PORTUGAL TELECOM SGPS SA
Form 6-K
May 26, 2011

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

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

Securities Exchange Act of 1934

For the month of May 2011

Commission File Number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of registrant as specified in its charter)

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

(Address of principal executive office)

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

Form 20-F x Form 40-F o

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

Yes o No x

First Quarter 2011

Earnings Release

26 May 2011

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Earnings Release

Lisbon, Portugal, 26 May 2011

Following the Vivo transaction on 27 September 2010, PT adjusted its 2010 financial statements in order to recognise Vivo as a discontinued operation and, following the acquisition on 28 March 2011 of a 25.3% stake in Oi and a 14.1% stake in Contax, PT s statement of financial position as at 31 March 2011 proportionally consolidated the assets and liabilities of these stakes. In 1Q11, consolidated operating revenues amounted to Euro 871 million, down by 3.9% y.o.y, while EBITDA reached Euro 357 million, down by 5.2% y.o.y. Consolidated EBITDA margin stood at 41.0%. Net income increased by 29.3% y.o.y to Euro 130 million and basic earnings per share stood at Euro 0.15. In 1Q11, capex decreased by 25.0% y.o.y to Euro 122 million, equivalent to 14.0% of revenues, and was primarily directed to the investment in the rollout of new technologies and services, namely the FTTH network and TV service and to investments in 3G and 3.5G. In 1Q11, EBITDA minus capex reached Euro 235 million, increasing by 9.9% y.o.y. EBITDA minus capex of the Portuguese businesses amounted to Euro 229 million, increasing by 7.4% y.o.y. In 1Q11, operating cash flow stood at Euro 315 million. Adjusting for the acquisition of PT s strategic investment in Oi and Contax, free cash flow stood at Euro 453 million in 1Q11 against negative Euro 6 million in 1Q10. As at 31 March 2011, excluding the impacts resulting from the strategic investment in Oi and Contax, net debt would have amounted to Euro 1,648 million. Following the strategic investment in Oi and Contax and the proportional consolidation of its net debt position and the transfer of regulatory unfunded pension obligations to the Portuguese State last December, consolidated net debt stood at Euro 7,429 million as at 31 March 2011, but this not include the Euro 2 billion of cash to be received from Telefónica which have been booked as an account receivable. As at 31 March 2011, after-tax unfunded post retirement benefits obligations from Portuguese businesses totalled Euro 706 million, down by 37.1% y.o.y from Euro 1,122 million as at 31 March 2010.

Table 1 _ Consolidated financial highlights (1) **Euro million**

	1Q11	1Q10	y.o.y
Operating revenues	871.1	906.9	(3.9)%
Operating costs, excluding PRBs and D&A	513.7	529.8	(3.0)%
EBITDA (2)	357.4	377.1	(5.2)%
Income from operations (3)	149.0	186.9	(20.2)%
Net income	129.7	100.3	29.3%
Capex	122.2	163.0	(25.0)%
Capex as % of revenues (%)	14.0	18.0	(3.9)pp
EBITDA minus Capex	235.2	214.1	9.9%
Free cash flow (4)	453.5	(6.0)	n.m.
Net debt (5)	7,428.5	4,879.7	52.2%
Net debt adjusted for TEF receivable (5)	5,428.5	4,879.7	11.2%
After-tax unfunded PRB obligations	705.6	1,121.8	(37.1)%
EBITDA margin (%) (6)	41.0	41.6	(0.5)pp
Net debt / EBITDA (x) (5) (7)	2.8	3.2	(0.4)x
Net debt adjusted for TEF receivable / EBITDA (x) (5) (7)	2.1	3.2	(1.1)x
Basic earnings per share	0.15	0.11	29.3%
Diluted earnings per share (8)	0.15	0.11	27.0%

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(1) 2010 figures were adjusted in order to recognise Vivo business line as a discontinued operation. Following PT s strategic investment in Oi and Contax on 28 March 2011, PT proportionally consolidated the assets and liabilities of these investments in its statement of financial position as at 31 March 2011, while net income of Oi and Contax will be proportionally consolidated as from 1 April 2011. **(2)** EBITDA = income from operations + post retirement benefits + depreciation and amortisation. **(3)** Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs (gains). **(4)** 1Q11 figure excludes the impact of the investment in

Oi and Contax. **(5)** The 2010 net debt was adjusted in order to reflect the deconsolidation of Vivo. **(6)** EBITDA margin = EBITDA / operating revenues. **(7)** With respect to 1Q11, EBITDA was adjusted in order to recognise the proportional contribution of Oi and Contax. **(8)** Earnings per share computed using net income excluding the costs associated with the convertible bonds divided by the diluted number of shares.

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Financial Review

Income Statement

In 1Q11, consolidated operating revenues decreased by 3.9% y.o.y to Euro 871 million, against a backdrop of challenging conditions in Portugal and significant revenue growth in international businesses, namely MTC in Namibia, Timor Telecom and Dedic / GPTI.

