PORTUGAL TELECOM SGPS SA
Form 6-K
April 23, 2004

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 April, 2004

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 _______

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

Yes _______ No ___X____

ANNUAL REPORT 2003

Collective Person No. 503 215 058 Share Capital: Euro 1,254,285,000
Registered at the Conservatory of the Commercial Registry of Lisbon under No.

3602, Section 4
Avenida Fontes Pereira de Melo, 40, 1069-300 Lisboa

CONSOLIDATED REPORT

2003

CONTENTS

PT Group Structure

HIGHLIGHTS

Euro million

Consolidated Results	**2003**	**2002**	**Δ %**
Operating Revenues	5,776	5,582	3.5
EBITDA	2,268	2,230	1.7
Operating Income	1,314	1,267	3.7
Income Before Taxes and Minority Interests	697	654	6.7
Net Income	240	391	(38.6)
Earnings per Share (Euro)	0.19	0.31	(38.6)

Euro million

Margins and Ratios	**2003**	**2002**	**Δ %**
EBITDA Margin (%)	39.3	39.9	(0.6 p.p.)
EBITDA / Net Interest (no. of times)	11.2	11.3	(0,1x)
Net Debt / (Net Debt + Shareholders' Equity) (%)	52.2	56.5	(4.3 p.p.)
Total Investment [(1)]	1,116	1,105	1.0
Capex [(1)] [(2)]	652	776	(16.0)
EBITDA minus Capex	1,616	1,454	11.2

Euro million

Financial Data	**2003**	**2002**	**Δ %**
Net Assets	13,558	13,726	(1.2)
Net Debt	3,216	4,037	(20.3)

Shareholders' Equity	2,941	3,111	(5.5)
Share Capital	1,254	1,254	0.0

million			
Customers / Accesses	**2003**	**2002**	**Δ %**
PT's Total Customers	33.5	28.4	18.2
Portugal	12.4	11.1	11.3
International Market [(3)]	21.1	17.2	22.7

number			
Employees	**2003**	**2002**	**Δ %**
PT Employees	24,872	23,109	7.6
Portugal	14,427	16,893	(14.6)
International Market [(3)]	10,445	6,216	68.0
Productivity			
Fixed Main Lines per Employee - Portugal	478	403	18.6
Mobile Cards per Employee - TMN	4,406	3,713	18.7

Note: Information based on proportional consolidation of 50% of Vivo in 2003 (including TCO's results since May 2003) and on full consolidation of TCP in 2002.

(1) Excluding in 2002 the acquisition of the ownership of the fixed network for Euro 348 million.

(2) Excluding goodwill.

(3) Including fully and proportionately consolidated companies.

MAIN FIGURES BY BUSINESS AREA

Wireline *Euro million*

	2003	**2002**	**Δ %**
Operating Revenues	2,288	2,441	(6.3)
EBITDA	907	985	(7.9)
EBITDA Margin (%)	39.7	40.4	(0.7 p.p.)
Capex [1]	165	256	(35.5)
EBITDA minus Capex	742	729	1.8
Capex / Operating Revenues (%)	7.2	10.5	(3.3 p.p.)

TMN *Euro million*

	2003	**2002**	**Δ %**
Operating Revenues	1,523	1,475	3.2
EBITDA	690	623	10.7
EBITDA Margin (%)	45.3	42.3	3.0 p.p.
Capex	168	283	(40.4)
EBITDA minus Capex	521	341	53.1
Capex / Operating Revenues (%)	11.1	19.2	(8.1 p.p.)

Vivo **[2]** *Euro million*

	2003	**2002 [3]**	**Δ %**
Operating Revenues	2,723	2,920	(6.7)
EBITDA	1,017	1,091	(6.8)

EBITDA Margin (%)	37.4	37.4	(0.0 p.p.)
Capex	329	432	(23.8)
EBITDA minus Capex	688	660	4.3
Capex / Operating Revenues (%)	12.1	14.8	(2.7 p.p.)

PT Multimedia *Euro million*

	2003	2002	Δ %
Operating Revenues	684	623	9.9
EBITDA	135	79	70.1
EBITDA Margin (%)	19.7	12.7	7.0 p.p.
Capex	57	79	(27.3)
EBITDA minus Capex	77	0	n.s.
Capex / Operating Revenues (%)	8.4	12.7	(4.3 p.p.)

Note: Values above include intra-group transactions.

(1) Excluding in 2002 the acquisition of the ownership of the fixed network for Euro 348 million.

(2) This business segment reports its results including 100% of Vivo's results and included TCO's results since May 2003. Vivo's financial results are proportionately consolidated by PT on a 50% basis.

(3) The values considered in this segment correspond to a pro-forma of Vivo in 2002, including pro-forma TCO's results from May to December 2002.

CHAIRMAN STATEMENT

Notwithstanding the fact that 2003 was a very difficult year in economic terms, with the domestic economy registering major falls in consumption and investment, and even a decrease in GDP, the PT Group was able to overcome these challenges and achieve good performance in operating and financial terms.

Our performance was only achieved by maintaining a clear focus on our vision for the future, underpinned by high levels of determination and commitment. We aim, in addition to continuing to be the recognized telecommunications leader in Portugal , to achieve a sustained position as one of the top telecommunications operators in Europe .

