

PORTUGAL TELECOM

Full Year 2006 Results Conference Call

Moderator: Mr. Zeinal Bava

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11:00 a.m. ET

Operator: Good morning, or good afternoon, ladies and gentlemen, and welcome to the Portugal Telecom Full Year 2006 Results Conference Call hosted by the Executive Board member of Portugal Telecom, Mr. Zeinal Bava and Mr. Luís Pacheco de Melo, Group CFO.

At this time, all participants are in a listen-only mode.

And the floor will be open for questions and comments following your presentation.

If you have any questions, please press the number star, one on your touchtone phone.

I would now like to turn the floor over to your host, Mr. Bava. Please go ahead, sir.

Mr. Zeinal Bava: Great. Thank you very much. Good afternoon, ladies and gentlemen. My team and I are very happy to have you on this call.

Before I kick-start the presentation, instantly I will be using the presentation, which we put out on our site, "Results Presentation Full Year 2006 (Unaudited)," dated the 8th of February, so I will be referring to pages of that presentation. And in order to be helpful, I will also mention the page each time I take you through any specific aspect.

Before I go into that, I will pass you onto our IR Director, Nuno Prego, who has a statement to make for legal reasons. Thank you.

Mr. Nuno Prego: As you know, Portugal Telecom is subject to an unsolicited cash tender offer by Sonaecom and its affiliates, which commenced on January 16th, 2007. In order to ensure our compliance with the U.S. tender offer regulations, we will not address the tender offer or answer questions about the tender offer on this call.

Portugal Telecom has separately responded to the tender offer in its statement on Schedule 14D9 as amended, filed with the U.S. Securities and Exchange Commission.

Thanks. I will now pass you to Zeinal Bava.

Mr. Zeinal Bava: Okay, thank you very much.

On page three of our presentation, which has the highlights, as you can see, the operating revenues decreased 0,7 percent in 2006 with a higher contribution from Vivo, due to appreciation of the real, and of course the contribution from PT Multimedia. Pacheco de Melo will take you through all these financials in more detail but, clearly, we continue to see some impact at the operating revenues level and EBITDA level from the continuing decline in termination rates, which had a negative impact in the top line of 22 million and 49 million respectively for the wireline and TMN.

EBITDA decreased by 2.9 percent year-on-year in 2006. This is equivalent to a margin of 38.2 percent. And again, there are a number of reasons why one has to look at this EBITDA, particularly when it comes to the fixed line, on a normalized basis. But again, Pacheco de Melo will take you through that, as well.

The net income increased by 32.5 percent to 867 million euros, and that was mainly due to the one-off effects recorded in the provision for income taxes, lower for workforce reduction program costs, and a positive impact of the adjustment in healthcare benefits.

The operating cash flow was up 22.5 percent in 2006, reaching almost 1.6 billion euros, and I think here we have actually delivered on some of the things that we have discussed in the past, namely improvement in the working capital investments, which saw a significant improvement in 2006.

In terms of consolidated net debt, notwithstanding the fact that we did make significant extraordinary contributions to our pension fund and the recent investment that we also did in Namibia in MTC, net debt was pretty much in line with what we had in beginning of the year, and it currently stands at about 3.7 billion and was an increase of less than 3 percent over the same period last year.

In terms of the unfunded pension liabilities, as of 31 December 2006, the market value for our funds, which are managed by our pension fund, were stood at about 2.9 billion. So, net of that, the unfunded pension liability after tax was 1.2 billion. That is a significant reduction in terms of unfunded compared to last year. That is about a billion improvement here, and we will take you through that in more detail later on also in our presentation.

I will now pass on to page four. With regard to EBITDA guidance that we gave for the three divisions, wireline, TMN and PT Multimedia, we have reported in these 2006 numbers, which are very much in line with the guidance. In the case of the wireline, the normalized 2005 939 million euros, we reported therefore on a comparable basis a flat EBITDA.

TMN we'd given a minus 2 to minus 3 percent guidance in spite of the fact that the commercial activity was well ahead of what we had estimated. We were able to do 2.2 percent, and that again I reiterate that that is against a backdrop where, commercially, we did much, much better and were more active than we had expected.

And in the case of PT Multimedia, we had indicated 5 to 10 percent EBITDA growth, and we reported 8.1 percent growth, again here underpinned not only by some

recovery in our movie exhibition business, but also a significant improvement in commercial activity on the pay TV and broadband Internet side, as well.