Table 2 _ Consolidated income statement (1) **Euro million**

	1Q11	1Q10	y.o.y
Operating revenues	**871.1**	**906.9**	**(3.9)%**
Wireline (2)	456.2	488.2	(6.6)%
Mobile • TMN (2)	303.0	345.9	(12.4)%
Other and eliminations	111.9	72.8	53.7%
Operating costs, excluding PRBs and D&A	**513.7**	**529.8**	**(3.0)%**
Wages and salaries	156.8	149.6	4.8%
Direct costs	124.9	133.7	(6.6)%
Commercial costs	72.8	84.5	(13.9)%
Other operating costs	159.3	161.9	(1.6)%
EBITDA (3)	**357.4**	**377.1**	**(5.2)%**
Post retirement benefits	12.0	17.8	(32.4)%
Depreciation and amortisation	196.4	172.4	13.9%
Income from operations (4)	**149.0**	**186.9**	**(20.2)%**
Other expenses (income)	**7.1**	**9.1**	**(21.3)%**
Curtailment costs, net	4.4	5.2	(15.0)%
Net losses (gains) on disposal of fixed assets	(0.1)	(0.6)	(85.9)%
Net other costs (gains)	2.8	4.5	(37.3)%
Income before financ. & inc. taxes	**141.9**	**177.8**	**(20.2)%**
Financial expenses (income)	**(55.6)**	**25.2**	**n.m.**
Net interest expenses (income)	(17.3)	59.1	n.m.
Equity in earnings of affiliates, net	(80.2)	(38.8)	106.8%
Net other financial losses (gains)	41.9	4.9	n.m.
Income before income taxes	**197.5**	**152.6**	**29.4%**
Provision for income taxes	(48.0)	(38.7)	23.9%
Income from continued operations	**149.5**	**113.9**	**31.3%**
Income from discontinued operations	0.0	15.3	n.m.
Income before non-controlling interests	**149.5**	**129.1**	**15.8%**
Losses (income) attributable to non-controlling interests	(19.8)	(28.8)	(31.3)%
Consolidated net income	**129.7**	**100.3**	**29.3%**

(1) 2010 figures were adjusted in order to recognise Vivo business line as a discontinued operation. Following PT s strategic investment in Oi and Contax on 28 March 2011, PT proportionally consolidated the assets and liabilities of these investments in its statement of financial position as at 31 March 2011, while net income of Oi and Contax will be proportionally consolidated as from 1 April 2011. **(2)** Wireline and TMN operating revenues include the impact of the decline in regulated mobile termination rates (MTRs). At TMN, this impact amounted to Euro 7 million in 1Q11. **(3)** EBITDA = income from operations + post retirement benefits + depreciation and amortisation. **(4)** Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + other costs (gains).

In 1Q11, revenues from Portuguese businesses decreased by 7.8% y.o.y (Euro 62 million), negatively impacted by: (1) lower equipment sales (Euro 9 million); (2) lower MTRs (Euro 7 million); (3) lower revenues from the directories business (Euro 6 million); (4) lower wholesale and data and corporate revenues (Euro 20 million), and (5) lower customer revenues at TMN (Euro 27 million).

Wireline operating revenues decreased by 6.6% y.o.y, from Euro 488 million to Euro 456 million. Nonetheless, retail revenues grew once again by 0.9% y.o.y in the period, wireline revenue performance was impacted by: (1) the

continued decrease of directories business (Euro 6 million); (2) lower corporate and data revenues (Euro 10 million) due to economic conditions affecting corporate and SME/SOHO customer segments including lower revenues derived from public administration contracts (Euro 4 million), and (3) lower wholesale revenues (Euro 10 million), affected by the Euro 3 million reduction in ULL and DSL wholesale revenues. These effects more than offset the significant increase in pay-TV and retail broadband revenues. In 1Q11, retail revenues grew by 0.9% y.o.y, from Euro 244 million to Euro 246 million, a slight acceleration when compared to 4Q10, as a result of the continued strong performance of the Meo triple-play offer (voice, data and pay-TV), which is underpinning growth in fixed telephone lines and fixed broadband.

In 1Q11, the wireline business continued to benefit from a relentless effort to transform PT s residential service offering from a legacy fixed telephone telecom to a triple play offering, which is more competitive and more resilient to adverse economic conditions. Total wireline retail accesses or retail revenue generating units (RGUs) increased by 7.0% y.o.y reaching 4,578 thousand, with pay-TV and broadband accesses already accounting for 41% of total retail accesses. Retail net additions reached 52 thousand in 1Q11, driven by the success of PT s pay-TV and triple-play offers, which are contributing to steady and consecutive gains in broadband market share and record reduction in fixed telephone line net disconnections. This solid performance was also underpinned by the investment in the coverage of one million households with FTTH, carried throughout 2009 and 2010, which continues to show steady commercial traction as more households become available for commercial sales. As a result, fibre customers reached 147 thousand as at the end of 1Q11, representing a 14.7% penetration over total FTTH households passed at year-end and a 23.3% penetration over the average number of households available for commercial sales. In February 2011, PT received an Innovation Award by the FTTH Council for the planning and deployment of its fibre network, which recognises PT s execution and engineering excellence and the company s ability to work successfully with its technological partners. In 2011, PT plans to extend the FTTH coverage to an additional 600 thousand households, thus enhancing its coverage and value proposition further to residential and also corporate and SME customers.