The Group's strategy and actions are, therefore, based on a common thread of vision for the future, which is comprised of 4 aspects:

- **Performance - the Group, in addition to being the sector leader in Portugal , also aims to be one of the best European telecommunications groups in terms of efficiency and profitability and in the creation of shareholder value;**
- **Role in Portugal - we play an important role in Portuguese society as a result of the impact of our social programs and our widely acknowledged economic success, contributing to development and innovation;**
- **International vocation - as a telecommunications operator with increasing significance and strengthened management capacity in Brazil , we are committed to consolidating our position in geopolitically favourable markets with which we enjoy strong cultural links;**
- **Human resources - the Group is one of the most prominent employers in Portugal, attracting, developing and motivating the best professionals, based on its Project which encourages a culture of motivation and an irreproachable ethical and professional ethos.**

In performance terms, our on-going commitment to cutting costs and our expanding focus at all business-levels on improving our capability for generating cash-flow and achieving synergies enabled our principal domestic businesses to achieve excellent levels of operating income in 2003. These businesses generated Euro 1,893 million in operating cash flow in 2003, a 54.5% increase over 2002, allowing us to launch a shareholder return (dividends and share buyback) programme of more than Euro 1 billion a benchmark achievement in the telecommunications sector.

I am confident that the execution of this shareholder return programme in no way jeopardises the PT Group's solid financial structure, evidenced by the fact that the Group was able to reduce net debt by more than Euro 800 to approximately Euro 3.2 billion in 2003, while continuing to maintain the risk levels allocated by the international rating agencies to Group debt.

With regard to the PT Group's role in Portugal , I wish to stress the corporate, macroeconomic significance of Group activities and our additional commitment to local endeavours, in respect of which we have made and shall continue to make decisive contributions to social and institutional responsibility and the promotion of innovation and the Information Society.

In international terms , reference should be made to our progress in Brazil since the creation of Vivo at the end of 2002, which, with more than 20 million customers, is currently the largest South American mobile telecommunications operator.

Vivo's acquisition of Tele Centro Oeste in 2003 enabled it to expand its influence into central and northern Brazilian states, covering more than 80% of Brazilian GDP.

This acquisition has enabled Vivo to further solidify its recognized Brazilian market leadership, which is confirmed by a market share of more than 50% and by the fact that it is much larger than its main competitor.

With regard to human resources , and in addition to necessary ongoing investment in strengthening the skills of Group employees, special note should also be made of the need (or rather demand) for growing investment in the preparation and training of staff in the Group's international operations, which plan to intensify their focus on human resources in 2004 and beyond.

2003 represented the consolidation of the current Chairman of the Board and Executive Committee articulation model . Throughout 2003, both Chairman and Executive Committee maintained an ongoing working relationship as a team, within the general framework of the Board of Directors, taking painstaking care in the examination of the major issues and challenges facing the Group.

In terms of corporate governance initiatives, work began in 2003 on creating an independent audit committee within the board of directors, which was successfully completed on January 1, 2004.

The creation of the audit committee represents not only effective progress in terms of the Group's corporate governance standards and compliance with the demands of the authorities and financial markets, namely, the legal framework imposed by the U.S. Sarbanes-Oxley Act, but also an important step forward in terms of the PT Group's commitment to a business-wide reinforcement of values, attitudes and standards of behaviour, based on the fulfilment of demanding ethical and professional criteria, thereby also creating a solid basis for integrity and trust in terms of non-company relationships.

In 2003, the Group committed itself to strengthening Group identity and self-awareness , by promoting the creation of a Group-wide culture, designed to fully integrate the multiple cultures represented within it.

I do not consider this to be a more or less coherent or consistent juxtaposition, pertaining to a simple common denominator but rather progress towards a new threshold of quality, which should open up new possibilities, new ways forward, new future Group self-awareness and affirmative configurations.

In short, as a result of clear vision for the Group's future, properly functioning corporate governance models and the finest human resources, I have every confidence in our ability to further our objectives of adding value, not only to the Group itself, but also in terms of shareholder capital and the work of all employees. Quality of vision, corporate governance and human resources constitute the three factors critical to the successful consolidation of the position of the Group of which I am proud to be the chairman.

Ernâni Lopes
Chairman of the Board of Directors

CEO MESSAGE

The past year has given us a great sense of achievement at Portugal Telecom. Amid a challenging environment both domestically and abroad, PT delivered on all the targets set out for the year. In fact, on many of them we managed to exceed our own already challenging stated objectives.

This could only have been done with our unique focus on client needs. It is a corporate priority within PT. This ever increasing focus on client needs has supported strong customer growth across all our business units, reinforcing our leading position in the markets in which we operate. In 2003, we added a total of 5.2 million new customers, bringing our total customer base to 33.5 million at the end of the year. PT clearly reinforced its growth profile in 2003, benefiting from its positioning as a fully integrated provider of telecoms and multimedia. Our focus on driving broadband in Portugal is worth highlighting. Through our two broadband platforms (ADSL and cable), we more than doubled the number of broadband customers to 391 thousand at the end of the year.

With this backdrop, we delivered a solid set of results in 2003. Top line and EBITDA growth were strong, driven primarily by the mobile (TMN and Vivo) and multimedia businesses. In constant currency terms, operating revenues and EBITDA grew by 10.0% and 7.7% respectively. Reported net income in 2003 totalled Euro 240 million. However, adjusting for curtailment costs and the one-off effect in deferred taxes resulting from the change in the corporate tax rate in Portugal , net income would have reached Euro 593 million, which represents an increase of almost 40% over the previous year.

