

PORTUGAL TELECOM SGPS SA

Form 6-K

June 02, 2014

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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 2014

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

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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

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Portugal Telecom

Consolidated Report

First Quarter 2014

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Consolidated report

First quarter 2014

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The terms PT , Portugal Telecom Group , PT Group , Group and Company refer to Portugal Telecom and its subsidiaries or any of them as the context.

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Telecommunications in Portugal

Customer segment (Euro million)	Revenues
Residential	179
Personal	151
Enterprise	190
Other	93
<i>Total</i>	<i>613</i>

Telecommunications in Brazil (Oi) (a)

Customer segment	Revenues (R\$million, 100%)
Residential	2,552
Personal	2,166
Enterprise	2,091
Other	66
<i>Total</i>	<i>6,877</i>

(a) This stake is accounted through the equity method.

Other telecommunications businesses

			Revenues (Euro million)
Unitel 25% (a)	> Angola	> Mobile	(b)
MTC 34% (a)	> Namibia	> Mobile	38
CVT 40% (a)	> Cape Verde	> Wireline, mobile	16
Timor Telecom 44%	> East Timor	> Wireline, mobile	9
CST 51% (a)	> São Tomé e Príncipe	> Wireline, mobile	3

(a) These stakes are held by Africatel, which is controlled 75% by PT. (b) This stake is accounted through the equity method.

Other businesses

Systems and IT [PT Sistemas de Informação 100%]; Innovation, research and development [PT Inovação 100%];

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Backoffice and shared services [PT PRO 100%]; Procurement [PT Compras 100%]; Call centres and telemarketing services [Contax in Brazil 44.4% and PT Contact 100%];

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Financial review

Consolidated income statement**Consolidated income statement (1)****Euro million**

	1Q14	1Q13	y.o.y
Operating revenues	690.0	717.6	(3.9)%
Portugal (2)	612.6	634.4	(3.4)%
Residential	178.8	179.2	(0.2)%
Personal	150.9	158.6	(4.9)%
Enterprise	190.0	203.2	(6.5)%
Wholesale, other and eliminations	92.9	93.4	(0.5)%
Other and eliminations	77.4	83.2	(7.0)%
Operating costs (3)	410.7	427.7	(4.0)%
Wages and salaries	100.2	108.8	(7.9)%
Direct costs	114.8	114.4	0.3%
Commercial costs	55.3	63.9	(13.4)%
Other operating costs	140.3	140.6	(0.2)%
EBITDA (4)	279.3	289.9	(3.7)%
Post retirement benefits	10.4	10.7	(2.5)%
Depreciation and amortisation	173.5	181.9	(4.6)%
Income from operations (5)	95.4	97.3	(2.0)%
Other expenses (income)	6.3	(24.5)	n.m.
Curtailement costs, net	0.3	0.6	(59.0)%
Net losses (gains) on disposal of fixed assets	(0.2)	(0.9)	(82.6)%
Net other costs (gains)	6.2	(24.3)	n.m.
Income before financ. & inc. taxes	89.0	121.9	(26.9)%
Financial expenses (income)	78.2	47.9	63.3%
Net interest expenses (income)	65.7	64.3	2.0%
Equity in earnings of affiliates and joint ventures, net	(3.5)	(24.1)	(85.7)%
Net other financial losses (gains)	16.0	7.7	108.8%
Income before income taxes	10.9	74.0	(85.3)%
Provision for income taxes	(16.0)	(34.2)	(53.3)%
Income before non-controlling interests	(5.1)	39.7	n.m.
Losses (income) attributable to non-controlling interests	(9.6)	(13.0)	(26.2)%
Consolidated net income	(14.7)	26.7	n.m.

(1) 1Q13 figures were restated in order to reflect the impact of the adoption of the IFRS 11 Joint Arrangements, as explained in more detail under the section Other disclosures, changes in accounting policies and estimates. Following the rollout of the convergent CRM, PT has changed its segmentation criteria of customers that are entrepreneurs in an individual basis, with impact in the Residential, Personal and Enterprises segments. 2013 figures were restated accordingly. (2) Businesses in Portugal include wireline and MEO (previously named TMN). (3) Operating costs = wages and salaries + direct costs + commercial costs + other operating costs. (4) EBITDA = income from operations + post retirement benefits + depreciation and amortisation. (5) Income from operations = income before financials and income taxes + curtailment costs + losses (gains) on disposal of fixed assets + net other costs (gains).