So, I will now take you through each of these divisions before I hand you over. So, page five, on the wireline, I think there are a number of important points here that I would like to bring to your attention. First and foremost, the unbundled local loop net adds continue declining in our market. They started off at rate of about 37,000 in the first quarter. We saw a marked slowdown in the third quarter, and that marked slowdown continued in the fourth quarter.

Preselection was also down and, as you know, there is a natural migration of clients from preselection to wholesale line rental. That, if you look net, has come down, and impact--in part what we are seeing is that our fixed line division is being far more successful than perhaps we were in the first half of this year in promoting more value in terms of the subscription charges that people pay every month, bundling in more minutes.

We are giving also in the case of the first installations of ADSL also some promotions there, so I think a lot of the initiatives and commercial initiatives that we put in place, including the marketing that we have done, are beginning to filter through in terms of our overall performance, and this is why, if you look at the loss of traffic generating accesses, we continue to see a decline in that loss. We lost 121,000 lines in the first quarter, 81,000 in the second quarter and, as I had indicated in our third quarter call, we had started basically doing better. The fundamentals had been changing, and I think we have been very happy to see that the fourth quarter has shown some stabilization also compared to the third quarter at about 42,000 line loss.

In terms of ADSL net adds, we continued to do, I would say, pretty well considering that we are not competing based on price, but we are competing based on the speed that we offer for our services, the quality of service that we offer to our customers, as well, and a number of traffic promotions, as well. So, we have been able to command in the fourth quarter of this year, this year meaning 2006, a 50 percent share of net adds, which I think it's a significant improvement to, for example, second quarter, where our share of net adds had come down to historic low of 36 percent.

In terms of efficiency, we are operating our business with about 613 lines per employee. As you know, we had committed to undertake a curtailment through negotiation--negotiated exits from our company and early retirements. We had indicated that we would curtail about 500 staff in 2006. We accelerated that program to reach 792. So, therefore we have done significantly more than we had expected and, once again, I think we are seeing efficiency ratios in our wireline division, which puts us very much in line with the top quartile of our peer group.

Turning now to our mobile division, TMN--this is slide six--what you see basically is a confirmation of what we saw in the third quarter, which is that TMN is gaining market share in the Portuguese mobile market. In the first half of 2006 we had a share of net adds of 13 percent. In the second half our share of net adds went up to 45 percent.

We have been able to achieve that not just in terms of total numbers, but also in terms of prepaid and postpaid. We are adding more postpaid and prepaid, and this shows that a number of our initiatives to build market share, particularly in the corporate segment, has beginning to give some results.

In terms of billing revenues, they're up 1.9 percent despite strong seasonality and Christmas. As you know, a lot of the subs that do acquire mobile handsets around the holiday period tend to activate those services between the 26th and the 31st, so I would say that the full upside of those additional subs will only filter through the first quarter of 2007.

Data revenues, again improving on the back of promotion of non-SMS services, particularly wireless broadband, where we have quadrupled the number of broadband subscribers during the course of 2006.

SARC remains stable, and I think another point that's worth highlighting is that the cost discipline has allowed us to post a pre-SARC margin of 62.7 percent. Of course, part of this is due to the fact that we are containing provision levels in our company, but also part of this improvement has to do with cost-cutting initiatives, maintenance, etc.

Turning now to PT Multimedia, page seven, we have a number of things to report here, first that we have passed 2.8 million homes. Just to give you a reference, Portugal has 4.5 million TV households. Three point five million TV households are first homes, and then you have an additional one million TV households, which are usually, you know, second homes or weekend homes. So, we have covered pretty much 2.8 million homes by now, and the DTH platform, which we have, do give us 100 percent national coverage.

As we had indicated in the third quarter announcement, we have seen a reversal in the trends both in pay TV, premium TV and, of course, broadband. And we added 7,000 pay TV net adds in the third quarter, 29,000 in the fourth quarter. Along the same lines, the sports premium package we have added 6,000 in the third quarter, 38,000 in the

fourth quarter. Likewise, in cable broadband, 5,000 in the third quarter, 13,000 in the fourth quarter.

This basically goes very much in line with what we have been saying, in that the fundamentals appear to be improving. The economy is also doing better, and the outlook of the economy has significantly improved in the second half versus the first half. As you know, the outlook for the Portuguese economy appears to be improving quarter after quarter, and we expect that 2007, on the back of that, we will also benefit pretty much across all our businesses.