The performance across all business units was very robust:

- The wireline business, although remaining under pressure because of fixed-mobile substitution and tough economic conditions primarily in the first half, continued to be the main cash flow generator of the group. EBITDA minus Capex amounted to Euro 742 million, which represented an improvement of 2% over the previous year.
- In terms of our domestic mobile business, subscriber growth remained strong, in excess of 10%, and EBITDA margin improved to over 45% for the full year.
- The multimedia business also posted a very positive performance in 2003. The Pay-TV EBITDA margin in the fourth quarter reached almost 34%, clearly above the stated target of 30%.
- The mobile business in Brazil , through Vivo, our joint venture with Telefónica Móviles, posted excellent growth in 2003. Net additions totalled 3.8 million, increasing the total subscriber base to 20.7 million. We highlight that in spite of intense commercial activity, EBITDA margins remained very strong at 37% for the full year. The acquisition of TCO at the beginning of the year was key to reinforce Vivo's already leading position in the Brazilian mobile market. At the end of the year, Vivo had a market share of 56% in the areas of operation and 45% for the whole of Brazil.

Regarding the targets that we set out in our last Investor Day, I would like to highlight one that was of particular importance to us, namely the reduction of net debt to around Euro 3,250 million at the end of the year. In effect, we managed to exceed our target by reducing net debt by Euro 821 million to Euro 3,216 million, underpinned by strong free cash flow generation of Euro 1,214 million during 2003. However, our net debt target excluded the share buyback programme. Adjusting for the investment of Euro 196 million in the acquisition of treasury stock until the end of 2003, the comparable net debt figure was in fact Euro 3,020 million, which represented a reduction of over Euro 1,000 million during the year.

This strong financial performance could not have been achieved without our continual drive to run our businesses more efficiently. During 2003, we implemented a staff rationalisation programme that covered around 1,500 employees, most of which belonging to the wireline division. As a result, our efficiency ratio in the fixed line business rose to 478 lines per employee, positioning us as one of the most efficient telecom operators in Europe . Notwithstanding the focus on reducing staff levels, PT continued to attract and retain among the best human talent available. The implementation of the shared services platform is being a huge success and is helping crystallise many of the cost rationalisation gains that have been achieved. We feel confident that with the various management initiatives being undertaken, PT is well positioned to become one of the three most efficient telecom operators in Europe within the next three years.

Shareholder return continues to be a top priority. PT's enviable financial position has allowed us to systematically increase the dividend per share paid to shareholders. In 2002, PT distributed Euro 0.10 per share, which was followed by a 60% increase in 2003 to Euro 0.16 per share. In 2004, the Board of Directors will propose a dividend payment of Euro 0.22 per share, which represents an increase of almost 38% over the previous year. Additionally, the 10% share buyback programme announced last September, clearly positions PT as one of the best telecom operators with regard to shareholder remuneration. In 2004, PT should return in excess of Euro 1 billion to shareholders until the end of the year.

At the base of all our achievements lies the professionalism and commitment of our employees, the confidence of customers, and the trust and support of our shareholders. To all of them, the Executive Committee and I would like to express our profound gratitude.

Miguel Horta e Costa
Chief Executive Officer

MAIN EVENTS

January 16

Signing by TCP of an agreement with the Brazilian company Fixcel to acquire TCO, the leading mobile operator in the Midwestern and Northern regions of Brazil, with approximately 3 million customers.

It was agreed that the acquisition of the total share capital of TCO would be executed in three stages through: (1) the acquisition of the common shares of TCO held by Fixcel, which represented 61.1% of TCO's voting capital, for approximately R$ 1,506 million, which was completed on April 25, 2003; (2) a tender offer for the remaining TCO common shares, which was completed on November 18, 2003; and (3) a merger of TCO into TCP through an exchange of TCP shares for the remaining TCO shares. This third stage was not concluded due to the cancellation of the merger in January 2004.

By acquiring control of TCO, Vivo has reinforced its leadership and competitive position in the Brazilian market, reaching over 20 million customers and a national market share of more than 50%. This transaction was completely funded in Reais by TCP.

February 14

Creation of a new instrumental company, PT Pro, that is the shared service centre platform for the PT Group. This new company is responsible for a number of back office functions of the Group, allowing for better coordination of these functions and the alignment of accounting proceedings within the Group. PT Pro is expected to improve the level of internal control, and allow for cost reduction by taking advantage of significant economies of scale.

February 21

Update of the fixed telephone service tariffs with a line rental increase of 3.8% and decreases of 10.7% and 15.2% in regional and in domestic long distance call prices, respectively. This corresponds to an annualized price basket decrease of 0.25%, thus complying with the 2003 price cap, which was determined based on an assumed 2.5% inflation rate in accordance with the Portuguese State budget. These changes in tariffs represent a further rebalancing of fixed telephony prices, thereby enhancing PT's competitive position in the domestic market.

March 24

Signing by TCP of the definitive share purchase and sale agreement regarding the acquisition of control of TCO, as contemplated in the January 16, 2003 agreement.

April 4

Approval at the AGM of the proposal to pay a cash dividend for 2002 of Euro 0.16 per share, amounting to a total of Euro 201 million, and corresponding to a pay-out ratio of 51.3%.

Approval at the same AGM of the composition of PT's new Board of Directors for the three-year period 2003/2005. Mr. Ernâni Rodrigues Lopes was appointed Chairman.