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Consolidated operating revenues

In 1Q14, consolidated operating revenues decreased by Euro 28 million to Euro 690 million (-3.9% y.o.y), reflecting primarily a revenue decline in the Portuguese telecommunications businesses (Euro 22 million) and a lower contribution from international operations, namely MTC, due to negative currency effect, and Timor Telecom.

Revenue performance from Portuguese telecommunications businesses continued to be impacted by pricing and competitive dynamics, namely in the Residential segment, and by the macroeconomic environment, reflected on the revenue decline across all segments. Residential revenues stood broadly stable at Euro 179 million, notwithstanding continued market share gains of MEO triple-play and quadruple-play offers. Personal segment revenues decreased by 4.9% y.o.y, to Euro 151 million, mainly due to lower customer revenues. The Enterprise segment is also penalised by competitive dynamics that are impacting pricing environment, namely on mobile services, notwithstanding an improved performance from large corporates in 1Q14 underpinned by both fixed line and mobile businesses. Revenues from Wholesale, other and eliminations decreased by 0.5% y.o.y in 1Q14 to Euro 93 million, reflecting higher accesses and traffic revenues that compensated lower capacity revenues and a circa Euro 2 million decline in the directories business (-22.9% y.o.y).

Other revenues, including intra-group eliminations, decreased by Euro 6 million (-7.0% y.o.y) to Euro 77 million in 1Q14, reflecting negative currency effects (Euro 11 million). Adjusting for this effect, other revenues would have increased by Euro 5 million, primarily explained by a higher contribution from MTC, mainly due to higher retail voice revenues and a significant increase in data services, partially offset by a lower contribution from Timor Telecom (Euro 4 million) following the entrance of two new competitors in the market during the year 2013.

The contribution from fully and proportionally consolidated international assets to consolidated operating revenues stood at 58.7% in 1Q13, while Brazil accounted for 53.7%.

Consolidated Operating Costs (excluding PRBs and depreciation and amortisation)

Consolidated operating costs excluding depreciation and amortisation costs and post retirement benefits decreased by Euro 17 million (-4.0% y.o.y) to Euro 411 million in 1Q14, as compared to Euro 428 million in 1Q13, primarily reflecting a lower contribution from Africatel businesses (Euro 2 million) and lower costs at Portuguese telecommunications business (Euro 16 million) due to (1) lower wages and salaries, reflecting higher efficiency levels in certain internal processes and lower costs due to the restructuring plan implemented in 2Q13, (2) lower commercial costs, and (3) lower third party services and other operating expenses, primarily explained by a relentless focus on cost cutting and profitability and also an increase in maintenance productivity due to the implementation of new generation access networks (FTTH) as referred to in the past.

Wages and salaries decreased by Euro 9 million (-7.9% y.o.y) to Euro 100 million in 1Q14, as compared to Euro 109 million in 1Q13, explained primarily by a lower contribution from Portuguese telecommunications business (Euro 3 million) and also lower costs at certain Portuguese support companies, both benefitting from higher efficiency levels at certain internal processes and lower costs due to the restructuring plan implemented in 2Q13.

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Direct costs remained broadly stable at Euro 115 million, the same trend occurred at the Portuguese telecommunications business, as the higher traffic costs were offset mainly by lower directories and interconnection costs.

Commercial costs, which include costs of products sold, commissions and marketing and publicity, decreased by 13.4% y.o.y (Euro 9 million) in 1Q14 to Euro 55 million, as compared to Euro 64 million in 1Q13, primarily reflecting a reduction in Portuguese telecommunications businesses (Euro 5 million), as a result of PT's cost cutting efforts, strong focus on profitability and also lower costs of goods sold, and notwithstanding the marketing campaigns supporting the rebranding of PT's mobile business from TMN to MEO.

Other operating costs, which mainly include support services, supplies and external services, indirect taxes and provisions, remained broadly stable at Euro 140 million.

