

PORTUGAL TELECOM SGPS SA
Form 6-K
March 17, 2010

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 March 2010

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 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

Annual Report

2009

Portugal Telecom, SGPS, S.A.

Public Company - Avenida Fontes Pereira de Melo, 40 •1069-300 Lisboa - Share capital: Euro 26,895,375

Registered in the Conservatory of the Commercial Registry of Lisbon and Collective Person under no. 503 215 058

Annual Report

2009

MANAGEMENT REPORT

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Management Report

Introduction

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The 2009 consolidated annual report of Portugal Telecom, SGPS, S.A. (Company or Portugal Telecom) provides a detailed explanation of its consolidated activity and the evolution of its businesses during 2009 and, as such, we propose to the shareholders the analysis of that report in conjunction with this report.

The standalone financial statements of Portugal Telecom SGPS, S.A were prepared in accordance with the accounting policies generally accepted in Portugal (PGAAP), while the consolidated financial statements were prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS), which are applicable to the listed companies in the European Union. The reconciliation of the shareholders' equity as at 31 December 2009 and net income for the year then ended, attributable to the Company's shareholders, between the standalone (under PGAAP) and the consolidated financial statements (under IFRS), is as follows (amounts in Euro million):

	Net income	Shareholders' equity
Under PGAAP	530	2,008
Financial instruments (IAS 39)	(7)	(141)
Post retirement benefits (IAS 19)	60	(804)
Goodwill and licences amortization (IAS 36 e 38)	77	323
Sale and lease back transactions (IAS 17)	6	(34)
Asset retirement obligation (IAS 16)	3	(21)
Start-up and research and development expenses (IAS 38)	(7)	(14)
Foreign currency translation adjustments related to the application of the equity method (IAS 21)	22	
Under IFRS	684	1,318

Business overview

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In 2009, apart from management of investments, Portugal Telecom did not conduct any other activity. In 2008, on a standalone basis, operating revenues resulted from management services rendered to Vivo Participações, S.A. until August 2008, when the contract entered into with this company ended and was not renewed.

Legal Information

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- There are no amounts due to the Portuguese State and the Social Security.

- The Company and its board and supervisory members did not enter into any material businesses or transactions, except for those mentioned in Note 44 of the 2009 Consolidated Annual Report.

Proposal for application of profits

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Considering that the net income for the year ended 31 December 2009 was Euro 529,778,473, and that as of that date the legal reserve represents at least 20% of the share capital, and therefore complies with the number 1 of the article 295.^o of the Portuguese Securities Code, the Board of Directors proposes:

- The total amount of Euro 515,494,687.5 shall be paid to the shareholders, corresponding to 57,5 Euro cents per share, with respect to the total number of issued shares, and the remaining amount of Euro 14,283,785.5 shall be transferred to retained earnings;

- As it is not possible to determine precisely the number of own shares that will be held in treasury on the date of the above mentioned payment without limiting the Company's capacity of intervention, the distribution of the overall amount of Euro 515,494,687.5, as provided for in the paragraph above, calculated on the basis of a unit amount per share issued (in this case, 57.5 Euro cents per share), shall be executed as follows:
 - a) Each share issued be paid the unit amount of 57.5 Euro cents;

 - b) The amount corresponding to the shares that belong to the Company itself on the day of the payment of the above mentioned amount (calculated on said unit amount of 57.5 Euro cents per share issued), which is not paid, shall be transferred to retained earnings.

- Considering that the shares resulting from the conversion of exchangeable bonds issued have the right to the payment mentioned above:
 - a) Each share resulting from the conversion of convertible bonds and entitled to a dividend be paid the said unit amount of 57.5 Euro cents;

 - b) The payment to each share resulting from the conversion of convertible bonds be carried out by using the retained earnings that are available after the payment mentioned above.

2009 events and recent developments

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The 2009 events and recent developments are described in the 2009 Consolidated Annual Report of Portugal Telecom.