In 1Q11, PT had 12 thousand net disconnections of fixed telephone lines, including 9 thousand net disconnections of carrier pre-selection lines. Traffic generating lines therefore only declined by 4 thousand, underpinned by fixed line net additions of 6 thousand in the residential segment. Fixed broadband retail customers increased by 13.2% y.o.y in 1Q11, with 18 thousand net additions in the quarter. According to the 4Q10 report issued by ANACOM, the Portuguese telecom regulator, PT has been increasing its fixed broadband market share for the past eleven consecutive quarters. As referred to above, the solid performance of Meo double-play and triple-play offers contributed decisively to mitigate fixed telephone line net disconnections to 12 thousand in 1Q11, thus comparing favourably to 14 thousand in 1Q10 and 30 thousand in 1Q09. As in previous quarters, this strong performance was particularly noteworthy in the residential segment, which saw positive fixed telephone line net additions and 22 thousand broadband net additions in 1Q11. PT s Meo offer continues to benefit from strong demand having reached an estimated market share of 31%. Notwithstanding significant scale back in promotions, pay-TV net additions reached 46 thousand in 1Q11. Total pay-TV customers reached 876 thousand, equivalent to 85.9% penetration of the fixed broadband retail customer base, up by 14.2pp y.o.y. Retail RGU per access increased by 9.0% y.o.y in 1Q11 to 1.71.

In 1Q11, TMN s operating revenues decreased by Euro 43 million (-12.4% y.o.y) to Euro 303 million, mainly due to: (1) lower customer revenues (Euro 27 million) against a backdrop of increased penetration y.o.y of Moche tribal plans (flat-fee prepaid tariff plans offering unlimited voice and sms traffic for customers using the same tariff plan), and lower demand particularly in the postpaid segment; (2) lower interconnection revenues (Euro 11 million), mostly as a result of the negative impact of lower MTRs (Euro 7 million), and (3) lower equipment sales (Euro 5

million). In order to enhance the value proposition of its offers, TMN launched TMN unlimited in July 2010 and all net unlimited and e nunca mais acaba in January 2011. The take up of these new offers has been encouraging as are being perceived by the market as best offers and are also ARPU accretive. Notwithstanding the significant growth in fixed broadband, data revenues at TMN increased by 1.4% y.o.y and accounted for 26.9% of service revenues (+3.6pp y.o.y).

Other revenues, including intra-group eliminations, increased by 53.7% y.o.y in 1Q11 to Euro 112 million. This was mainly due to: (1) an increase of 17.7% and 13.6% y.o.y at Timor Telecom and MTC, respectively; (2) the improving business trends of PT s Brazilian BPO business, Dedic, and (3) the impact of the consolidation of GPTI, an IT / IS company acquired by Dedic, as from 1 March 2010.

EBITDA decreased by 5.2% y.o.y in 1Q11 to Euro 357 million, equivalent to a margin of 41.0%. EBITDA performance in the period was impacted by the decline in TMN revenues, notwithstanding a 12.5% y.o.y reduction in operating costs excluding D&A and PRBs. Wireline EBITDA was flat in 1Q11 at Euro 188 million (-0.2% y.o.y) as a result of increasing operational leverage of the triple-play services, higher penetration of fibre and a relentless focus on cost cutting. The proportional EBITDA of international businesses reached Euro 53 million, an increase of over 4% y.o.y.

Wireline EBITDA of Euro 188 million in 1Q11 (-0.2% y.o.y), was equivalent to a 41.2% margin, a 2.6pp y.o.y improvement. This performance marked a robust and steady improvement (-5.3% in 4Q10, -5.9% y.o.y in 3Q10, -6.4% y.o.y in 2Q10 and -9.4% in 1Q10) and represents the best performance in the last eighteen quarters, notwithstanding the continued commercial investment in the roll-out of triple-play offers as referred to above. The improvement in EBITDA trend was achieved on the back of a streamlined cost structure resulting from fixed-mobile convergence and restructuring of the Portuguese businesses along customers segments. EBITDA also benefited from the critical mass of Meo, which is leading to lower programming costs per customer, which declined 14% y.o.y. This solid EBITDA performance in the wireline segment was achieved against a backdrop of lower contribution to revenues and EBITDA derived from the directories business, which contracted a further Euro 6 million and Euro 2 million, respectively. PT has a financial investment of 25% (50% of voting rights) in the yellow pages company, which is managed by Truvo.

Table 3 _ EBITDA by business segment (1)(2) **Euro million**

	1Q11	1Q10	y.o.y
Wireline	188.1	188.5	(0.2)%
Mobile • TMN	144.0	164.1	(12.2)%
Other and eliminations	25.3	24.4	3.7%
EBITDA	**357.4**	**377.1**	**(5.2)%**
EBITDA margin (%)	41.0	41.6	(0.5)pp

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(1) 2010 figures were adjusted in order to recognise Vivo business line as a discontinued operation. **(2)** EBITDA = income from operations + post retirement benefits + depreciation and amortisation.

TMN s EBITDA decreased by 12.2% y.o.y to Euro 144 million in 1Q11, as a result of the decline in service revenues (Euro 39 million), which have a high operational leverage. In effect, service revenues less direct costs declined Euro 28 million, while EBITDA only declined by Euro 20 million as a result of lower support costs (Euro 6 million), which is benefiting from initiatives promoting the use of self-care, increased simplicity of commercial offers and processes and lower maintenance and repairs (Euro 2 million). As a result of the cost cutting efforts, EBITDA margin stood at 47.5%, remaining flat y.o.y.

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Other EBITDA increased by 3.7% y.o.y to Euro 25 million in 1Q11 as a result of the 20.7% and 10.6% y.o.y growth in Timor Telecom and MTC, respectively. After several quarters of EBITDA contraction at CVT in Cape Verde, primarily due to weaker economic conditions and adverse regulation, in 1Q11 CVT s EBITDA increased by 2.7% y.o.y.

Post retirement benefits costs decreased to Euro 12 million in 1Q11, compared to Euro 18 million in 1Q10, reflecting primarily the impact of the transfer of regulatory unfunded pension obligations to the Portuguese State, which was completed in December 2010.