EBITDA

In 1Q14, consolidated EBITDA decreased by Euro 11 million (-3.7% y.o.y) to Euro 279 million, having significantly improved the quarterly trend when comparing to 4Q13 (-5.8% y.o.y), 3Q13 (-9.9% y.o.y), 2Q13 (-11.1% y.o.y) and 1Q13 (-12.4% y.o.y). The EBITDA decline was mainly due to: (1) the Portuguese telecommunications businesses, where EBITDA decreased by Euro 6 million (-2.2% y.o.y), primarily due to lower revenues (Euro 22 million), and (2) the 25.3% y.o.y (Euro 5 million) decrease in EBITDA from other businesses, reflecting the depreciation of the Namibian Dollar and other negative currency effects (Euro 5 million). On a constant currency basis, EBITDA from other businesses would have remained broadly flat at Euro 19 million, as the higher contribution from MTC was offset by a lower contribution from Timor Telecom and CVT. Additionally, excluding the impact of foreign currency movements against the Euro, consolidated EBITDA would have declined only by 1.9% y.o.y in 1Q14.

EBITDA by business segment (1) (2)

Euro million

	1Q14	1Q13	y.o.y
Portugal	265.6	271.6	(2.2)%
Other	13.7	18.4	(25.3)%
EBITDA	279.3	289.9	(3.7)%
EBITDA margin (%) (3)	40.5	40.4	0.1pp

(1) 1Q13 figures were restated in order to reflect the impact of the adoption of the IFRS 11 Joint Arrangements, as explained in more detail under the section "Other disclosures, changes in accounting policies and estimates". (2) EBITDA = income from operations + post retirement benefits + depreciation and amortisation. (3) EBITDA margin = EBITDA / operating revenues

Net income

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Depreciation and amortisation costs amounted to Euro 174 million in 1Q14, compared to Euro 182 million in 1Q13, a decrease that reflects lower depreciation and amortisation costs in the Portuguese telecommunications businesses (Euro 7 million), explained by the decline in capex occurred in the last years following of the investments in future proof technologies and network undertaken in previous years, namely in FTTH and 4G-LTE coverage.

Net other losses amounted to Euro 6 million in 1Q14 as compared to net other gains of Euro 24 million in 1Q13. In 1Q13, this caption includes mainly a gain related to the wireline Concession Agreement amounting to Euro 26 million.

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Net interest expenses increased to Euro 66 million in 1Q14 as compared to Euro 64 million in 1Q13, reflecting primarily an increase in the average net debt and an increase in the average cost of net debt, from 5.3% in 1Q13 to 5.4% in 1Q14, mainly as a result of a lower return on cash applications.

Equity in earnings of affiliates and joint ventures, which includes PT's share in the earnings of associated companies and also joint ventures that are now accounted for by the equity method following the adoption of IFRS 11, decreased to Euro 3 million in 1Q14, as compared to Euro 24 million in 1Q13, reflecting primarily lower earnings from Unitel. In 1Q13, equity in earnings of affiliates also included Euro 8 million from CTM, which was disposed in 2Q13.

Net other financial losses, which include net foreign currency gains, net losses on financial assets and net other financial expenses, increased from Euro 8 million in 1Q13 to Euro 16 million in 1Q14, reflecting primarily: (1) lower foreign currency gains (Euro 3 million), mainly due to the impact of the appreciation of the US Dollar against the Euro, and (2) higher net other financial expenses mainly related to certain banking services and other costs incurred in connection with ongoing business combination between PT and Oi.

Income taxes decreased to Euro 16 million in 1Q14 as compared to Euro 34 million in 1Q13, due to lower taxable earnings across all businesses, reflecting mainly the non-recurring gains recognised in 1Q13 and lower equity in earnings of associated companies in 2014.

Income attributable to non-controlling interests amounted to Euro 10 million in 1Q14 and Euro 13 million in 1Q13, a decrease of Euro 3 million that reflects lower income attributable to non-controlling interests of Timor Telecom (Euro 2 million) and the African businesses (Euro 1 million).

Net income amounted to a net loss of Euro 15 million in 1Q14 compared to a net profit of Euro 27 million in 1Q13. This decrease is explained primarily by: (1) lower EBITDA from Portuguese telecommunications businesses (Euro 6 million); (2) lower non-recurring gains (Euro 30 million), reflecting primarily the net compensation receivable by PT regarding the universal service recognised in 1Q13, and (3) a reduction in PT's share in the earnings of equity assets and joint ventures (Euro 21 million). These effects were partially offset by lower depreciation and amortisation expenses at Portuguese operations (Euro 7 million).