In terms of ARPU, worth highlighting is also that ARPU is up 7 percent year-on-year, and that increase in ARPU is explained by two specific things. First is pay TV ARPU is up about one euro, and the premium services have also improved contribution, and that explains basically another sort of 50 cents to one euro improvement, as well. Broadband ARPU remains pretty much stable year-on-year. So, blended ARPU is up 7 percent, and that is underpinning the top line performance in PT Multimedia, which saw revenues grow 12 percent in the fourth quarter.

Turning now to Vivo, and again I will just whiz through the slide, this is eight, because Vivo announced results yesterday, and they had also a conference call where they provided significant amounts of detail.

What you see is net adds showing recovery. You see commercial costs very tight, 125 reals fourth quarter versus 137 first quarter, so you see a marked decline there. And even against that backdrop, we added more subs than we did in the first quarter. The EBITDA performance is also improving but, most importantly, free cash flow has gone up significantly.

So, with regard to Vivo, albeit that the sort of comparative outlook for that market remains very challenging, what we are seeing is that Vivo is beginning to deliver on the turnaround. We have a roadmap that we are following, the management has I would say a formidable task ahead of them, and I think, quarter after quarter, they seem to be delivering on improvements.

And with regard to the migration or GSM rollout that we are doing, it's also progressing according to plan. Systems have stabilized, the integration of these various companies that we brought under one umbrella, that was basically done beginning of 2006, is also beginning to show, I would say, a positive impact. We are no longer running several information systems, etc.

The time to market of Vivo has also improved as a result of that, and I think what fourth quarter really does is confirm the trends. And whilst it is better than what had been expected, there is still a lot of work to be done, but we remain very, very optimistic that, together with our partners, Telefonica, we will be able to ensure that Vivo delivers on this turnaround quarter after quarter, with increased momentum.

Turning now to page nine, I think we just have here some data for you on some of our other main international assets, and we have highlighted for you in particular the performance of two of our businesses where we have a 25 percent stake in one of them, and we also have a management responsibility, and also Meditel Morocco, where we have a 32 percent stake and, jointly with Telefonica, we also have the management responsibility.

Unitel has gone above two million subs, 71 percent growth in customer numbers. EBITDA was up 41 percent 2006 over 2005. This business continues to show very, very

strong growth, we expect this business to continue to post solid growth going forward. In terms of Mediatecom, again customer numbers were up 28 percent. EBITDA was up 20 percent.

So, with this slide, I will now pass you over to my colleague, Luís Pacheco de Melo, the CFO of Portugal Telecom Group, so that he can take you through the consolidated financials and by division in more detail.

Thank you very much.

Mr. Luís Pacheco de Melo: Thank you, Zeinal. Good afternoon, ladies and gentlemen.

As Zeinal mentioned, group revenues increased by 0.7 percent, or 42 million euros. The lower interconnect rates impacted negatively in 71 million, so that explains more the decline.

If we now go to each one of the divisions, wireline declined in fixed charges and traffic were not compensated by the increasing ADSL revenues, therefore, revenues declined by 142 million, or 6.4 percent.

In TMN, interconnects had an overall impact of 49 million in revenues. That, together with the lower sales in handsets, justified more than the 55 million decline in TMN revenues, or 3.5 percent.

On PTM, higher penetration of the digital package and the Internet helped revenues growing by 6.1 percent in a year. So, overall, revenues declined by .7 percent from 2005 to 2006.

EBITDA fell by 2.9 percent, or 72 million, to 2.42 billion. The 72 million decline is probably explained by the impact of the interconnection rates of 32 million and one-off reversal of provisions in the wireline booked in 2005 of 53 million.

Clean wireline EBITDA remained stable at 937 million. TMN EBITDA decreased by 2.2 percent but, if you exclude the impact of the interconnects, then they would have increased by 1.6 percent, and PTM increased by 8.1 percent. Therefore, as Zeinal mentioned before, delivering on our annual guidance.

Worth highlighting is also the strong EBITDA performance of both Vivo on the fourth quarter and TMN stable EBITDA, despite very strong net adds and the impact of the interconnect. Capex increased by 6.1 percent as we started to deploy the GSM network at Vivo, which is well underway, and upgraded our investments in TMN primarily towards network capacity and 3G and 3.5G coverage.

On slide 11, the operating cash flow increased by 22 percent in 2006, and the free cash flow, if you exclude the financial investments that we did in 2006 and the financial divestitures that we did in 2005, then it increased by 35 percent.

As to the curtailment program, in 2006, 792 employees joined the plan to either suspend, pre-retire or agreed to leave the company, and total curtailment charge amounted to 229 million.