Lisbon, 3 March 2010

Henrique Granadeiro, Chairman of the Board of Directors

Zeinal Bava, Chief Executive Officer

Luís Pacheco de Melo, Executive Director, Chief Financial Officer

Carlos Alves Duarte, Executive Director

Rui Pedro Soares, Executive Director

Manuel Rosa da Silva, Executive Director

Fernando Soares Carneiro, Executive Director

Shakhaf Wine, Executive Director

José María Álvarez-Pallete Lopéz, Non-Executive Director

Francisco Manuel Marques Bandeira, Non-Executive Director

José Guilherme Xavier de Basto, Non-Executive Director

Santiago Fernández Valbuena, Non-Executive Director

João Manuel de Mello Franco, Non-Executive Director

Joaquim Anibal Brito Freixial de Goes, Non-Executive Director

Mário João de Matos Gomes, Non-Executive Director

Gerald Shephen McGowan, Non-Executive Director

Rafael Luís Mora Funes, Non-Executive Director

Maria Helena Nazaré, Non-Executive Director

Amílcar Carlos Ferreira de Morais Pires, Non-Executive Director

António Manuel Palma Ramalho, Non-Executive Director

Francisco Texeira Pereira Soares, Non-Executive Director

Jorge Humberto Correia Tomé, Non-Executive Director

Paulo José Lopes Varela, Non-Executive Director

Milton Almicar Silva Vargas, Non-Executive Director

Nuno Rocha dos Santos de Almeida e Vasconcellos, Non-Executive Director

PORTUGAL TELECOM, SGPS, S.A.

BALANCE SHEETS

AS AT 31 DECEMBER 2009 AND 2008

(Amounts stated in Euro)

Assets	Notes	Gross assets	2009 Amortization and adjustments	Net assets	2008 Net assets
FIXED ASSETS:					
Intangible fixed assets:					
Research and development expenses	8,10	7,305,329	(7,305,329)		
Industrial property and other rights	8,10	626,704	(626,704)		18,747
Goodwill	9.10	149,484,379	(61,434,340)	88,050,039	90,474,041
		157,416,412	(69,366,373)	88,050,039	90,492,788
Tangible fixed assets:					
Buildings and other constructions	10	111,715	(111,715)		34,135
Transport equipment	10	1,427,126	(909,267)	517,859	558,284
Tools and dies	10	574	(574)		
Administrative equipment	10	903,600	(875,843)	27,757	47,349
Other fixed tangible assets	10	1,045,754	(70,000)	975,754	996,633
		3,488,769	(1,967,399)	1,521,370	1,636,401
Financial investments:					
Investments in Group companies	10.16	2,427,704,089		2,427,704,089	1,739,221,801
Loans granted to Group companies	10.16	9,078,580,268		9,078,580,268	9,368,252,297
Investments in associated companies	10.16	78,344,033	(1,995,192)	76,348,841	52,754,701
Loans granted to associated companies	10.16	38,423,199	(2,588,741)	35,834,458	35,318,668
Investments in other companies	10.16	1,593,306		1,593,306	1,356,188
Advances for investments	10	32,000		32,000	2,117,000
		11,624,676,895	(4,583,933)	11,620,092,962	11,199,020,655
CURRENT:					
Accounts receivable:					
Group companies	16	824,588,884		824,588,884	277,323,663
Advances to suppliers		83,974		83,974	88,563
State and other public entities	49	44,345,636		44,345,636	129,915,108
Other debtors		14,409,780	(37,249)	14,372,531	21,114,574
		883,428,275	(37,249)	883,391,026	428,441,908
Bank deposits and cash:					
Bank deposits	53	34,589,078		34,589,078	324,727,073
Cash	53	2,000		2,000	2,000
		34,591,078		34,591,078	324,729,073
Accruals and deferrals:					
Accrued income	50	32,670,455		32,670,455	34,638,331
Prepaid expenses	50	2,141,450		2,141,450	2,660,190
Deferred taxes	6	3,715,393		3,715,393	17,833,899
		38,527,298		38,527,298	55,132,420

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Total amortization		(71,333,772)		
Total adjustments		(4,621,182)		
Total assets	12,742,128,727	(75,954,954)	12,666,173,773	12,099,453,245

The accompanying notes form an integral part of the balance sheet as at 31 December 2009.

Accountant

The Board of Directors

PORTUGAL TELECOM, SGPS, S.A.