Following this appointment, the Board of Directors chose from among its members the following Executive Committee members:

CEO:	Mr. Miguel Horta e Costa
Officers:	Mr. Zeinal Bava
	Mr. Carlos Vasconcellos Cruz
	Mr. Iriarte Esteves
	Mr. Paulo Fernandes

April 8

Launch of a new nation-wide brand - Vivo - for the 50/50 joint venture between PT and Telefónica for mobile operations in Brazil . Vivo is a single brand for mobile operations in 20 states and the Brasilia federal district, covering 85% of Brazil and 74% of the Brazilian population and representing 86% of Brazilian GDP.

April 25

Conclusion by TCP of the acquisition of a controlling interest in TCO. The price of the controlling shares was R$ 1,506 million, corresponding to R$ 19.49 per 1,000 common shares acquired. R$ 308 million was paid on April 25, 2003 to Fixcel, and the balance was paid in instalments pursuant to the terms and conditions of the purchase agreement.

May 2

Payment of dividends for 2002 amounting to Euro 0.16 per share, equivalent to a total of Euro 201 million.

June 23

Creation of an instrumental company, PT Corporate, to provide personalized services to the top corporate clients of the PT Group. This company, 100% owned by PT, covers the 48 top corporate clients of the Group. PT Corporate offers, on an integrated basis, fixed telecommunications, mobile services and information technology services. However, the billing for such services continues to be done directly by the different PT Group operating companies.

June 24

PT's 2003 Investor Day held in Lisbon . The Company's Executive Committee met with institutional investors and financial analysts to present the PT Group's corporate strategy and prospects by business area.

Announcement that the Executive Committee had proposed to the Board of Directors that the payment of a cash dividend for the year ended December 31, 2003 of between Euro 0.20 and 0.22 per share, subject to PT's financial and market conditions, be submitted to the shareholders for approval at the AGM.

June 25

Launch by TMN of the multimedia mobile portal I9 - Inove. This is an innovative and user-friendly mobile product that optimizes the current capacities of the GSM-GPRS system. I9 allows faster, cheaper and easier access to a wide range of services and contents, such as Java games, the contents of the three national free to air TV channels and messaging services, as well as, in exclusive, goals in video, TV Cabo's programming guide and the first m-commerce service in Portugal (the Lusomundo ticketing service).

July 7

Signing by PT of an agreement with Citizens to sell its 50.01% stake in Mascom, for a total consideration of Botswana Pulas 250 million, which is equivalent to approximately Euro 46 million. An initial payment of Botswana Pulas 200 million, equivalent to Euro 41 million has already been received by PT and is being held in an escrow account until the completion of the transaction, which is pending regulatory approval. Despite the sale, PT expects to continue to provide consulting services to Mascom's management under the scope of the existing Management Agreement.

July 8

Creation of a new advisory body, the Advisory Council, which will address certain key strategic issues facing the PT Group with management. In line with international best practice on corporate governance, the Advisory Council will further enhance the governance model of PT Group.

July 20

Signing by PT of an agreement with SIBS for the acquisition of the remaining 12.5% stake in PT Prime that it does not already own, for Euro 39 million in cash. This transaction was part of the restructuring of the wireline business. The full ownership of PT Prime will allow for greater efficiency in this business segment through better integration and coordination of the wireline business and is expected to capture synergies and achieve cost reductions. The transfer of PT Prime shares was completed on October 6, 2003.

July 22

Cancellation by the Government of Guinea-Bissau of the concession contract established with Guiné Telecom to provide public telecommunications services in the country. Guiné Telecom, which is 51% owned by the PT Group and 49% by the Guinea-Bissau State , had been granted a concession in 1989 for a period of 20 years. PT has taken legal action to resolve this situation, which does not have any impact on PT's current financial results.

September 16

Confirmation by PT's Executive Committee that the Board of Directors will propose at the AGM the approval of a dividend of Euro 22 cents per share, which is at the top end of the range indicated at the Investor Day, subject to PT's financial and market conditions .

Announcement of the Executive Committee's intention to buyback 10% of PT's share capital by the end of 2004, subject to PT's financial and market conditions.

October 9

Launch by TCP of a tender offer to acquire the 43,385,533,827 common shares of TCO held by minority shareholders. The offering price of R$ 16.58 per 1,000 shares represented 80% of the price paid to the former controlling shareholder (Fixcel) on September 23, 2003.

October 17

Notification to PT Comunicações that the Portuguese Supreme Court upheld the earlier decision of the Court of Appeals, which ruled that the activation fees included in the prices for fixed telephone services, which were introduced by Portugal Telecom, S.A. in February 1998, were illegal. The Supreme Court ordered PT Comunicações, the legal successor to Portugal Telecom, S.A., to refund the amounts charged to subscribers as activation fees in 1999.

October 30

PT awarded four awards at the 2003 Investor Relations Awards ceremony promoted by Semanário Económico and Deloitte in Portugal , recognizing PT Group's standing in the national and international financial communities. The four awards were as follows:

- Best CEO in the Investor Relations area
- Best Global Investor Relations Programme - PSI20
- Best Usage of Technology in terms of Investor Relations
- Honourable Mention - Annual Report (non-financial sector)

November 18

Conclusion of the tender offer to acquired the common shares of TCO. In the tender offer, TCP acquired 32,205,831,707 common shares of TCO, representing 74.2% of the total outstanding common shares, for R$ 538.8 million. Following the tender offer, TCP now owns 90.7% of total voting shares and 29.3% of total share capital of TCO, excluding the treasury shares held by TCO.