As for net income, net income grew by 33 percent to 867 million euros primarily due to the recognition of tax credits in the first and second quarter, lower level of curtailments in 2006, and the reduction of the healthcare benefits.

In 2006 PT did not benefit from any capital gains in disposal of assets.

If we now move to our net debt position, net debt decreased by 350 million in the fourth quarter, or to approximately 3.75 billion despite the dividend payment, the extraordinary contribution to the pension fund and the acquisition of the Namibian assets. The total undrawn amount of standby facilities and cash in hand in Portugal totaled 2.5 billion, giving us an excellent financing flexibility.

On the operating cash flow side, we are also very happy with the result of our initiatives on the working capital management. Working capital has reduced 228 million euros in 2006. The total average cost of our debt, excluding Vivo and the cost of the swaps on PTM shares, stand at 3.79 percent, i.e. 37 basis points below the eight-year mid-swaps at the end of December of 2006. Overall maturity of our debt is now at 7.9 years, excluding Vivo, and approximately 62 percent of our gross debt is set in fixed rate.

In what regards pension liabilities, we have made a considerable progress both by containing the salary growth and by announcing the new healthcare benefit plan, and also by agreeing to end the protocol with the national healthcare system. The combined impact of the healthcare and the protocol was a reduction on the PBO of 367 million.

During the year we also made extraordinary and normal contributions to the pension fund of 582 million. The combined effect of these movements has brought our unfunded pension liability after tax to approximately 1.2 billion compared to 1.9 billion at the end of 2005. Our distributable reserves stand at 2.77 billion.

Let me wrap up now just by highlighting that our good operational performance in all our domestic business, very strong fourth quarter at Vivo that shows signs of some recovery, good operational performance of all our international assets, strong cash flow generation, very solid and flexible financial situation, significant progress in reducing our

pension fund deficit, and a good set of financial results, once again delivering on our guidance.

Thank you very much. We now open the floor for any questions that you might have. Thank you.

Operator: Thank you.

The floor is now open for questions. If you would like to ask a question, please press star, one on your telephone keypad. If at any point your question is answered, you may remove yourself from the queue by pressing star, two. We do ask, when you pose your question, that you pick up your handset to provide optimum sound quality. Please stand by for a few moments as we poll for questions.

Our first question comes from Bosco Ojeda. Please state your question.

Mr. Bosco Ojeda: Hi, good afternoon. Couple of questions.

First one is I wonder if you could update us in terms of the status of your treasury stock. I'm not sure how the treasury stock accounts in the case of the shareholders meeting. I'm sure if you could also give us some light on that.

And also, a question on working capital. You obviously had a very strong inflow in 2006. I wonder if you could also give us some guidance on how would that reverse, or is that going to reverse in '07 or stabilize.

Thank you.

Mr. Zeinal Bava: Okay, thank you very much.

With regard to the treasury stock, we have essentially an equity swap, which covers about 1.83 percent of our stock. We have no idea how those shares will vote in a shareholders meeting, be it related to whatever aspect of any shareholders meeting.

We have essentially on that equity swap a financial settlement mechanism and, as you know, we had resorted to using the equity swap to acquire shares as part of a buyback program, which we had announced in 2005, which was for 3 percent. And we had to stop because of the offer that was launched in February the 6th. That equity swap amounts to about 187 million equivalent and, like I said, it covers 1.83 percent of the shares.

And with regard to the working capital, Luis, would you like to answer that, please?

Mr. Luís Pacheco de Melo: Okay. With regards to the working capital, what I have to say is that we have put in place all the disciplines for a strong working capital management discipline, and our aim here is to remain at the same levels of working capital. It might be considered as an aggressive one, but we will aim at maintaining exactly the same level of working capital investments for this year.

Mr. Bosco Ojeda: Thank you.

Operator: Our next question comes from Chi Chan with Execution Limited. Please state your question.

Mr. Chi Chan: Hi there. I have two questions, please.

The first one is there was an article in yesterday's Financial Times that was saying that Telefonica is confident of acquiring your stake in Brazil Cell because you've indicated that you'd be willing to sell if the Sonaecom bid is not successful. Can you confirm whether this is the case?

And the second question is with regard to the result report, where you mentioned that the unfunded pension obligation fell because you decided not to sign a new protocol

with the national healthcare system. I'm just a simple telecom analyst. Can you explain kind of the mechanics of that and what the implications are? Thank you.

Mr. Zeinal Bava: Thank you.