BALANCE SHEETS

AS AT 31 DECEMBER 2009 AND 2008

(Amounts stated in Euro)

Shareholders Equity and Liabilities	Notes	2009	2008
SHAREHOLDERS EQUITY			
Share capital	36,40	26,895,375	26,895,375
Adjustments to shareholders equity of subsidiaries and associates	40	1,122,778,402	393,744,049
Reserves:			
Legal reserve	40	6,773,139	6,773,139
Other reserves	40	118,024,008	137,381,149
Retained earnings	40	203,306,065	148,823,527
Net income for the year	40	529,778,473	488,717,970
Total shareholders equity		2,007,555,462	1,202,335,209
LIABILITIES:			
Provisions			
Provisions for taxes	34	20,024,631	21,035,793
Other provisions	34	76,262,184	155,733,797
		96,286,815	176,769,590
Accounts payable - non current:			
Bonds	48	750,000,000	750,000,000
Bank loans	48	367,592,977	477,644,528
Other loans	48	2,121,200,000	1,490,700,000
Fixed asset suppliers	15	197,532	251,987
		3,238,990,509	2,718,596,515
Accounts payable - current:			
Bank loans	48	110,051,551	110,051,551
Other loans	48	355,500,000	686,326,163
Accounts payable trade		2,050,089	4,939,385
Accounts payable trade - invoices in conference		226,773	226,774
Group companies	16	45,002,357	718,130,468
Other shareholders		689,764	665,485
Fixed asset suppliers		248,424	303,548
State and other public entities	49	799,197	114,774,600
Other creditors		47,257	132,548
		514,615,412	1,635,550,522
Accruals and deferrals:			
Accrued expenses	50	41,200,222	68,487,317
Deferred income	50	6,767,525,353	6,297,714,092
		6,808,725,575	6,366,201,409
Total liabilities		10,658,618,311	10,897,118,036
Total shareholders equity and liabilities		12,666,173,773	12,099,453,245

The accompanying notes form an integral part of the balance sheet as at 31 December 2009.

Accountant

The Board of Directors

PORTUGAL TELECOM, SGPS, S.A.

INCOME STATEMENTS (BY NATURE)

FOR THE YEARS ENDED 31 DECEMBER 2009 AND 2008

(Amounts stated in Euros)

	Notes	2009		2008	
COSTS AND LOSSES					
Supplies and external services			5,691,004		6,761,638
Wages and salaries:					
Remuneration		13,401,141		11,483,308	
Social Security charges		1,016,753	14,417,894	444,330	11,927,638
Depreciation and amortization	10	345,225		1,823,606	
Provisions	34	3,627,575	3,972,800	5,260,937	7,084,543
Taxes		1,320,819		1,210,634	
Other operating costs		230,070	1,550,889	154,504	1,365,138
(A)			25,632,587		27,138,957
Goodwill amortization	45,10	9,959,142		10,151,618	
Losses in Group and associated companies	45	4,059,757		32,927,094	
Interest and other financial costs:					
Related to Group companies	45	74,312		5,757,009	
Other	45	184,538,476	198,631,687	134,460,331	183,296,052
(C)			224,264,274		210,435,009
Extraordinary costs	46		27,910,607		9,547,422
(E)			252,174,881		219,982,431
Income tax	6		(20,815,121)		(14,318,693)
(G)			231,359,760		205,663,738
Net income			529,778,473		488,717,970
			761,138,233		694,381,708
INCOME AND REVENUES					
Services rendered					16,641,249
Supplementary income					97,442
(B)					16,738,691
Return from short-term investments	45	16,015		35,862	
Gains in Group and associated companies	45	591,515,995		524,341,777	
Other interest and financial income:					
Related to Group companies	45	63,234,349		53,151,661	
Other	45	20,541,017	675,307,376	29,783,160	607,312,460
(D)			675,307,376		624,051,151
Extraordinary income	46		85,830,857		70,330,557

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(F)		761,138,233	694,381,708
Operating income:	(B)-(A)	(25,632,587)	(10,400,266)
Net financial income:	(D-B)-(C-A)	476,675,689	424,016,408
Current income:	(D)-(C)	451,043,102	413,616,142
Income before tax:	(F)-(E)	508,963,352	474,399,277
Net income	(F)-(G)	529,778,473	488,717,970

The accompanying notes form an integral part of the income statement (by nature) for the year ended 31 December 2009.

Accountant

The Board of Directors

PORTUGAL TELECOM SGPS, S.A.