November 20

Signing by PT and PT Comunicações of an agreement with RTP relating to the payment by RTP of an outstanding receivable balance due to PT Comunicações. The agreement covers outstanding invoices for services rendered by PT Comunicações to RTP up to December 31, 2002, plus interest. Under the agreement, RTP will pay a total of Euro 83 million to PT. As of December 31, 2003, Euro 67 million had already been paid by RTP and the remaining balance is expected to be paid in the first half of 2004.

December 10

Vivo's customer base reached 20 million, which corresponds to 46% of the total active customers in Brazil and to a 57% market share in Vivo's concession area. This underscores Vivo's leadership position in the Brazilian mobile telecommunications market.

MACRO ECONOMIC ENVIRONMENT

International

In 2003 there was moderate recovery in the international macroeconomic environment. Unlike 2002, this recovery extended to all the main economic regions. In particular, there was a reversal of the deceleration cycle in the Euro Zone during the second half of the year, as a result of economic recovery in the United States and the return of the Japanese economy to positive growth rates. 2003 was characterized by a general increase in confidence levels of economic agents, contributing to a recovery of equity capital markets.

Despite the progressive strengthening of activity throughout the year, there was, at a global level, excess production capacity that resulted in low inflation in the main economic areas. The evolution of world economy was also marked by the risks associated with some important economic imbalances, including the upward trend of the fiscal and external deficit in the United States that contributed to a strong depreciation of the US dollar in 2003.

The United States economy is estimated to have grown by approximately 3.1% in 2003, compared to 2.4% in 2002. This growth is mainly attributable to US domestic demand that continued to benefit from a strong monetary and fiscal policy, contributing to an increase in household disposable income and in an improvement in the financial condition of corporations. The US Federal Reserve made a new cut in reference rates in 2003, decreasing the fed funds target rate from 1.25% to 1%. Because of an increase in confidence levels of economic agents, the second half of the year saw a significant acceleration of investment by corporations. This, combined with moderate recovery in job creation due to cost cutting measures and the strong growth in labour productivity, allowed the United States economy to continue growing without significant inflationary pressures.

In the Euro Zone, GDP is estimated to have grown 0.4% in 2003, compared to 0.9% in the previous year. Despite the GDP stagnation seen in the first half of 2003 there was an acceleration in GDP growth in the third and fourth quarters, as a result of a growth in external demand (due to an improvement in the US and Asian economic environment), and a positive evolution of the main business confidence level indicators. Domestic private demand continued to be low in the Euro Zone as a result of high indebtedness levels of both corporations and households and a rising unemployment rate (increasing from 8.6% in January to approximately 8.8% in December). In addition, contrary to what occurred in the United States , fiscal policy did not assume an expansionary nature, due to the constraints imposed by the Stability and Growth Pact.

In 2003, the average inflation rate in the Euro Zone is estimated to have been approximately 2.1%. A decrease in inflation to a value near the European Central Bank reference level, combined with more restrictive monetary conditions imposed by the appreciation of the Euro , led the Euro Zone's monetary authority to extend in 2003 the cycle of lowering reference interest rates started in 2001. This resulted in a reduction of the main refinancing rate by 75 basis points, which reached 2% at the end of the year.

The growing perception of macroeconomic imbalances associated with the external and fiscal deficit in the United States resulted in a volatile period in currency markets in 2003, with the U.S. dollar falling an average of 16.4% against the Euro and 18.4% against the Brazilian Real.

In 2003, after a period of [internal and external uncertainty in Brazil , an agenda of macroeconomic continuity contributed to an almost complete elimination of the risk premium that had been placed in 2002 on Brazilian assets. The Brazilian Real recovered part of its value, with the exchange rate decreasing from 3.54 USD/BRL to 2.89 USD/BRL, remaining at a level that stimulated the expansion of the exports sector. Inflation, despite being aggravated by currency depreciation, returned to manageable levels, with rates below two digits. The IPCA index registered an increase in inflation of 9.3% in 2003, compared with 12.5% in 2002.

During 2003 there was a sharp cut in reference rates by the Brazilian Central Bank, with the *Selic* rate falling from 26.5% in February to 16.5% in December. During the second half of the year, there was an improvement in production indicators but no improvement in internal consumption, due to the cumulative loss of 15% in Brazilian household average Real income and an unemployment rate of 12.4%. In 2003, Brazilian GDP is estimated to have increased between 0% and 0.5%.

After the fulfilment of the terms of the agreement signed with the IMF in 2002, the Brazilian Government agreed an extension of the financial program for an additional 15 months ending in March 2005. Following this extension, and also taking into account advances in social security and tax reforms and the approval of a new bankruptcy law, two rating agencies revised their analysis of the Brazilian economy, resulting in a reduction in the risk factors associated with the country's financial solvency and the improvement in macroeconomic fundamentals.

Portuguese Economy

The Portuguese GDP posted an estimated negative real growth of -1.2% in 2003. Despite some signs of stabilization in the end of the year, private consumption decreased by approximately 0.8% in 2003, after an increase in real terms of 0.4% in 2002. With private consumption increasing less than disposable income in 2003, there was a slight increase in household savings rates to approximately 12.5% of disposable income.