With regard to Vivo, our statements have been, I would say, pretty consistent from day one. We are committed to Brazil. We are committed to the Vivo turnaround. And as I earlier on said in my brief presentation, we are engaged with the management of Vivo to make sure that we deliver on the roadmap that we have basically designed to improve the performance of that company going forward, having now stabilized a number of IT systems, etc.

And with regard to a future of Vivo, what we have also said, and again referring to the article that you just mentioned, is that we have a great partner called Telefonica, with whom we get on with extremely well. And clearly, in light of the good relations we have with Telefonica, I'm sure we will no doubt have significant opportunity to discuss various strategic options going forward. I highlight the fact that we do have a very good relationship with them, and that we have been working together with them as a team to assist Vivo's management in turning around that business.

With regard to the unfunded pension liability, Luis, please?

Mr. Luís Pacheco de Melo: So, there's two parts on the healthcare benefits. One is the national healthcare system, and the other one is the change in the benefits of our pensioners.

So, with regards to the national healthcare system, how it worked was that our employees could go to any public hospital in Portugal. This public hospital would charge

us for any expenses that they had at that hospital, and then we had a protocol with the national healthcare system that would pay us something on a per-add basis.

Since the amount that the hospitals charged us was higher than what we received from the national healthcare system, for each employee we had a deficit. So, on our pension liabilities before, what we had was the net present value going forward forever of these benefits, of these negative funding that we have, our costs per employee that we have over there. So, by ending the protocol, since that was already accounted in our liability, we took out that liability because, from now onwards, we won't have any deficit.

With regard to the pensioner's benefits, what we did was twofold. One, we increased the contribution by our employees, the monthly contribution and, second, we reduced the benefits that they had.

So, just an example, whereas before any of our employees could go to one of our medical centers and pay zero for any doctor visits, now we have a minimum charge that they have to pay, two euro that they have to pay, every time they visit the doctor. So, this is an example of one of the benefits.

So, there are other benefits. All of those benefits computed together with the SNS gave us a reduction on our future liabilities of 367 million.

Now, that together with the 582 million of contributions and payments related to the pension fund, these two factors explain 90 percent of the reduction of the unfunded pension liability.

Okay, thank you.

Operator: Our next question comes from Giorgios Ierodiconou with Dresdner Kleinwort. Please state your question.

Mr. Giorgios Ierodiconou: Good afternoon. I've got two questions, please.

The first one is regarding the wireline. You've mentioned the improvement in recouping preselection and WLR lines. I was wondering, since wholesale lines have reached 142 by year-end, from what I understand now you would be allowed to come up with new retail tariffs. I was wondering if anything was announced, or whether you can give us some of your plans for the future, and whether you would expect the line losses to slow down on the back of that.

And my second question would be on the mobile. As in your presentation, you do mention that there has been a bound in the pre-SARC margin. Are there any provisions that have contributed to that? Is it underlying, and would you expect that to continue in '07?

Thank you.

Mr. Zeinal Bava: Okay, thank you.

I think with regard to your question as to are we going to get more flexibility to offer our Portuguese clients on the fixed line more or better tariffs and perhaps more bundles as a result of the total number of wholesale line rental and ULL lines reaching those numbers that you just mentioned, yes, we think it will. We have, as you know, been working with the Portuguese regulator for quite some time to see whether we can incorporate minutes in the monthly bill that we charge to our consumers.

Increasingly, we want to work towards having a flat rate, be it for voice, be it for Internet and, as you also know, our fixed line business is also engaging in a pilot for IPTV, so we do see in the future us being able to offer, on the fixed line also, a triple-play offer with a bundled rate.

The discussions with the regulator are ongoing. We are, I would say, making some progress, and we do see that the regulator understands the challenges that the fixed line business in Portugal, and have to say that we are making progress, albeit that we have not been able to yet achieve what we have been striving for.

Having said that, as you know, with regard to regulation, we believe that we should be getting significant relief going forward also because of the decision that we have already taken to spin off PT Multimedia. So, against that background, we are working with the regulator to see if further flexibility can be provided, and which we think is absolutely critical.

Notwithstanding that, I think it's worth highlighting that the line loss, in terms of traffic generating lines, is now stabilized at 41,000, 42,000, and that is a significant improvement over what we saw in the first half of 2006.

And in that regard, clearly, two things are worth highlighting. First is that the Portuguese economy appears to be doing better, as probably you no doubt have been following, that the outlook in terms of growth is positive this year. Analysts are talking about 1.5, 1.6 percent growth. Exports are doing very well, and employment rate is coming down.