INCOME STATEMENTS (BY FUNCTIONS)

FOR THE YEARS ENDED 31 DECEMBER 2009 AND 2008

(Amounts stated in Euro)

	Note 52	2009	2008
Services rendered	a)		16,641,249
Costs of services rendered	b)		(14,770,742)
Gross profit			1,870,507
Other operating income and revenues			98,666
Administrative costs		(340,452)	(419,896)
Other operating costs	c)	(32,243,821)	(10,179,695)
Operating profit		(32,584,273)	(8,630,418)
Net financing costs	d)	(100,837,422)	(57,282,519)
Net gains (losses) in subsidiaries and associated companies	e)	616,387,190	531,464,808
Net gains (losses) on other investments		16,015	35,862
Current profit		482,981,510	465,587,733
Income tax	f)	46,796,963	23,130,237
Net income		529,778,473	488,717,970
Earnings per share		0.59	0.55

The accompanying notes from an integral part of the income statement (by functions) for the year ended 31 December 2009.

Accountant

The Board of Directors

PORTUGAL TELECOM, SGPS, S.A.

CASH FLOW STATEMENTS

FOR THE YEARS ENDING 31 DECEMBER 2009 AND 2008

(Amounts stated in Euros)

	Notas	2009	2008
OPERATING ACTIVITIES:			
Collections from clients	53.a)	10,767,183	30,437,731
Payments to suppliers		(18,225,675)	(9,856,235)
Payments to employees		(13,758,489)	(11,798,477)
Cash flows from operations		(21,216,981)	8,783,019
Receipts (payments) relating to income taxes	53.b)	20,500,376	(63,250,312)
Other receipts (payments) relating to operating activities		5,585,779	(9,729,954)
Cash flows generated before extraordinary activities		4,869,174	(64,197,247)
Receipts (payments) relating to extraordinary activities		(55,817)	(65,345)
Cash flows from operating activities (1)		4,813,357	(64,262,592)
INVESTING ACTIVITIES:			
Cash receipts resulting from:			
Short-term financial applications			1,320,287,460
Financial investments	53.c)	346,187,140	1,151,896,135
Tangible fixed assets		5,731	417,861
Loans granted	53.d)	63,536,444	372,271,602
Interest and related income		89,466,730	43,242,313
Dividends	53.e)	343,090,976	542,970,970
		842,287,021	3,431,086,341
Payments resulting from:			
Short-term financial applications			(433,197,509)
Financial investments	53.f)	(29,897,696)	(615,877,664)
Tangible fixed assets		(56,372)	(78,825)
Loans granted			(1,407,161,946)
		(29,954,068)	(2,456,315,944)
Cash flow from investing activities (2)		812,332,953	974,770,397
FINANCING ACTIVITIES:			
Cash receipts resulting from:			
Loans obtained	53.g)	27,108,205,257	43,407,158,455
Other financing activities	40	10,087,800	7,472,641
		27,118,293,057	43,414,631,096
Payments resulting from:			
Loans obtained	53.h)	(27,501,816,959)	(42,311,194,716)
Lease rentals		(298,751)	(658,130)
Interest and related expenses		(169,108,713)	(150,634,077)
Dividends	40	(515,494,688)	(541,967,947)
Acquisition of treasury shares			(1,049,745,618)

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Other financing activities	53.i)	(37,616,042)	
		(28,224,335,153)	(44,054,200,488)
Cash flow from financing activities (3)		(1,106,042,096)	(639,569,392)
Change in cash and cash equivalents (4)=(1)+(2)+(3)		(288,895,786)	270,938,413
Effect of exchange differences		(1,242,209)	198,373
Cash and cash equivalents at the beginning of the period	53.j)	324,729,073	53,592,287
Cash and cash equivalents at the end of the period	53.j)	34,591,078	324,729,073

The accompanying notes form an integral part of the cash flow statement for the year ended 31 December 2009.

Accountant

The Board of Directors

PORTUGAL TELECOM, SGPS, S.A.

NOTES TO THE FINANCIAL STATEMENTS

As at 31 de December 2009

(Amounts in Euro)

Introduction

Portugal Telecom, SGPS, S.A. (Portugal Telecom or Company) and its subsidiaries and associated companies (Note 16), which represent its corporate Group (Portugal Telecom Group or Group), operate primarily in the telecommunications sector, in Portugal and in foreign countries.

These financial statements, which are related to the Company on a standalone basis, were prepared in accordance with accounting principles generally accepted in Portugal, and, as such, the financial investments were accounted for under the equity method, as explained in Note 3.c). The Company prepared and presented separately its consolidated financial statements, which include the financial statements of the companies controlled by Portugal Telecom. In these standalone financial statements, the shareholders' equity as at 31 December 2009 and the net income for the year then ended include the effect of the consolidation of the shareholders' equity and net income of the Company's subsidiaries, based on their respective financial statements, but do not include the effect of the fully proportionally consolidation of their assets, liabilities, costs and revenues.