Capex

Capex amounted to Euro 103 million in 1Q14, equivalent to 14.9% of revenues, as compared to Euro 120 million in 1Q13. This decrease is explained by a lower contribution from Portuguese telecommunications businesses (Euro 20 million), which stood at Euro 80 million in 1Q14, reflecting: (1) lower infrastructure and technology related capex, as a result of the strong investments made in the past years, both on FTTH and 4G-LTE networks; (2) lower IS / IT related capex, primarily explained by the investment made in PT's data centre in 2013, and (3) lower customer related capex, explained by lower unitary equipment costs and lower churn across the pay-TV and broadband services. In 2014 capex is expected to be below Euro 400 million since the recent investments in the modernisation of the networks and in technology should lead to a more demand driven capex. Capex from other businesses increased by 11.8% y.o.y to Euro 23 million in 1Q14, reflecting mainly a higher capex at MTC and CVT, that more than compensated a Euro 3 million decrease in Timor Telecom and notwithstanding currency effects (Euro 4 million).

Table of Contents**Capex by business segment (1)****Euro million**

	1Q14	1Q13	y.o.y
Portugal	79.6	99.2	(19.8)%
Other	23.0	20.6	11.8%
Total capex	102.6	119.7	(14.3)%
Capex as % of revenues	14.9	16.7	(1.8)pp

(1) 1Q13 figures were restated in order to reflect the impact of the adoption of the IFRS 11 Joint Arrangements, as explained in more detail under the section Other disclosures, changes in accounting policies and estimates .

Cash Flow and Net Debt

In 1Q14, operating cash flow stood at Euro 127 million as compared to Euro 75 million in 1Q13. This increase in operating cash flow (Euro 53 million) is explained by a lower investment in working capital (Euro 49 million), benefitting from the lower capex in 4Q13 compared to 4Q12 that translated into lower payments to fixed asset suppliers in 1Q14 compared to 1Q13, and a higher EBITDA minus Capex (Euro 7 million), mainly related to the capex decrease in the Portuguese telecommunications businesses.

Free cash flow (1)**Euro million**

	1Q14	1Q13	y.o.y
EBITDA minus Capex	176.8	170.2	3.9%
Non-cash items	2.7	5.1	(47.1)%
Change in working capital	(52.0)	(100.5)	(48.3)%
Operating cash flow	127.5	74.8	70.5%
Interests	(113.4)	(85.5)	32.6%
Net reimbursements (contributions) to pension funds (2)	(11.0)	(9.8)	12.4%
Paym. to pre-retired, suspended employees and other	(39.5)	(34.4)	14.9%
Other cash movements	(36.3)	40.4	n.m.
Free cash flow	(72.7)	(14.5)	n.m.

(1) 1Q13 figures were restated in order to reflect the impact of the adoption of the IFRS 11 Joint Arrangements, as explained in more detail under the section Other disclosures, changes in accounting policies and estimates . (2) In 1Q14 and 1Q13, this caption includes payments related to the transferred regulated pension plans to the Portuguese State amounting to Euro 4.8 million and Euro 5.2 million, respectively.

In 1Q14, consolidated free cash flow stood at negative Euro 73 million and Euro 15 million in 1Q13. The Euro 58 million increase in the negative free cash flow is primarily explained by: (1) lower dividends received from affiliated companies (Euro 75 million), reflecting the dividends received in 1Q13 from Oi (Euro 51 million) and CTM (Euro 25 million); (2) higher interest payments (Euro 28 million), reflecting a different interest payment calendar compared to 2013, related to the business combination between PT and Oi, which is expected to be compensated until the end of 2014, and (3) higher payments related to post-retirement benefits (Euro 6 million). These effects were partially offset by the improvement in operating cash flow (Euro 53 million) as referred to above.

Total consolidated net debt amounted to Euro 4,879 million as at 31 March 2014, as compared to Euro 4,798 million as at 31 December 2013, an increase of Euro 81 million reflecting primarily the negative free cash flow generated in the period (Euro 73 million), as explained above, and dividends paid by PT's subsidiaries to non-controlling shareholders (Euro 10 million). These effects were partially offset by the impact of the appreciation of the Brazilian Real against the Euro on our Brazilian cash and deposits, which resulted in a net debt decrease of Euro 11 million.