We think all this will lead to consumer confidence levels going up, and therefore, as a result of that, our businesses are doing better. As you know, there is a strong correlation between the way our businesses do and the outlook for the economy.

With regard to TMN and the pre-SARC margin, as I mentioned to you, there are obviously some impact in that coming from lower provisions. Why lower provisions? Well, two things worth highlighting. The first is that we have been able to reduce the

cost per air mile that we give in our air miles program, or our loyalty program that we have at TMN. So, subsidies there are coming down. The cost per unit point there is coming down, so that is of course resulting in us having to provide for less.

The second is a change that we announced in the first quarter of 2006, which was reflected in our provisions, which is that we were providing for bad debts, including the VAT charge. We think the VAT charge can be recouped and, therefore, that is perhaps the only other material change that we have made.

But, the pre-SARC margin improvement is coming also from the cost discipline that we have, be it maintenance costs. We are increasingly trying to see whether we can work more with suppliers, and possibly even other operators in the Portuguese market, to reduce not just the overall Capex that we have in our company, but also the OpEx associated with the network, and so on.

So, we think that the continuing trend of improving pre-SARC margin is likely to continue as we remain focused.

Mr. Giorgios Ierodiconou: Okay, thank you.

Operator: Our next question comes from Teresa Martinho with Banif. Please state your question.

Ms. Teresa Martinho: Hello. I have four questions, if I may.

First, what will be, in your opinion, wireline business future trends, given the inevitable increased competition due to the spin-off of PT Multimedia and the launch of coverage and products by all mobile operators?

Second, taken in consideration the savings due to the termination of the protocol with the national healthcare system, what average cost per employee should we consider for the headcount reduction program?

Third, can you elaborate a little bit on what will be the strategy of TMN going forward, considering the high mobile penetration rate in Portugal and the introduction of MVNOs?

And four, if you can give any guidance for 2007.

Mr. Zeinal Bava: Okay, thank you very much.

With regard to the spin-off of PT Multimedia, as I mentioned earlier, we expect that, against that backdrop, we can obtain regulatory relief for our fixed line business. In fact, increasingly, regulation in Portugal, when it comes to Competition Authority, appears to be moving in the direction of regulating the wholesale business as opposed to the retail business, and we think that this increased flexibility on the retail side of our business should allow us to bundle better our services and, hopefully, provide better services and better value to our consumers.

This regulatory relief, again just to remind you, one of the, for example, aspects that we have brought to bear in the recent road shows we have done is, for example, related to the universal service obligations. Our universal service obligations that Portugal Telecom has, namely in the fixed line business, is costing Portugal Telecom somewhere between 100 and 150 million euros.

We believe that this cost should be borne by all operators in the Portuguese market, and not just by Portugal Telecom. Increasingly, with now even mobile operators moving also to the fixed line business, there is absolutely no reason why our fixed line

business should be the only one bearing this cost, 100 to 150 million euros. Granted that, because we have the higher market share, we will end up paying the bulk of this, but we believe that other operators have to chip in into this cost.

The other thing that is important to mention in terms of regulatory relief also is that spectrum fees in Portugal are very high. As you know, we have two issues in Portugal when it comes to spectrum fees. One is that the cost per subscriber is very high compared to the European average and, number two, what you find also is that the model that's being used to charge that spectrum fee we believe is no longer adequate. It's on a per-sub basis as opposed to being in terms of capacity or usage of spectrum and, therefore in our view, it is not in favor of operators managing the spectrum more efficiently.

So, we hope that these are two examples of things that, perhaps, you know, should change as a result of this increased competition that, no doubt, we will see in the Portuguese market with the spin-off of PT Multimedia. And when it comes to spectrum fees, we're talking roughly about five euros per sub. TMN has about 5.7 million subs. I think you can see the kinds of reductions that could potentially imply if we were to adopt the model, which we believe makes increasingly more sense for where the industry is going right now.

With regard to TMN trends and MVNOs, well, what I can say there is that, at the moment as you know, there isn't a view as to how these MVNOs will happen in the Portuguese market, what terms and conditions, and even this very detailed review that was undertaken by the Competition Authority as part of the offer that's ongoing. Left a lot of those details either they were not detailed or they were considered to be

confidential, so very little is known as to what kind of model MVNOs will have in this market.