The consolidated financial statements of Portugal Telecom have been prepared, since 1 January 2005, in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union. Therefore, the shareholders' equity as at 31 December 2009 and 2008 and the net income for the years then ended, which are included in the consolidated financial statements of Portugal Telecom, differ from the amounts presented in these standalone financial statements.

a) Shareholders

As a result of the privatization process between 1 June 1995 and 4 December 2000, Portugal Telecom's share capital is held mainly by private shareholders. As at 31 December 2009, the Portuguese State and its controlled entities owned, 9.72% of the capital of Portugal Telecom, including the 500 Class A shares (Note 36), which grant it special rights.

b) Listed shares

The shares of Portugal Telecom are listed on the Euronext and on the *NYSE - New York Stock Exchange*.

3. Basis of presentation and main accounting policies

The standalone financial statements of Portugal Telecom were prepared in accordance with the accounting principles established under the Official Accounting Plan (POC) and other Portuguese legislation, and, when appropriate, in accordance with the International Financial Reporting Standards; these financial statements were prepared in accordance with the principle of historic cost and with the accounting principles of prudence, going concern assumption, accrual basis, consistency, materiality and substance over form.

The notes of this report use the order and index defined by the POC for presentation of standalone financial statements. Certain notes were not included in this report because they are not applicable to the Company or because its presentation is not considered relevant for the analysis of the standalone financial statements.

The main valuation criteria used in the preparation of these standalone financial statements were as follows:

a) Intangible fixed assets

Intangible fixed assets include primarily goodwill arising from the acquisition of equity investments in Group and associated companies, which is amortized in accordance with the criteria mentioned in Note 9.

b) Tangible fixed assets

Tangible fixed assets are stated at acquisition cost and are amortized on a straight line basis from the month they are incorporated or available for use.

The depreciation rates correspond to the following estimated average economic useful lives (in years):

Buildings and other constructions	3 -5
Transport equipment	4
Administrative equipment	3 - 8
Other tangible fixed assets	3 - 8

c) Financial investments

Financial investments in Group and associated companies are recorded under the equity method of accounting, being initially recorded at acquisition cost. The difference between the acquisition cost and the value corresponding to the Company's proportion in the equity of those companies at the acquisition date, if positive, is recorded as goodwill and amortized over the recoverable period of the investment, and, if negative, is recorded under shareholders' equity under the caption "Adjustments to shareholders' equity of subsidiaries and associates".

In accordance with the equity method of accounting, financial investments are adjusted for the Company's share in net income and other changes in shareholders' equity, which are recorded under financial income or costs, and as adjustments to capital of subsidiaries and associates, respectively. Dividends distributed by subsidiaries and associated companies are deducted from financial investments when they are attributed. Additionally, the accumulated losses that exceed the total investment amount are recorded under the caption "Provisions for losses in financial investments" (Note 34).

Gains resulting from the disposal of subsidiaries and associated companies within the Group are deferred or reversed until the date these investments are disposed of to a third party. Whenever these gains are deferred, its recognition in earnings is recorded under the caption "Extraordinary income", on the same proportion that goodwill recorded by the acquirer is amortized (Note 46.a).

Additional capital contributions and loans granted to Group and associated companies are recorded at nominal value, reduced by adjustments for estimated losses if applicable.

The financial investments in other companies (interests lower than 20%) are recorded at acquisition cost or, for loans granted, at nominal value, reduced by adjustments for estimated losses if applicable.

d) Finance leasing

Fixed assets acquired under finance lease contracts, which meet the conditions of Accounting Directive no. 25, as well as the corresponding liabilities, are recorded in the balance sheet and are amortized in accordance with the useful lives referred to in Note 3.b). The capital and interest components of the rents related to the finance lease contracts are recorded as a reduction to the liability and as financial costs, respectively (Note 15).

e) Accruals and deferrals

The Company records its revenue and expenses as they are generated or incurred, regardless of when they are received or paid.

f) Balance classification

Realizable assets and liabilities due over a period greater than one year from the balance sheet date are classified under non-current assets and non-current liabilities, respectively.

g) Vacation pay and vacation subsidy

Vacation pay and vacation subsidies are recorded as a cost for the period in which the employee acquires the right to receive them. Consequently, the amount of vacation pay and subsidies due and unpaid at the balance sheet date has been estimated and included under the caption Accruals and deferrals (Note 50).

h) Income tax

From the year 2000, Portugal Telecom adopted the special taxation regime for Groups of companies, which applies to all companies in which it holds, directly or indirectly, at least 90% of the share capital and that, simultaneously, are located in Portugal and are subject to corporate income tax. Any gain generated as a result of the adoption of this regime is recorded in earnings under the caption Gains in Group and associated companies (Note 45.d). The companies which are not under this regime are subject to corporate income tax on a standalone basis, based on the respective taxable profits and tax rates.