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Change in net debt (1)	Euro million	
	1Q14	1Q13
Net debt (initial balance)	4,798.1	4,760.3
Less: free cash flow	(72.7)	(14.5)
Translation effect on foreign currency debt	(10.8)	(10.8)
Other	19.1	26.2
Net debt (final balance)	4,879.0	4,790.2
Change in net debt	81.0	29.9
Change in net debt (%)	1.7%	0.6%

(1) 1Q13 figures were restated in order to reflect the impact of the adoption of the IFRS 11 Joint Arrangements, as explained in more detail under the section Other disclosures, changes in accounting policies and estimates .

As at 31 March 2014, total consolidated gross debt amounted to Euro 7,227 million, of which 81.3% was medium and long-term, reflecting the 2020 one billion Eurobond issued in 2Q13, and 82.8% was set at fixed rates. The amount of cash available plus the undrawn amount of PT s committed commercial paper lines and facilities totalled Euro 3,048 million at the end of March 2014, which includes Euro 700 million of undrawn committed commercial paper lines and facilities.

PT s average cost of net debt stood at 5.4% in 1Q14, compared to 5.3% in 1Q13, reflecting a lower return on cash applications. Cost of gross debt stood at 4.8% in 1Q14 compared to 4.9% in 1Q13. The maturity of PT s net debt was 5.2 years as at 31 March 2014, benefiting from the 1 billion 7-year Eurobond issued in May 2013 and the repayment in April 2013 of the 1 billion Eurobond issued in 2009.

As stated in the MOU signed on 1 October 2013 by PT, Oi and certain of their shareholders, a condition precedent to the execution of the Business Combination was obtaining the necessary waivers and consents from the lenders of PT SGPS Group.

As such, PT has executed a consent solicitation to the holders of all the notes issued by PT Group, who have given their consent to the following main amendments: (1) except for the retail bond, the release and discharge of PT SGPS and PTC, as keep well providers, from all of their respective obligations under the applicable keep well agreements; (2) for the retail bond issued by PT SGPS, the substitution, in place of PT SGPS, of PT Portugal as issuer and principal obligor; (3) the addition of an unconditional and irrevocable guarantee from Oi; (4) the waiver of any and all of the events of default and potential events of default that could be triggered by the Capital Increase and/or the Business Combination or any transaction executed as part of, or pursuant to, the Capital Increase and/or the Business Combination, and (5) in the case of the Exchangeable Bonds only, the amendment of the exchange right.

In addition, PT has also entered into amendment agreements with its counterparties under bank debt agreements, which include a waiver similar to the one provided under PT s notes, and some or all of the following: (1) replace PT SGPS and PT Comunicações with PT Portugal or PT International Finance BV as borrower; (2) modify certain definitions, covenants and events of default to provide that such provisions apply to PT Portugal; (3) add an unconditional and irrevocable guarantee from Oi, and (4) modify certain covenants and related definitions to conform to the corresponding terms of certain existing credit facilities of Oi and to provide that certain related calculations are made based on the financial statements of Telemar Participações S.A.

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Under all these agreements related to existing notes or credit facilities of PT Group, the waiver was effective upon signature of such agreements, while the other modifications were effective upon the completion of the Capital Increase.

Post Retirement Benefit Obligations

As at 31 March 2014, the projected post retirement benefit obligations (PBO) related to pension complements and healthcare amounted to Euro 492 million and the market value of assets under management amounted to Euro 418 million, compared to Euro 494 million and Euro 386 million as at 31 December 2013, respectively. In addition, PT had liabilities in the form of salaries due to suspended and pre-retired employees amounting to Euro 816 million as at 31 March 2014 and Euro 852 million as at 31 December 2013, which are not subject to any legal funding requirement. These monthly salaries are paid directly by PT to the beneficiaries until retirement age. As a result, total gross unfunded obligations from Portuguese businesses amounted to Euro 891 million and after-tax unfunded obligations amounted to Euro 686 million. PT's post retirement benefits plans for pensions and healthcare in Portugal are closed to new participants.