Gross fixed capital formation is estimated to have contracted at least 8%, in 2003 (-5.7% in 2002). The negative trend in investment resulted from declining corporate confidence indicators as a result of a decline in internal demand and sluggish external demand, primarily due to the stagnation of the German and French economies, two of the three main destinations of Portuguese exports. Public sector investment remained stable in 2003, reflecting the Portuguese Government's efforts to reduce public expenses.

	rates in real terms (%)		
Main Economic Indicators	**2001**	**2002**	**2003**
GDP	**1.7**	**0.4**	**(1.2)**
Private Consumption	**1.3**	**0.6**	**(0.8)**
Public Consumption	**3.5**	**2.4**	**(0.4)**
Investment	**0.1**	**(5.5)**	**(8.5)**
Exports	**1.8**	**2.4**	**3.0**
Imports	**0.9**	**(0.6)**	**(1.5)**
Inflation (CPI)	**4.4**	**3.6**	**3.3**
Fiscal Deficit (% of GDP)	**(4.1)**	**(2.7)**	**(2.8)**
Public Debt (% do GDP)	**55.6**	**58.1**	**59.5**
Unemployment (% of active population)	**4.1**	**5.1**	**6.5**
Current Balance (% oF GDP)	**(8.4)**	**(5.7)**	**(3.0)**

Source: INE, Ministry of Finance, BAnk of Portugal, ES Research for 2003.

Public consumption decreased by 0.4% in 2003, after an increase of 2.4% in 2002, as a result of the Portuguese Government's goal of maintaining the fiscal deficit below 3% of the GDP, in order to comply with the rules of the Stability and Growth Pact.

The decrease in economic activity had a negative impact on the labour market, with the unemployment rate increasing from 5.1% in 2002 to approximately 6.4% of the active population in 2003.

Inflation in 2003 reached 3.3%, compared to 3.6% in the previous year. The decrease in price levels resulted from wage moderation, an increase in the rate of unemployment and the favourable effects of the decrease in the price of imports.

CORPORATE GOVERNANCE

Due to the growing importance and complexity of the matters related to Corporate Governance Disclosures, PT presents annexed to this report, as integrant part of it, the Corporate Governance Report, which details these matters in compliance with CMVM's Regulation 7/2001.

Corporate Governance structure specifies the distribution of rights and obligations between Board, Management, Shareholders and Stakeholders. One of PT priorities is the clear and transparent definition and improvement of these rules, as they accomplish the increase and maintenance of investors confidence and the long term financial well-being.

The Group's organisational structure

PT Group is now structured by business areas which correspond to 5 large core areas: Wireline Business in Portugal , Mobile Business in Portugal , Multimedia Business, International Business, which includes Vivo (the Joint-Venture with Telefónica Móviles for the mobile business in Brazil) and finally, Instrumental Companies. The Business Units are coordinated by the Holding of the Group, led by its Executive Committee, with support of the corporate centre. The subsidiaries companies' reporting is functional, not based on hierarchy and, therefore, effective articulation becomes possible to assure.

Instrumental companies are processes oriented which are transversal to the PT Group: Group companies working to the Group.

Portugal Telecom, the holding of the PT Group, is responsible for the definition of policies and for the normalisation and harmonization of procedures, in order to ensure the implementation of the strategic guidelines defined by the management bodies.

Thus, every business area works in accordance with principles of management autonomy, guided by a common policy, under the coordination of a System of Corporate Planning and Control.

The Corporate Centre is directed for the coordination of several businesses. It reports to the Executive Committee of Portugal Telecom, and it is composed of the following Directorates:

- Human Resources
- Quality Analysis and Customer Satisfaction
- Internal Audit
- Communication
- Management Control
- Businesses Development
- Finance
- Know-How Management and Training
- Legal Services
- Planning
- Regulation and Competition
- Investor Relations
- Institutional Relations
- Report and Consolidation
- Security

The Corporate Centre responsibilities represent the functional need of PT Group and its participated companies.

Board Committees

In order to develop performance, the Board of Directors has created several committees, responsible for some specific tasks of the Board, namely the Strategy and Audit Committees.

The Strategy Committee's main functions are: (1) to debate, analyse and present recommendations about the Group's Strategic Plan; (2) to deem the impact and efficiency of the Strategic Plan and the strategic decisions and propose eventual adjustments; (3) to study and prepare issues for further discussion, suggested by the Chairman and/or the CEO, related with strategic topics that may arise during the year.

The Audit Committee was established in line with legal requirements of the markets in the United States of America where PT is listed. The Committee main functions consist in advising the Board of Directors and the Executive Committee in (1) supervising financial reporting quality and integrity,

(2) analysing external auditors independence and capability, (3) assessing internal control system quality, integrity and efficiency, and (4) supervising external auditors and the Internal Audit Department performance.

Furthermore, the Audit Committee must ensure the company's compliance with legal provisions, regulations, recommendations and guidelines issued by the relevant authorities, and ensure at the same time definition and implementation of policies aiming to ensure compliance with national and international laws and regulations to which the Company is bound.

The Audit Committee's creation represented an important step to strengthen the values, attitudes and behaviour patterns founded on compliance of demanding ethical criteria, and created a solid base of seriousness and trust in the relation with the outside world. The criteria are provided and have been disclosed in PT Group Ethics Code.

Internal Control System

According with the need of compliance with the CMVM and SEC rules, PT Group is performing a Corporate Internal Control project, with the main purposes of: (1) ensure the compliance with the established objectives, policies and procedures; (2) ensure the financial information reliability;
(3) ensure the effectiveness and efficiency of operations; and (4) minimize fraud.

This project, based on best practices and new requirements of the *Sarbanes-Oxley Act,* is being performed in major subsidiaries, being our goal its extension to all subsidiaries.

