedness and had not recorded Brasilcel's indebtedness at December 31, 2002.

Debt	As of December 31, 2001		As of December 31, 2002			
	(fully consolidating TCP)		(fully consolidating TCP)		(proportionately consolidating 50% of Brasilcel)	
	Eur millions	% of total indebtedness	Eur millions	% of total indebtedness	Eur millions	% of total indebtedness
Short term	1,319.3	19.6%	1,176.1	18.9%	1,094.4	17.3%
Bond loans	197.0	2.9%	285.1	4.6%	285.1	4.5%
Bank loans	360.1	5.3%	332.3	5.3%	257.3	4.1%
Other loans	762.2	11.3%	558.7	9.0%	552.0	8.7%
Medium and long term	5,428.3	80.4%	5,043.1	81.1%	5,219.1	82.7%
Exchangeable bond loans	1,059.0	15.7%	1,059.0	17.0%	1,059.0	16.8%
Other bond loans	2,724.7	40.4%	2,724.7	43.8%	2,724.7	43.2%
Bank loans	1,411.1	20.9%	1,112.9	17.9%	1,289.8	20.4%
Other loans	233.5	3.5%	146.5	2.4%	145.6	2.3%