Post retirement benefit obligations	Euro million	
	31 March 2014	31 December 2013
Pensions obligations	116.1	117.2
Healthcare obligations	376.2	376.5
PBO of pension and healthcare obligations	492.3	493.7
Market value of funds	(417.6)	(386.3)
Unfunded pensions and healthcare obligations	74.7	107.4
Salaries to suspended and pre-retired employees	816.2	851.7
Gross unfunded obligations from Portuguese businesses	890.9	959.0
After-tax unfunded obligations from Portuguese businesses	686.0	738.5

Equity

As at 31 March 2014, shareholders' equity excluding non-controlling interests amounted to Euro 1,771 million, representing an increase of Euro 130 million when compared to Euro 1,641 million as at 31 December 2013. This increase is primarily explained by: (1) positive foreign currency translation adjustments generated in the period (Euro 107 million), which mainly relates to the impact of the appreciation of the Brazilian Real against the Euro, and (2) net actuarial gains recorded in the period (Euro 22 million, net of taxes). These effects more than offset the negative net income generated in the period amounting to Euro 15 million.

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Change in shareholders' equity (excluding non-controlling interests)	Euro million
	1Q14
Equity before non-controlling interests (initial balance)	1,641.3
Net income	(14.7)
Net currency translation adjustments	106.8
Dividends paid by PT	0.0
Net actuarial gains (losses), net of taxes	21.8
Other	16.0
Equity before non-controlling interests (final balance)	1,771.2
Change in equity before non-controlling interests	129.9
Change in equity before non-controlling interests (%)	7.9%

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Total assets decreased to Euro 11.8 billion as at 31 March 2014 compared to Euro 12.0 billion as at 31 December 2013, reflecting the decrease in cash and equivalents (Euro 0.2 billion), partially offset by the impact of the appreciation of the Brazilian Real against the Euro on PT s investment in Oi and Contax (Euro 0.1 billion). Total liabilities stood at Euro 9.8 billion as at 31 March 2014 compared to Euro 10.2 billion as at 31 December 2013, reflecting the decrease in indebtedness (Euro 0.1 billion) and post retirement benefits (Euro 0.1 billion).

Consolidated statement of financial position**Euro million**

	31 March 2014	31 December 2013
Cash and equivalents	2,348.1	2,573.1
Accounts receivable, net	1,288.8	1,170.7
Inventories, net	85.4	85.9
Financial investments	2,926.6	2,941.8
Intangible assets, net	1,089.9	1,098.3
Tangible assets, net	3,373.3	3,438.5
Accrued post retirement asset	1.9	1.8
Other assets	92.4	80.2
Deferred tax assets and prepaid expenses	619.0	630.1
Total assets	11,825.4	12,020.4
Accounts payable	523.5	587.7
Gross debt	7,227.1	7,371.1
Accrued post retirement liability	892.8	960.9
Other liabilities	726.9	742.7
Deferred tax liabilities and deferred income	448.6	491.1
Total liabilities	9,819.0	10,153.6
Equity before non-controlling interests	1,771.2	1,641.3
Non-controlling interests	235.2	225.5
Total shareholders equity	2,006.4	1,866.8
Total liabilities and shareholders equity	11,825.4	12,020.4

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Business performance

Portuguese Telecommunications Businesses

In 1Q14, the Portuguese telecommunications businesses continued to show stable customer growth, with the fixed retail customers growing by 1.8% y.o.y to 5,184 thousand (net additions reached 26 thousand in 1Q14), and mobile customers up by 2.7% y.o.y to 7,854 thousand (42 thousand net disconnections in 1Q14, notwithstanding postpaid performance, reaching 150 thousand net additions in the quarter), on the back of the success of PT's offering, namely M4O, which continued gaining momentum, having reached 2.1 million RGUs in May 2014.

Portuguese operating data

	1Q14	1Q13	y.o.y
Fixed retail accesses ('000)	5,184	5,091	1.8%
PSTN/ISDN	2,534	2,592	(2.2)%
Broadband customers	1,316	1,251	5.1%
Pay-TV customers	1,334	1,248	6.9%
Mobile Customers ('000)	7,854	7,647	2.7%
Postpaid	3,075	2,565	19.9%
Prepaid	4,779	5,082	(6.0)%
Net additions ('000)			
Fixed retail accesses	26	38	(31.7)%
PSTN/ISDN	(16)	(13)	(21.3)%
Broadband customers	22	27	(17.8)%
Pay-TV customers	20	25	(19.1)%
Mobile Customers	(42)	49	(186.2)%
Postpaid	150	96	56.3%
Prepaid	(192)	(47)	n.m.
Data as % of mobile service revenues (%)	38.1	35.6	2.5pp

Growth of fixed retail customers was underpinned by a solid performance of MEO, with pay-TV customers up by 6.9% y.o.y to 1,334 thousand (net additions of 20 thousand in 1Q14), confirming the continued success and the attractiveness of MEO in the Portuguese market, even against a backdrop of intense competitive environment and already high penetration of pay-TV. PT's triple-play customers (voice, broadband and pay-TV) accounted for 37 thousand net additions in 1Q14 reaching 989 thousand customers (up by 14.7% y.o.y).