Depreciation and amortisation costs increased by 13.9% y.o.y to Euro 196 million, reflecting mainly a higher contribution from the wireline business, as a result of the investments in the rollout of a fibre network and the pay-TV service, and from MTC in Namibia.

Net interest income amounted to Euro 17 million in 1Q11, compared to net interest expenses of Euro 59 million in 1Q10, mainly as a result of: (1) an Euro 51 million interest on cash deposits in Brazilian Reais which were used to pay the strategic investment in Oi on 31 March 2011; (2) the decrease in the average net debt, following the first and second instalments received from Telefónica in 2010 (Euro 5,500 million), related to the Vivo transaction, which more than offset dividends paid in December 2010 (Euro 876 million) and the debt related to the transfer of unfunded pension obligations completed in December 2010 (Euro 1,022 million), and (3) the reduction in the average cost of debt, excluding the impact of the interest on cash deposits in Brazilian Reais as referred to above, which stood at 3.6% in 1Q11 compared to 4.8% in 1Q10.

Equity in earnings of affiliates in 1Q11 amounted to Euro 80 million compared to Euro 39 million in 1Q10. In 1Q11, this caption includes a gain of Euro 38 million related to the completion of the disposal of the investment in UOL for a total amount of Euro 156 million. Adjusting for this effect and PT s share in UOL s earnings in 1Q10, equity in earnings of affiliated companies would have amounted to Euro 43 million in 1Q11 and Euro 32 million in 1Q10, reflecting primarily the improvement in earnings of other international assets.

Net other financial losses, which include net foreign currency losses, net losses on financial assets and net other financial expenses, amounted to Euro 42 million in 1Q11 compared to Euro 5 million in 1Q10. Net foreign currency losses amounted to Euro 16 million in 1Q11 (net gains of Euro 3 million in 1Q10), primarily as a result of the impact on US denominated assets of the depreciation of the US Dollar against the Euro during 1Q11. Net losses on financial assets amounted to Euro 1 million in 1Q11, which compares to net gains of Euro 0.4 million in 1Q10. Other financial expenses, which include banking services, financial taxes and other financing costs, increased from Euro 8 million in 1Q10 to Euro 25 million in 1Q11, mainly due to financial taxes incurred in Brazil in connection with the transfer of funds for the strategic investment in Oi.

Income taxes increased to Euro 48 million in 1Q11, from Euro 39 million in 1Q10, corresponding to an effective tax rate of 24.3% and 25.4%, respectively. Adjusting for certain non-taxable net interest income and expense in 1Q11 and 1Q10, respectively, the effective tax rate would have been 26.8% and 22.1%. This increase in the effective tax rate is primarily explained by a higher statutory tax rate in Portugal (26.5% in 1Q10 and 29.0% in 1Q11) and by certain adjustments to prior year income taxes recorded in both periods.

Income attributable to non-controlling interests decreased by Euro 9 million to Euro 20 million in 1Q11, reflecting the reduction in non-controlling interests from Vivo (Euro 12 million in 1Q10), following the acquisition of this investment by Telefónica in September 2010, which was partially offset by the increase in non-controlling interests from African businesses (Euro 4 million).

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Net income increased by 29.3% y.o.y to Euro 130 million, compared to Euro 100 million in 1Q10, reflecting primarily the decrease in net interest expenses, as a result of the Vivo transaction, and higher gains related to affiliated companies, mainly due to the disposal of UOL. These effects were partially offset by: (1) higher depreciation and amortisation charges in the wireline business; (2) certain financial taxes recorded in 1Q11 in connection with the investment in Oi, and (3) foreign exchange losses resulting from the impact of the depreciation of the US Dollar against the Euro.

Shareholder remuneration

In 2010 PT paid an ordinary dividend of Euro 0.575 per share relating to fiscal year 2009 and, as an anticipation of 2010 dividends, an initial instalment amounting to Euro 1.00 per share relating to the exceptional dividend of Euro 1.65 per share that was announced following the Vivo transaction.

Following the approval at the Annual Shareholder s Meeting, held on 6 May 2011, PT will pay the second instalment of the exceptional dividend (Euro 0.65 per share) and an ordinary dividend of Euro 0.65 per share relating to fiscal year 2010 on 3 June 2011, with ex-dividend date on 31 May 2011.

With the payment of these dividends, amounting to Euro 1.3 per share, PT reinforces further its commitment to continue to deliver best in class returns and free cash flow payout to its shareholders, while retaining a solid balance sheet and financial flexibility to continue investing in its core markets, new products and services and maintaining its long term strategic competitive position.

Capex

Capex decreased by 25.0% y.o.y in 1Q11 to Euro 122 million, equivalent to 14.0% of revenues (-3.9pp y.o.y). Wireline capex decreased by 26.7% y.o.y, from Euro 112 million in 1Q10 to Euro 82 million in 1Q11, reflecting: (1) lower customer-related capex and lower equipment prices; (2) lower infrastructure-related capex following the significant efforts in the FTTH coverage undertaken in 2009 and 2010, and (3) lower investment in legacy infrastructure, following the FTTH rollout. The higher efficiency of wireline capex also reflected synergies from fixed-mobile integration. Capex to sales ratio in wireline stood at 18.1% of revenues, down by 5.0pp when compared to 1Q10. PT aims at strengthening further the value proposition to its corporate, SME/SOHO and residential customers by extending FTTH coverage to an additional up to 600 thousand households and investing in the construction of a state of the art 45 thousand sqm data centre.