The program predicts not only the implementation of internal control procedures, but also its review, assessment and continuous improvement. Quarterly, Disclosure Controls and Procedures are evaluated concerning its design and effectiveness.

In 2003, PT has implemented a cascade model of management certifications, which purpose is to make responsible the main intervenients of the financial reporting process. It is based on Annual Certifications, Monthly Management Questionnaires and Quarterly Responsibility Declarations, prepared in accordance with corporate templates.

The above mentioned certifications' goal is to make sure that the main intervenients in the information disclosure process, including subsidiaries' CEOs and CFOs, are responsible for the financial and non financial information that was reported to the corporate centre, assuring that it was complete and correct.

Risk Management

Risk management is ensured by Portugal Telecom and its subsidiaries. Based on the identification and prior establishment of critical risks in terms of priorities, the companies develop risk management strategies which aim to implement controls deemed to be adequate and that ensure reduction of risk to an acceptable level.

The adopted risk management strategies aim to ensure that:

- Control systems and procedures and the established policies allow answering expectations of management bodies, shareholders and public in general;
- Control systems and procedures and the established policies comply with all applicable laws and regulations;
- Financial and operational data is complete, reliable, safe and periodically reported in due time;
- PT Group's resources are used efficiently and rationally;
- Shareholder's value is maximised; and
- Operational management took the necessary measures to correct issues reported earlier.

Dividend Policy

Portugal Telecom's dividends distribution policy takes into consideration business opportunities, investors' expectations and equity funding requirements , concerning the opportunity cost of capital .

The dividends distribution proposal is an exclusive responsibility of PT's Board of Directors and it has to comply with Portuguese law and the company's articles of association. In accordance with the company's articles of association, at least 40% of PT's[1] distributable results shall be distributed to the shareholders as dividends, without prejudice of the General Meeting being able to decide - by qualified majority of two thirds of casted votes for a reduction of the dividends or even for its non distribution. It is required the majority of the votes corresponding to Class A shares to deliberate the distribution of dividends that exceed 40% of distributable net results.

[1] Calculated in accordance with accountancy principles generally accepted in Portugal , after deducting losses carried over, and an allocation of 5% for legal reserves until these reach 20% of the share capital

Investor Relations

The Investor Relations Office was created in March 1995, with the goal of ensuring adequate relations with shareholders, investors and analysts, as well as with financial markets in general, and in particular, with the Stock Exchanges where PT is listed and their respective supervising authorities: CMVM and SEC. PT's representative for market relations is the Director of the Investor Relations Office, Dr. Nuno Prego.

Exercising of voting and representation rights by shareholders

Qualified shareholders may exercise their voting rights in the General Meeting, directly or by correspondence, regarding that to every 500 euros of capital, i.e., to each 500 shares, corresponds one vote and that there are no restrictions whatsoever to the vote by correspondence.

Company Rules

The Code of Ethics, approved by the Board of Directors on 18 December, 2001, and communicated to all companies of the Group in 2002, is valid for all companies of the Group.

In accordance with article 13 of the company's articles of association, votes issued by a shareholder holding common shares by him/herself, or by a representative or when acting as a representative on behalf of another shareholder should these exceed ten percent of the total share capital, shall not be counted.

On the other hand, besides common shares, PT's share capital is also represented by 500 Class A shares, which are owned by the State and confer special rights, resulting from the established in article 14, no. 2, and article 19, no. 2, of the company's articles of association.

Board of Directors

PT's Board of Directors is comprised of 23 directors, elected individually by a joint proposal moved by private shareholders and by the State in the General Meeting held on 4 April 2003, with no indication of any kind of representation. The majority of Directors are considered independent, according to CMVM's independence criteria.

The Portugal Telecom Corporate Governance model lay on a clear split of powers between the Board of Directors and the Executive Committee. This split of power is based on three elements: effectiveness, simplicity and clearance, making the Executive Committee more operational. In this model, the supervision and control functions are separated from operational management functions, being the Board of Directors responsible for monitoring strategic and regulatory issues as well as monitoring management performance.

nder the terms of the articles of association and in harmony with commercial law, the company's daily management belongs to an Executive Committee, comprised of 5 or 7 Directors. Members have equal voting rights and all resolutions of the Executive Committee require a majority of votes. The Chairman is entitled to a casting vote, should parity occur. The Executive Committee meets once a week and is comprised of the following Directors :

Calculated in accordance with accountancy principles generally accepted in Portugal , after deducting losses carried over, and an allocation of 5% for legal reserves until these reach 20% of the share capital.

CAPITAL MARKET

Shares

2003 represented a turning point in the financial markets, after the downturn in the markets that began in 2000. In the first quarter of 2003, financial markets were negatively impacted by the lack of uncertainty over the possibility of an upturn in the US and Eurozone economy and by the war in Iraq . A slight recovery took place in the second quarter, after the end of the war in Iraq . A contributing factor to this slight recovery was the fall in the US and Eurozone of interest rates to their lowest level in the last few decades. It was, however, not until the second half of 2003 that performance began to improve more significantly, as a result of an upturn in the US economy and gradual recovery in Japan .

Notwithstanding the negative impact in the first quarter of the factors mentioned above, the European telecommunications sector index performed well, with a 18.9% increase in 2003. On Euronext, PSI Geral, PSI 20 and Euronext 100 indices grew by 17.4%, 15.8% and 12.7% , respectively, and PT shares increased 21.8% to close at Euro 7.98 at the end of 2003. The Lisbon , Paris , Brussels and Amsterdam exchanges adopted a single trading platform on November 7, 2003.