The income tax recorded in the financial statements was assessed in accordance with the terms of the Accounting Directive no. 28. In assessing the cost of income tax for the year, besides the current tax determined on the basis of profit before-tax adjusted for in accordance with tax legislation, it is also considered the effects resulting from temporary differences between the income before tax and the taxable earnings arising

in that year or in the preceding ones, as well as the effect of reportable tax losses at the balance sheet date. Deferred tax assets are only

recorded when there is a reasonable expectation of sufficient future tax profits which allow their use, or when there is deferred tax liabilities whose reversal is expected to occur in the same period in which those deferred tax assets will be reversed.

The current or deferred income tax related to transactions recorded directly in reserves or retained earnings, is also recorded directly in those same captions, without any impact in the net income for the period.

Deferred tax assets and liabilities are computed and evaluated annually, using the taxation rates which are expected to be in force at the date of reversal of these temporary differences, and other relevant changes in the tax legislation.

i) Foreign currency balances and transactions

All assets and liabilities expressed in foreign currency and for which no agreement on fixing the exchange rate exists, were converted into Euros using the exchange rates applicable at the balance sheet date (Note 4).

Favourable and unfavourable exchange rate differences arising from the differences between exchange rates in force at the date of the respective transactions and those applying on the date of collection, payment or balance sheet date have been recorded as income and costs in the income statements (Note 45).

For purposes of the application of the equity method of accounting, the exchange rate differences arising from the conversion into Euros of the financial statements of subsidiaries and associated companies presented in foreign currency is made through the following exchange rates:

- Exchange rate at the balance sheet date, for the conversion of assets and liabilities;
- Average exchange rate of the period, for the conversion of the income statements and cash flows; and
- Historical exchange rates, for the conversion of the captions of shareholders' equity.

The exchange rate differences arising from the conversion into Euros of the financial statements of subsidiaries and associated companies presented in foreign currency have been included in shareholders' equity under the caption Adjustments to shareholders' equity of subsidiaries and associates (Note 40).

j) Financial instruments and risk management

Financial instruments include primarily interest and exchange rate swaps and equity swaps over own shares.

The interest rate and exchange rate swaps are contracted to reduce the exposure to fluctuations in interest and exchange rates, following the policy of hedging financial liabilities. In addition, Portugal Telecom also enters into *forwards* and exchange rate options (Note 51).

The gains or losses resulting from derivative instruments which are hedging the risks mentioned above, are recorded in earnings in order to compensate the losses and gains related to the respective assets and liabilities. If the instruments are not hedging those risks, or are not related to any specific risk, they are recorded at fair value at the balance sheet date, with gains and losses related to the change in the fair value recorded in earnings.

Fees received or paid, as well as other expenses incurred in connection with these transactions, are recognized in earnings through the period of these transactions.

Equity swaps over own shares were contracted in connection with the share buyback program, with the purpose of allowing a more flexible execution of the program.

4. Rates Used for Conversion of Balances into Foreign Currency

Assets and liabilities as at 31 December 2009 and results for the year then ended denominated in foreign currencies were translated into Euros using the following exchange rates:

Designation	Closing exchange rate	Average exchange rate
US Dollar	1.4406	1.3948
British Pound	0.8881	0.8881
Brazilian Real	2.5113	2.7674

6. Taxes

(a) The Company is subject to corporate income tax (IRC), at a normal rate of 25%, added by a municipal tax up to a maximum of 1.5%, resulting in an aggregate tax rate of 26.5%.