Table 4 _ Capex by business segment (1) **Euro million**

	1Q11	1Q10	y.o.y
Wireline	82.4	112.4	(26.7)%
Mobile • TMN	19.0	23.5	(19.3)%
Other	20.8	27.1	(23.2)%
Total capex	**122.2**	**163.0**	**(25.0)%**
Capex as % of revenues (%)	14.0	18.0	(3.9)pp

(1) 2010 figures were adjusted in order to recognise Vivo business line as a discontinued operation.

TMN s capex decreased by 19.3% y.o.y to Euro 19 million in 1Q11, equivalent to 6.3% of revenues. The decrease in TMN s capex is primarily explained by the decision to focus on cash flow generation and crystallisation of synergies

from fixed-mobile integration. Capex continued to be directed towards expanding network capacity and coverage, namely in urban areas and main roads to improve further the quality of service. Infra-structure related capex was broadly flat as a result of the continued focus on the provision of high quality mobile voice and data services and on accommodating increased voice and data usage. TMN s network quality continues to stand out in the context of the Portuguese market due to its coverage and reliability both in voice and broadband. The most recent study issued by Anacom, the Portuguese telecom regulator, recognised TMN as the Portuguese mobile operator with the best coverage, both in the urban areas and in the main motorways and roads, for mobile broadband services. The same study recognised TMN as the Portuguese mobile operator with the best call termination rate, the best quality of audio and video calls and the best coverage for video call services. PT aims at strengthening further its mobile data capabilities and its network quality by leveraging the existing FTTH deployment to boost its mobile network quality, which at the end of 2011 is expected to have 80% of its sites covered with fibre and Ethernet backhauling, thus paving the way for 4G. TMN is currently carrying out a swap of its 2G network for a new technology which is already 4G-enabled and thus TMN expects to lead the 4G roll-out in the Portuguese market in line with its standing as the market leader.

In 1Q11, other capex decreased to Euro 21 million, compared to Euro 27 million in 1Q10, primarily as a result of the investments undertaken in 1Q10 related to the expansion of Dedic, namely the construction of new sites.

Cash Flow

EBITDA minus Capex amounted to Euro 235 million, increasing by 9.9% y.o.y, while EBITDA minus Capex of Portuguese businesses amounted to Euro 229 million, increasing by 7.4% y.o.y.

Operating cash flow reached Euro 315 million in 1Q11 against Euro 24 million in 1Q10, mainly due to a significant improvement in working capital investment and also improvement in EBITDA minus Capex as referred to above. The improvement in working capital investment is primarily explained by: (1) the one-off reduction in the payment cycle to certain suppliers undertaken in 4Q10, following the cash inflow from the Vivo transaction, leading to lower payments to suppliers in 1Q11, and (2) a lower investment related to trade receivables in the Portuguese businesses.

Table 5 _ Free cash flow (1) **Euro million**

	1Q11	1Q10	y.o.y
EBITDA minus Capex	235.2	214.1	9.9%
Non-cash items	5.3	10.7	(50.6)%
Change in working capital	74.9	(200.8)	n.m.
Operating cash flow	**315.4**	**24.0**	**n.m.**
Interests	4.2	(95.7)	n.m.
Net reimbursements (contributions) to pension funds	5.0	68.5	(92.7)%
Paym. to pre-retired, suspended employees and other	(41.1)	(35.6)	15.5%
Income taxes	(41.8)	(15.2)	175.6%
Dividends received	117.9	8.4	n.m.
Disposal of stake in UOL	155.5	0.0	n.m.
Share capital reductions at Brasilcel	0.0	36.1	n.m.
Other cash movements (2)	(61.6)	3.4	n.m.
Free cash flow	**453.5**	**(6.0)**	**n.m.**

(1) 2010 figures were adjusted in order to recognise Vivo business line as a discontinued operation and excluding the impacts of the acquisition of PT s strategic investment in Oi and Contax. **(2)** In 1Q11, this caption included financial taxes paid in connection with the strategic investment in Oi, bank commissions and certain payments of contractual penalties.

Excluding the impacts of PT s investment in Oi and Contax, free cash flow in 1Q11 amounted to Euro 453 million, against negative Euro 6 million in 1Q10. This performance is primarily explained by: (1) a higher operating cash flow (Euro 291 million) as referred to above; (2) proceeds amounting to Euro 156 million received from the disposal of the investment in UOL; (3) dividends received from Unitel (Euro 98 million) in 1Q11 in relation to 2009, while the 2008 dividends had been fully received in 4Q09, and (4) a reduction in interest paid amounting to Euro 100 million, due to the decrease in the average net debt and the interest received on cash deposits in Brazilian Reais which were used to pay the strategic investment in Oi. These effects were partially offset by: (1) a decrease in net reimbursements from pension funds (Euro 69 million), due to the Euro 75 million reimbursement in 1Q10 due to the excessive funding of the healthcare plan, and (2) higher payments of income taxes (Euro 27 million).