Having said that, would like to mention the following, the three mobile operators in Portugal have what we call the no-frills brands already. TMN's no-frills brand is Uzo, and no doubt you know that these three brands have already occupied, I would say, an important part of the market, which would be the natural addressable market of any future MVNO.

So, I think we would like to think and believe that some of that negative impact that may come from MVNOs entering the market is already reflected in our accounts. And as you know, one of the reasons why you have seen some dilution in average revenue per minute of TMN is due to the fact of some of these new brands, new no-frill brands coming in with far more aggressive tariffs in the Portuguese market, albeit that the level of service and the services in general which they offer is not the same as the main brands.

With regard to the fixed line business, while we have been operating under very aggressive competition from mobile operators, including our own sister company, TMN, for quite some time, and I have said this many times before, that the fixed mobile cannibalization in the Portuguese market, has probably been ahead of what has been seen in other markets. And that's why today more than 65 percent of the voice minutes in Portugal are already mobile.

And I think we have been able to sustain this increased competition by investing in broadband. ADSL take-up has been significant. We are still growing ADSL at a rate which we believe is pretty attractive. We expect the potential to grow broadband to be

even higher as PC penetration grows and equipment prices come down. We have to continue to focus on costs, and we have said this before.

Clearly, when it comes to the fixed line division, we will have to maintain a high level of cost discipline in order to continue to deliver sustainable cash flows going forward. So, ultimately, as far as we are concerned, PT Comunicações game plan has to involve a very, very clear, I would say, initiatives to ensure that EBITDA minus CapEx remains stable and continues to be an important driver of the cash flow of Portugal Telecom Group.

I think you had one other point, which was relating to the headcount reduction and the costs. Maybe Luis can answer that.

Mr. Luís Pacheco de Melo: Okay. I think the question was the impact of the end of the SNS protocol on the curtailment cost per head.

Basically, the curtailment cost per head on round numbers, 95 percent of which is the NPV of the salaries, more or less 3 percent is the NPV of future pensions, and 2 percent is the healthcare. So, the impact is negligible in the impact of the cost of the curtailment per head.

Going forward and also taking into account the lower age of our employees that will leave the company, and if we continue through the method of pre-retirement and suspended contract, we are targeting in an average cost per head between 275 and 300,000 per head.

Thank you.

Mr. Zeinal Bava: Just on guidance, just like to say then the following. We are not, for obvious reasons and considering the context under which we are operating at the

moment with this offer out there, we are not going to provide you specific guidance, as we have done in the past other than to say, and I think this is trying to be as helpful as we can, that we are generally comfortable with the consensus of the analysts that are out there. I think with regard to that, our IR Director, Nuno Prego, would be more than happy to take any calls you may have after this conference call. But, that is as much guidance as we can give you at this stage.

Thank you.

Operator: Ladies and gentlemen, we have time for one more question, and that comes from Mr. James Ratzer with New Street Research. Please state your question.

Mr. James Ratzer: Yes, good afternoon. I have three questions, please.

Zeinal, just following up on the last statement you made regarding analyst consensus, I was wondering if I could ask what you felt about consensus levels for CapEx going forward, year-on-year CapEx growth rates I see picked up quite a bit in the fourth quarter, total of a billion euros for '06. Is that a good run rate to be looking at going forward?

Second question I had was just regarding the broadband market. It seems as if net adds for the total DSL market, including unbundling, has been slowing throughout the year, and I was wondering if there was a specific driver for that and whether we should expect acceleration going into '07.

And the final question I had was, in an environment where PT Multimedia is a competitor to you, would you consider rolling out a fiber network? And we've seen that in both Holland and the U.S., and it can prove to be quite a value-accretive strategy.

Thank you.

Mr. Zeinal Bava: Okay, thank you. Thank you very much, James. Very good questions.

Well, first with regard to Capex, I suggest you speak to Nuno Prego. As I mentioned, we are not going to give you a specific number. However, I will say one of two things here.

First is that, clearly, when it comes to Vivo, you know, we are investing in GSM and, therefore, there is a very valid reason for those CapEx numbers there. With regard to Portugal, we decided that, in the second half of 2006, we needed to beef up some investments in order to prepare ourselves to offer better services, new services to our customers.

If you, no doubt, saw the presentation, if you take, for example, PT Multimedia, we have put a huge amount of investments in digitalizing our network, in making our network VoIP compliant, and it's very good to see that 45 percent of our 1.5 million customers are now digitally enabled.