In the year ended 31 December 2009, the taxable profit of the Company was estimated in accordance with the special taxation regime for groups of companies (tax consolidation), including the following companies: PT Comunicações, S.A. (PT Comunicações); TMN Telecomunicações Móveis Nacionais, S.A. (TMN); PT Prime Soluções Empresariais de Telecomunicações e Sistemas, S.A. (PT Prime); PT Contact Telemarketing e Serviços de Informação, S.A. (PT Contact); PT Imobiliária, S.A. (PT Imobiliária); PT Inovação, S.A. (PT Inovação); PT Móveis, SGPS, S.A. (PT Móveis); PT Pro - Serviços Administrativos e de Gestão Partilhados, S.A. (PT Pro); PT-Sistemas de Informação, S.A. (PT SI); PT Compras - Serviços de Consultoria e Negociação, S.A. (PT Compras); PT Participações SGPS, S.A. (PT Participações); PT Investimentos Internacionais Consultoria Internacional, S.A. (PT II); PT Prestações Mandatária de Aquisições e Gestão de Bens, S.A. (PT Prestações); PT Portugal, SGPS, S.A. (PT Portugal); PT Sales, S.A. (PT Sales); PT Centro Corporativo, S.A. (PT Centro Corporativo); and Infonet Portugal Serviços de Valor Acrescentado, Lda. (Infonet).

(b) In accordance with the prevailing legislation, taxation returns are subject to review and correction by the fiscal authorities during a period of four years (five years for Social Security, with a period of ten years formerly applying for payments and contributions for years prior to 2001), except where there have been tax losses, fiscal benefits have been granted, or there are inspections, claims or challenges under way; in such cases these periods may be extended or suspended, depending on the circumstances. Based on the information supplied by its tax advisory services, the Board of Directors considers that any corrections to the tax returns that might result from reviews carried out by the tax authorities will not have a significant effect on the financial statements as at 31 December 2009, considering the provisions record and the actual expectations to resolve the current situations (Note 34).

As at 31 December 2009, there are some tax contingencies against certain Portuguese subsidiaries of the Group which are primarily related to the deductibility of certain financial costs incurred between 2004 and 2007 (Euro 120 million) and the deductibility of a capital loss occurred in 2007 following the liquidation of a subsidiary (Euro 63 million). The Company already received tax assessments regarding these matters for all the years mentioned above

and granted bank guarantees to tax authorities totaling Euro 78 million (Note 18) related to the years 2004 and 2005. As at 31 December 2009, Portugal Telecom strongly disagrees with these assessments and considers, based on the opinion of its tax advisers, that there are solid arguments to oppose the position of the tax authorities.

(c) In relation to the Value Added Tax, the Company uses the effective allocation and the pro rate method in order to compute the deductible tax.

(d) The detail of balances and movements occurred in deferred tax assets during the year ended 31 December 2009 was as follow:

	Opening balance	Net income	Ending balance
Financial instruments (i)	14,590,299	(14,590,299)	
Other	3,243,600	471,793	3,715,393
	17,833,899	(14,118,506)	3,715,393

(i) As at 31 December 2008, these deferred tax assets were related primarily to: (1) exchange rate swaps existing as at that date amounting to Euro 43.3 million (Notes 50 and 51), which were settled in 2009; and (2) exchange and interest rate swaps entered into by Portugal Telecom (Note 51), which still existed as at 31 December 2009, but, following a decision from the Portuguese Tax Authority in 2009, there is no longer any difference between the accounting and tax basis regarding this matter.

The reconciliation between the nominal tax rate and the income tax recorded in the income statement is as follows:

Income before taxes	508,963,352
Nominal tax rate	26.5%
Estimated tax charge	134,875,288
Permanent differences (i)	(160,490,210)
Reversal of deferred taxes from previous years (ii)	2,923,184
Effect of the change in municipal tax (iii)	1,938,730
Collection adjustments	(62,113)
	(20,815,121)
Income tax has the following composition:	
Income tax-current (Note 49)	(34,933,627)
Deferred tax	14,118,506
	(20,815,121)

(i) The detail of permanent differences is as follows:

Effect of the equity method of accounting (Notes 45.b) and d))	(545,071,860)
Recognition of deferred capital gains (Note 46)	(67,059,241)
Gains on disposal of other investments (Note 46)	(13,647,630)
Gain related to the tax consolidation regime (Note 45.d)	(42,384,378)
Non deductibility of certain financial costs	36,476,578
Adjustments to the provision for income taxes of previous year (Note 46)	17,216,274
Goodwill amortization (Note 45)	9,959,142
Other	(1,112,318)
	(605,623,433)
Nominal tax rate	26.5%
	(160,490,210)

(ii) This caption corresponds to the reversal of a deferred tax recognized in previous years related to interest and exchange rate swaps entered into by Portugal Telecom, following a decision by the Portuguese Tax Authority in 2009 regarding to taxation of these operations. The difference as at 31 December 2008 was considered for tax purposes in 2009 as an adjustment to the provision for income taxes of previous periods.