Consolidated Net Debt

Excluding the impacts resulting from PT s strategic investment in Oi and Contax, consolidated net debt would have amounted to Euro 1,648 million as at 31 March 2011, compared to Euro 2,100 million as at 31 December 2010. The decrease of Euro 451 million reflects the free cash flow generated in the period (Euro 453 million), as explained above. Total net debt as at 31 March 2011 included Euro 904 million for future contributions to the pensions funds as a result of the pensions fund transfer to the Portuguese State. Following the strategic investment in Oi and Contax and the proportional consolidation of its net debt position, consolidated net debt increased to Euro 7,429 million. Nevertheless, the Euro 2 billion, which is still to be received from Telefónica in connection with the Vivo transaction have been booked as a receivable. Adjusting for this receivable, net debt would be approximately Euro 5,429 million, equivalent to a net debt to EBITDA ratio of 2.1x.

As at 31 March 2011, total consolidated gross debt amounted to Euro 11,922 million, of which 72.5% was medium and long-term and Euro 3,749 million relates to the proportional consolidation of Oi and Contax. Excluding the gross debt related to the proportional consolidation of Oi and Contax, gross debt would have amounted to Euro 8,174 million, of which approximately 67.9% was medium and long-term and 87.0% was set at fixed rates.

Table 6 _ Change in net debt **Euro million**

	1Q11	**1Q10**
Net debt (initial balance as reported)	2,099.8	5,528.0
Less: Vivo s net debt	0.0	699.0
Net debt (initial balance adjusted)	2,099.8	4,829.0
Less: free cash flow	453.5	(6.0)
Acquisition of strategic investment in Oi and Contax	3,727.6	0.0
Changes in consolidation perimeter (Oi)	2,052.5	0.0
Changes in consolidation perimeter (GPTI)	0.0	30.8
Other (1)	2.1	14.0
Net debt (final balance)	**7,428.5**	**4,879.7**
Change in net debt	5,328.7	50.7
Change in net debt (%)	253.8%	0.9%

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(1) In 1Q10, this caption included mainly Euro 13 million related to dividends paid by PT s fully consolidated subsidiaries to non-controlling interests.

The amount of cash available in PT s Portuguese businesses plus the undrawn amount of PT s committed commercial paper lines and standby facilities totalled Euro 4,595 million at the end of March 2011, of which Euro 1,890 million was undrawn committed commercial paper and

standby facilities. In January 2011, PT issued a 5-year Eurobond amounting to Euro 600 million, with a spread of 295bp over the mid swaps of similar maturity, equivalent to an annual coupon of 5.625%, thus increasing its liquidity position and the average maturity of its

debt. In March and April 2011, PT signed a credit facility amounting to Euro 1,200 million, which will mature in March 2014, with a number of leading international banks. These transactions are part of PT s financing strategy, which aims at having diversified maturities and sources of financing. Therefore, PT now has its debt maturities fully financed until the end of 2013 and financial flexibility to continue to invest in its businesses whilst honouring its commitments to its shareholders.

In 1Q11, excluding the Euro 51 million interest on cash deposits related to the strategic investment in Oi, PT s average cost of debt stood at 3.6%, down from 4.8% in 1Q10. As at 31 March 2011, PT s consolidated net debt had a maturity of 5.6 years. Excluding the consolidation of Oi and Contax, the maturity of PT s net debt was 5.4 years. As at the end of March 2011, the net debt to EBITDA ratio was 2.8x compared to 3.2x in 1Q10. Excluding the strategic investment in Oi and Contax and its proportional consolidation on PT s financial statement as at 31 March 2011, the net debt to EBITDA ratio was 1.1x.

Post Retirement Benefits Obligations

As at 31 March 2011, the projected post retirement benefits obligations (PBO) from Portuguese businesses related to pensions and healthcare amounted to Euro 471 million and market value of assets under management amounted to Euro 425 million, compared to Euro 472 million and Euro 448 million as at 31 December 2010, respectively. In addition, PT had liabilities in the form of salaries due to suspended and pre-retired employees amounting to Euro 895 million as at 31 March 2011, which are not subject to any legal funding requirement. These monthly salaries are paid directly by PT to beneficiaries until retirement age. As a result, total gross unfunded obligations from Portuguese businesses amounted to Euro 941 million as at 31 March 2011 and after-tax unfunded obligations amounted to Euro 706 million. PT s post retirement benefits plans for pensions and healthcare in Portugal are closed to new participants.

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

Table 7 _ Post retirement benefits obligations in Portugal **Euro million**

	31 March 2011	31 December 2010
Pensions obligations	128.9	129.9
Healthcare obligations	342.0	342.5
PBO of pension and healthcare obligations	**470.9**	**472.4**
Market value of funds (1)	(425.3)	(448.1)
Unfunded pensions and healthcare obligations	**45.6**	**24.2**
Salaries to suspended and pre-retired employees	895.2	924.3
Total gross unfunded obligation	**940.8**	**948.6**
After-tax unfunded obligations	**705.6**	**711.4**
Unrecognised prior years service gains	17.9	18.3
Accrued post retirement benefits	958.7	966.9

(1) The reduction in the market value of funds resulted mainly from: (i) payments of pensions and supplements of Euro 2.1 million; (ii) the negative performance of assets under management amounting to Euro 9.8 million (equivalent to negative 2.2% in 1Q11), and (iii) the refund of healthcare expenses paid previously by PT amounting to Euro 10.9 million.

Excluding the impact of the change in consolidation perimeter related to Oi consolidation, total gross unfunded obligations decreased by Euro 8 million to Euro 941 million as at 31 March 2011, primarily as a result of salary

payments to suspended and pre-retired employees made during the period amounting to Euro 41 million, which were partially offset by net actuarial losses recorded in 1Q11 (Euro 16 million) and total post retirement benefits and curtailment costs recognised in the period (Euro 12 million).