Likewise, you know, we continue to grow homes passed. When it comes to the wireline, we have invested in broadband coverage, and we are at the moment, for example, investing in IPTV pilots. When it comes to TMN, we want to differentiate ourselves in the Portuguese market with good coverage and, therefore, you know, what you have seen is some ramp-up in CapEx.

Having said that, I think that, you know, we will, and I have emphasized this many times before, we will continue to look at the cash flow generation of our company to make sure that we continue to deliver similar sorts of performances that we have had

in the past, and therefore, we will be prepared to adjust and contain investments as and when.

And of course, this is not even discussing at the moment in this call, but I'm sure we will no doubt have a number of opportunities in the future as to what is the implication of fixed to mobile convergence, or possibly even, you know, mobile operators cooperating with each other along the lines of some other announcements that we have seen recently in the industry and what kind of impact, and I'm sure positive impact, this will have in terms of the Capex run rate.

So, I think on this one, I can just say that we are investing where we think we can generate more revenues. We are investing where we believe we have interesting returns, and we are investing where we believe we can probably justify and--in line with our EBITDA performance, considering the cash flow objectives that we have.

With regard to broadband, should say that, if you look at the fourth quarter numbers that we posted, worth highlighting here is that you have seen some recovery on cable broadband net adds, as well. And therefore, clearly, the cable broadband net adds have been going up in terms of total market. That is a trend which is very much on the back of the repositioning that we did of the Netcabo brand at PT Multimedia, and I would say a pretty novel, I would say offer that we put out, where we have taken basically off all the limits of traffic for all of our broadband cable customers.

So, I think that the broadband market continues to grow, and I think we saw that second half last year. We are seeing similar trends in the beginning of this year as well, which is very encouraging, but most encouraging is the fact that the Portugal Telecom

share of net adds we believe is very solid and, if anything, we are doing better than we had expected ourselves.

With regard to your third question, let me just--yes, the fiber to the home. At the moment, there are no plans to invest in fiber to the home. We are in the fixed line obviously investing in--we're upgrading the network to offer IPTV. Obviously, the investments in IPTV will have to be rational, we will of course be looking to roll it out where we think it makes business and financial sense.

With regard to PT Multimedia, we have already invested, I would say, in 2006 what we had in mind in terms of fiber rings, in terms of changing the architecture and taking as much fiber to the cells as we thought was necessary to offer services like 24 mega. So, we have at this stage no additional plans to invest in fiber to the home other than what we have already done in 2006. And of course, we will have, of course, something in the plans for 2007, but won't be that material.

So, I think that, ultimately, we will of course be looking also at the regulatory framework in order to better decide as to how much we want to invest, how we want to invest because, clearly, experience has shown to us that we are bearing the bulk of the costs in digitalizing this country, in providing more bandwidth, newer products, and we have to make sure that we are getting the right regulatory relief to incentivize us to continue investing the way we have done in the past.

I actually have just one other thing I would like to highlight. Again, it was a question that was done earlier--asked earlier to me about pre-SARC margins at TMN. Just to say that, if you look at the '05 pre-SARC margins, it was 62.1 percent. Q4 '06 is

64 percent. So, basically, it's just to re-emphasize that point, that provisions of course had some impact, but it wasn't just the only impact.

And by the way, this number that I just gave is after provisions, so our pre-SARC margins after provisions in Q4 is 64 percent and, in '05, Q4 was 62 percent. So, basically in terms of the overall numbers, just to say that we are confident that we are essentially seeing improvement in the economy, and that is filtering through the performance that we're having in our domestic businesses.

Significant work is being done also in terms of ensuring we have cost discipline. We are, again when it comes to pension funds and managing unfunded pension liability, we are actively working to ensure that we can live up to the promise that we have made that we will fully fund that deficit within six years. We are very confident that we can achieve that.

And last but not the least, I think the Vivo turnaround is something that we all are very keen to ensure that happens sooner rather than later. And both us and Telefonica remain committed to make sure that that happens sooner rather than later and creates value for all shareholders, not just of course PT / Telefonica, but also the minorities at Vivo.

So, I appreciate very much you being in the call. With regard to any other further questions that you may have, our IR Director, Nuno Prego, would of course be very happy to answer any questions you may have after the call.

And on behalf of the PT Board and my team and I here, Pacheco de Melo and the rest of the team, thank you very much for being available. And as we will be on the road show the next two weeks, and we look forward to seeing you.

Thank you very much. Bye-bye.

Operator: Thank you.

This concludes today's conference call. Please disconnect your lines at this time, and have a wonderful day. Thank you.