(iii) In accordance with tax legislation in force, municipal tax is only applicable for collectable tax, and, as such, when tax losses occurs, the tax rate applicable is only 25%.

7. Average number of employees

In 2009 and 2008, the average number of employees working for the Company, which includes employees of other Group companies, is as follows:

	2009	2008
Effective personnel	23	20
Personel on term contract		1
	23	21
Personnel on loan from other entities	3	3
	26	24

The liabilities with post retirement benefits related to employees from other Group companies were recorded directly by those companies and the respective cost was then invoiced to Portugal Telecom and included under the caption Wages and salaries .

8. Research and development expenses and industrial property and other rights

As at 31 December 2009 and 2008, these captions are as follows:

	2009	2008
Research and development expenses:		
Studies and projects	7,305,329	7,305,329
Accumulated amortization	(7,305,329)	(7,305,329)
Industrial property and other rights:		
Software user licenses	433,050	433,050
Other	193,654	193,654
Accumulated amortization	(626,704)	(607,957)
		18,747

9. Goodwill

As at 31 December 2009, the detail of goodwill is as follows (Note 10.a):

Gross amount	Accumulated amortization	Net amount
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Páginas Amarelas	89,338,063	(32,385,048)	56,953,015
UOL	60,146,316	(29,049,292)	31,097,024
	149,484,379	(61,434,340)	88,050,039

Goodwill resulting from acquisitions of financial investments is depreciated on a straight line basis during the expected period of recovery of the investment, which is 20 and 10 years for Páginas Amarelas and UOL, respectively.

10. Fixed assets

a) Intangible and tangible fixed assets

During 2009, the movements in intangible and tangible fixed assets, as well as in the respective accumulated depreciation, were as follows:

	Gross assets			Foreign currency translation adjustments (Note 40)	Closing balance
	Opening balance	Increases	Disposals		
Intangible fixed assets:					
Research and development expenses	7,305,329				7,305,329
Industrial property and other rights	626,704				626,704
Goodwill (Note 9)	136,197,176		(377,006)	13,664,209	149,484,379
	144,129,209		(377,006)	13,664,209	157,416,412
Tangible fixed assets:					
Buildings and other constructions	111,715				111,715
Transport equipment	1,270,880	214,032	(57,786)		1,427,126
Tools and dies	574				574
Administrative equipment	892,942	10,658			903,600
Other tangible fixed assets	1,045,754				1,045,754
	3,321,865	224,690	(57,786)		3,488,769

	Accumulated depreciation			Foreign currency translation adjustments (Note 40)	Closing balance
	Opening balance	Increases	Disposals		
Intangible fixed assets:					
Research and development expenses	7,305,329				7,305,329
Industrial property and other rights	607,957	18,747			626,704
Goodwill (Notes 9 and 45)	45,723,135	9,959,142		5,752,063	61,434,340
	53,636,421	9,977,889		5,752,063	69,366,373
Tangible fixed assets:					
Buildings and other constructions	77,580	34,135			111,715
Transport equipment	712,596	241,214	(44,543)		909,267
Tools and dies	574				574
Administrative equipment	845,593	30,250			875,843

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Other tangible fixed assets	49,121	20,879		70,000
	1,685,464	326,478	(44,543)	1,967,399

b) Financial investments

During 2009, the movements in financial investments were as follows:

	Opening balance	Increases (i)	Disposals (ii)	Adjustments and transfers (iii)	Reductions (iv)	Equity method (v)	Dividends (vi)	Closing balance
Financial investments:								
Investments in Group companies (Note 16)	1,739,221,801	23,912,696	(277,509,177)	734,483	(11,000,000)	1,295,586,240	(343,241,954)	2,427,704,089
Loans granted to Group companies (Note 16)	9,368,252,297	2,700,000	(268,408,872)	(9,463,157)	(14,500,000)			9,078,580,268
Investments in associated companies (Note 16)	54,749,893		(715,689)			24,379,954	(70,125)	78,344,033
Loans granted to associated companies (Note 16)	38,516,979			(93,780)		&		