Table 8 _ Change in gross unfunded obligations in Portugal **Euro million**

	1Q11	1Q10
Gross unfunded obligations (initial balance)	948.6	1,467.4
Post retirement benefits costs (PRB)	7.6	18.3
Curtailment cost	4.4	5.2
Net reimbursements (contributions) to pension funds (1)	5.0	68.5
Salary payments to pre-retired, suspended employees and other	(41.1)	(35.6)
Net actuarial (gains) losses	16.4	2.5
Gross unfunded obligations (final balance)	940.8	1,526.3
After-tax unfunded obligations	705.6	1,121.8

(1) In 1Q11, this caption includes termination payments amounting to Euro 0.7 million and reimbursements net of healthcare expenses amounting to Euro 5.6 million.

Table 9 _ Post retirement benefits costs **Euro million**

	1Q11	1Q10
Service cost	0.9	2.0
Interest cost	13.3	50.5
Expected return on assets	(6.5)	(34.2)
Sub-total	7.6	18.3
Amortisation of prior year service gains	(0.4)	(0.5)
Service cost related to liabilities transferred to Portuguese State	4.8	0.0
Post retirement benefits costs	**12.0**	**17.8**

The decrease in post retirement benefits costs reflected primarily the impact of the transfer of regulatory unfunded pension obligations to the Portuguese State, completed in December 2010.

Equity

Table 10 _ Change in shareholders equity (excluding non-controlling interests) **Euro million**

	1Q11
Equity before non-controlling interests (initial balance)	**4,392.4**
Net income	129.7
Net currency translation adjustments	(135.5)
Net actuarial gains (losses), net of taxes	(12.3)
Acquisition of treasury shares	(61.5)

Other	2.5
Equity before non-controlling interests (final balance)	**4,315.4**
Change in equity before non-controlling interests	**(77.0)**
Change in equity before non-controlling interests (%)	**(1.8)%**

As at 31 March 2011, shareholders equity excluding non-controlling interests amounted to Euro 4,315 million, which represents a decrease of Euro 77 million in 1Q11. This decrease is primarily explained by: (1) negative currency translation adjustments amounting to Euro 136 million, in connection with the depreciation of the Real against the Euro in the period, following the cash transferred to Brazil for the strategic investment in Oi; (2) the acquisition by Oi of PT s own shares (Euro 61 million), which for accounting purposes are classified as threasury

shares, and (3) net actuarial losses related to post retirement benefits amounting to Euro 12 million (net of taxes). These effects more than offset the net income generated in the period of Euro 130 million.

Strategic Investment in Oi

On 31 March 2011, PT concluded its strategic investment in Telemar Norte Leste, S.A. (Oi) and Contax, S.A. (Contax) for a total consideration of R$8,437 million (Euro 3,728 million). These strategic investments were made in connection with the agreements entered into with the controlling shareholders of Telemar Participações, S.A., which controls and fully consolidates Oi, and CTX Participações, S.A., which in turner controls and fully consolidates Contax. Under these agreements, PT shares the control of these companies and will play a key role in the strategic financial and operating decisions and, consequently, proportionally consolidated the assets and liabilities of the companies in its statement of financial position as at 31 March 2011, as explained in more detail in the section of consolidated statement of financial position.

PT made the strategic investment in Oi and Contax through its wholly owned holding companies Bratel Brasil and PT Brasil, respectively, having acquired economic interests of 25.3% in Oi and 14.1% in Contax, through the acquisition of direct stakes in these companies and indirectly through the acquisition of stakes in the investment vehicles of the controlling shareholders of these companies.

Consolidated Statement of Financial Position

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

The impact of the consolidation of Oi and Contax in PT s consolidated statement of financial position as at 31 March 2011 includes total assets and liabilities of Euro 9.3 billion and Euro 6.8 billion, respectively, and non-controlling interests of Euro 0.7 billion. In addition, PT recorded a preliminary goodwill of Euro 1.8 billion as a result of this transaction.

Excluding the impact of the proportional consolidation of the investments in Oi and Contax, total assets and liabilities would have increased from Euro 15.2 billion and Euro 10.6 billion as at 31 December 2010 to Euro 16.2 billion and Euro 11.5 billion as at 31 March 2011, reflecting primarily the Euro 600 million Eurobond issued in January 2011.

Table 11 _ Consolidated statement of financial position **Euro million**

	31 March 2011	Before Oi and Contax	31 December 2010
Cash and equivalents	4,493.7	6,525.2	5,106.5
Accounts receivable, net	3,975.8	3,215.0	3,403.2
Inventories, net	132.2	119.2	101.5
Financial investments	393.9	385.8	539.6
Intangible assets, net	4,916.4	1,088.9	1,111.7
Tangible assets, net	6,430.1	3,798.0	3,874.6
Accrued post retirement asset	12.4	1.8	1.9
Other assets	1,676.0	329.5	338.1
Deferred tax assets and prepaid expenses	1,474.1	689.4	692.7
Total assets	23,504.6	16,152.7	15,169.9
Accounts payable	1,287.2	771.8	722.6
Gross debt	11,922.2	8,173.6	7,206.3
Accrued post retirement liability	1,023.7	960.5	968.8
Other liabilities	3,074.1	1,078.4	1,063.0
Deferred tax liabilities and deferred income	953.1	509.8	600.1
Total liabilities	18,260.3	11,494.1	10,560.8
Equity before non-controlling interests	4,315.4	4,445.5	4,392.4
Non-controlling interests	928.8	213.1	216.7
Total shareholders equity	5,244.3	4,658.6	4,609.1
Total liabilities and shareholders equity	23,504.6	16,152.7	15,169.9

The main effects following the strategic investment in Oi and Contax and its proportional consolidation on PT s statement of financial position as at 31 March 2011 are: (1) the Euro 5,780 million increase in net debt, reflecting PT s investment (Euro 3,728 million) and the proportional consolidation of Oi s net debt (Euro 2,052 million); (2) the increase in total tangible and intangible assets (Euro 6,460 million), including the preliminary goodwill recognised as a result of this transaction (Euro 1.8 billion), and (3) an increase in other liabilities and other assets, mainly related to provisions and judicial deposits.