As for other European telecommunications companies, France Telecom (+56.8%), Telefónica (+43.2%), TDC (+23.8%), Vodafone (+22.3%) and Deutsche Telecom (+18.4%) all saw their share prices increase and British Telecom (-3.5%) and KPN (-1.3%) saw their share prices fall.

Approximately 1,250 million PT shares were traded in 2003, equivalent to a daily average of 4.8 million, with the trading volume comprising more than 43% of global trading on Euronext Lisbon. PT continues to be the domestic market leader in liquidity terms and the national company with the largest trading volume on Portuguese stock market indices. PT's trading volume represented 21.7% of the PSI Geral and 20.7% of the PSI 20 at the end of 2003. PT ranked 35 th on the Euronext 100 Index and first out of the top seven Portuguese companies.

On the major financial markets, Nasdaq increased by 50.4%, and positive performance levels were also achieved in the other markets.

PT's ADRs increased 46.7% on the New York Stock Exchange in 2003, closing at US$ 10.02. An average of approximately 94 thousand ADRs were traded daily in 2003, with 58 million ADRs outstanding at the end of the year.

Bonds

After a relatively long period of ratings deterioration in the European telecom sector, 2003 saw a general stabilization in terms of the credit quality (only a few adjustments on some corporates' rating). This performance was achieved through the consolidation of financial structures, namely using generated cash flow to reduce debt. This, together with the reduction in debt issuances by telecom companies and the beginning of economic recovery, contributed to a general tightening in telecom credit spreads in 2003.

Although PT's credit rating was downgraded by Standard & Poor's to A- in 2003, it still retains one of the strongest ratings in the sector, due to its strong ability to generate cash flows, its highly liquid balance sheet and its debt profile. Standard & Poor's justified the downgrade as having resulted from concerns about PT's current level of pension and health care liabilities. PT's credit spreads remained almost unchanged immediately after the rating change.

Later in the year, after the announcement of the share buyback programme for up to 10% of PT's share capital, Moody's and Standard & Poor's reiterated PT's rating, recognizing PT's credit quality. The stabilization of the political and economical situation in Brazil has also helped to reduce PT's risk profile. As a result of these factors, PT's credit spreads tightened during 2003.

The interest rate declines until the beginning of June and the improvement of PT's spreads during this period contributed to a slight increase in the market price of its Eurobonds. Since June, interest rates in Europe have started to rise, principally at the longer end of the curve, due to a general improvement in the world economy. Nevertheless, as credit spreads continued to tighten in 2003, the market price of PT's bonds has stabilized.

During the first half of 2003, PT's Exchangeable Bond prices continued the recovery observed in the last months of 2002, due to the decline in market interest rates and PT's spreads for relevant maturities (2004 and 2006). During the second half of 2003, bond prices increased slightly, as PT's spreads tightening and share price increase more than compensated for the increase in market interest rates.

During the first half of 2003, PT cancelled Euro 58.6 million of its Exchangeable Bonds maturing in 2004 that were purchased for Euro 56.5 million during 2002 in the secondary market. After this cancellation, PT bought back, at below par value, another Euro 50.2 million of Exchangeable Bonds maturing in 2006. At the end of 2003, PT cancelled all of the 2006 Exchangeable Bonds that it had acquired, totaling Euro 109.7 million.

Investor Relations Activities

Of fundamental importance to PT is clear and effective communication with the financial community relating to the PT Group's affairs and its strategy of value creation.

The Company's Executive Committee and the CEOs of its principal subsidiaries met with investors and analysts from the most important domestic and international research houses on Investor Day on June 24, 2003. The programme provided information on the various Group businesses and their strategies.

In recognition of PT Group's standing in the national and international financial communities, on October 30, 2003 the PT Group was awarded the following four 2003 Investor Relations Awards, promoted by Semanário Económico and Deloitte:

- Best CEO in the Investor Relations area
- Best Global Investor Relations Programme - PSI20
- Best Usage of Technology in terms of Investor Relations
- Honourable Mention - Annual Report (non-financial sector).

In June 2003, PT was also singled out by the Institutional Investor Research Group as having the second best Investor Relations (IR) Department in Europe and the best in Portugal , and the director of PT's IR department was ranked fourth in the Thompson Financial sector ranking of individual IR professionals.

Four roadshows were held in Europe and the US during the year, the most significant of was held after the announcement of the company's first half 2003 results. This roadshow took place between September 16 and October 3, and involved contacts with 11 banks in 13 countries and 17 cities. Approximately 200 contacts with investors and 5 sales force presentations were made. Approximately 280 one-on-one sessions were held at roadshows in 2003.

PT participated in fourteen major domestic and international conferences, involving around 120 one-on-ones, in 2003. In addition to its day-to-day contacts during 2003, PT also had more than 150 one-on-ones and conference-calls with analysts and investors.

The international financial community continues to consider PT to be one of the leaders in the sector in terms of the degree and quality of its information disclosures.

Main Shareholders

As of December 31, 2003 qualified holdings in PT's share capital were as follows:

Qualified Holdings

Institution	No. of Shares	% of Capital
Banco Espirito Santo Group	122,274,074	9.7%
Brandes Investment Partners	67,279,052	5.4%
Capital Group Companies	63,193,870	5.0%
T		