03

Operational Review

Portuguese Businesses

Revenues from Portuguese businesses, which include wireline and TMN, decreased by 7.8% y.o.y in 1Q11. In the wireline segment, retail revenues increased by 0.9% y.o.y in 1Q11 underpinned by the performance of the residential segment, which benefited from the solid and steady growth of Meo s double-play and triple-play offers. Wireline revenues declined by 6.6% y.o.y in the quarter, impacted by: (1) lower data and corporate revenues (Euro 10 million), against a backdrop of a challenging economic environment, affecting corporate and SME/SOHO customers, as well as a reduction in some structural projects, including lower revenues derived from a contract with public administration related to the provision of broadband in schools (Euro 4 million); (2) lower wholesale revenues (Euro 10 million), affected by the Euro 3 million reduction in ULL and DSL wholesale revenues; (3) the secular declining trend of the directories business (Euro 6 million), and (4) lower equipment sales (Euro 4 million). Revenue performance at TMN was impacted by: (1) lower customer revenues (Euro 27 million), as a result of the economic conditions, including the 3pp y.o.y increase in VAT and increased popularity of tribal plans; (2) lower interconnection revenues (Euro 11 million), due to lower MTRs, and (3) lower equipment sales (Euro 5 million).

Table 12 _ Portuguese operations income statement (1) **Euro million**

	1Q11	1Q10	y.o.y
Operating revenues	**735.0**	**797.2**	**(7.8)%**
Wireline	456.2	488.2	(6.6)%
Mobile • TMN	303.0	345.9	(12.4)%
Other and eliminations	(24.2)	(36.9)	(34.4)%
EBITDA (2)	**330.7**	**351.5**	**(5.9)%**
Post retirement benefits	12.0	17.8	(32.4)%
Depreciation and amortisation	179.1	159.7	12.2%
Income from operations (3)	**139.5**	**174.0**	**(19.8)%**
EBITDA margin	45.0%	44.1%	0.9pp
Capex	102.1	138.7	(26.4)%
Capex as % of revenues	13.9%	17.4%	(3.5)pp
EBITDA minus Capex	228.5	212.8	7.4%

(1) Operations in Portugal include the wireline segment, TMN, PT Inovação, PT SI, PT Pro, PT Contact and PT Sales. **(2)** EBITDA = income from operations + post retirement benefits + depreciation and amortisation. **(3)** Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs.

In 1Q11, EBITDA from Portuguese businesses declined by 5.9% y.o.y to Euro 331 million. EBITDA margin increased by 0.9pp y.o.y to 45.0%. In 1Q11, EBITDA in the wireline remained flat (-0.2% y.o.y), the best performance in the last eighteen quarters, benefiting from the pay-TV customer base having reached critical mass and thus confirming the success of Meo as the key driver for an effective turnaround in the wireline business. It is worth highlighting that programming costs per customer decreased by 14% y.o.y in the quarter. This solid EBITDA performance in the wireline segment was achieved against a backdrop of lower contribution to revenues and EBITDA derived from the directories business, which declined by Euro 6 million and by Euro 2 million, respectively. EBITDA at TMN declined by 12.2% y.o.y. EBITDA margin was up 0.1pp y.o.y to 47.5%. Operating expenses excluding D&A declined by 12.5% y.o.y reflecting PT s cost discipline and the benefits of fixed-mobile integration.

Capex in the Portuguese businesses decreased by 26.4% y.o.y to Euro 102 milllion in 1Q11, reflecting: (1) lower customer-related capex, notwithstanding the continued growth in pay-TV services albeit lower than in 2010; (2) lower infrastructure-related capex following the significant efforts in the FTTH coverage undertaken in 2009 and 2010, and (3) lower investment in legacy infrastructure, following the FTTH rollout.

EBITDA minus Capex from Portuguese businesses increased by 7.4% y.o.y in 1Q11 to Euro 229 million, as a result of the focus on cost cutting, improving profitability and commitment to a solid cash flow generation.

Wireline

In 1Q11, retail net additions reached 52 thousand, as a result of the growth of the pay-TV service, which accounted for 46 thousand net additions, bringing the total pay-TV customers to 876 thousand (up by 35.6% y.o.y). Fixed broadband net additions in the quarter stood at 18 thousand, with fixed broadband customer base growing by 13.2% y.o.y. As a result of this solid performance underpinned by Meo, according to the 4Q10 report issued by ANACOM, the Portuguese telecom regulator, PT has increased its pay-TV market share and fixed broadband market share for the past eleven consecutive quarters.

Table 13 _ Wireline operating data

Main accesses (000)	4,922	4,674	5.3%
PSTN/ISDN	2,683	2,732	(1.8)%
Carrier pre-selection	87	122	(28.9)%
TV customers	876	646	35.6%