In 1Q14, mobile customers continued to benefit from the performance of postpaid customers, which grew by 19.9% y.o.y to 3,075 thousand (150 thousand net additions in 1Q14), benefiting from the convergent offer M4O, launched in January 2013, which continues leading to a prepaid to postpaid migration in mobile customer base.

Residential

In 1Q14, residential retail accesses or retail revenue generating units (RGUs) increased by 1.1% y.o.y, reaching 3,848 thousand, with pay-TV and broadband accesses already accounting for 57.4% of total residential retail accesses as at 31 March 2014. In 1Q14, fixed retail accesses reached 18 thousand net additions, reflecting: (1) 8 thousand PSTN/ISDN net disconnections; (2) 10 thousand pay-TV net additions, and (3) 16 thousand fixed broadband net additions. This performance was impacted by aggressive commercial offers in the market and

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already high penetration of pay-TV in the Portuguese market. Pay-TV reached 1,168 thousand customers in the quarter (+3.6% y.o.y) while fixed retail broadband reached 1,042 thousand customers (+3.1% y.o.y), underpinned by PT's bundled offers and M4O, which is still gaining momentum. Unique customers in the residential segment reached 1,798 thousand while triple-play customers stood at 849 thousand (+9.9% y.o.y) and already represented 47.3% of PT's residential customers, extending its leadership in this market. The continued and sustainable growth of triple and quadruple-play bundles have led to an ARPU growth of 0.9% y.o.y to Euro 32.1 and to an increase of RGUs per unique customer from 2.06 in 1Q13 to 2.14 in 1Q14, despite a lower contribution from other value added services.

Residential operating data (1)

	1Q14	1Q13	y.o.y
Fixed retail accesses ('000)	3,848	3,808	1.1%
PSTN/ISDN	1,638	1,669	(1.8)%
Broadband customers	1,042	1,011	3.1%
Pay-TV customers	1,168	1,127	3.6%
Unique customers	1,798	1,852	(2.9)%
Net additions ('000)			
Fixed retail accesses	18	28	(33.7)%
PSTN/ISDN	(8)	1	n.m.
Broadband customers	16	14	13.9%
Pay-TV customers	10	13	(20.1)%
ARPU (Euro)	32.1	31.8	0.9%
Non-voice revenues as % of revenues (%)	67.8	64.8	3.0pp

(1) Following the rollout of the convergent CRM, PT has changed its segmentation criteria of customers that are entrepreneurs in an individual basis, with impact in the Residential, Personal and Enterprises segments. 2013 figures were restated accordingly.

In 1Q14, revenues in the Residential segment remained broadly stable reaching Euro 179 million. Service revenues decreased by 0.9% y.o.y due to: (1) increased competitive dynamics and aggressiveness, namely in terms of pricing, with impact in terms of retention programmes; (2) already high pay-TV penetration, and (3) shifting of market share gains coming from pay-TV market expansion in price sensitive segments. As a result of the higher penetration of triple and quadruple-play offers, the weight of non-voice services in Residential service revenues stood at 67.8% (+3.0pp y.o.y) in 1Q14 and the weight of flat revenues stood at 89.6% (+1.3pp y.o.y).

Personal

In 1Q14, mobile Personal customers, including voice and broadband customers, continued to show a strong performance having increased by 3.0% y.o.y to 6,316 thousand. In 1Q14, mobile Personal customers registered 73 thousand net disconnections, as the solid performance in postpaid was more than offset by prepaid customers net disconnections. The solid performance in postpaid customers (116 thousand net additions in 1Q14) is anchored on the strong commercial success of M4O, which is supporting the transformation of the Portuguese mobile market by introducing convergence which allows additional differentiation, while at the same time is shifting the focus from prepaid to postpaid. In fact, according to Anacom, PT has gained market share in 4Q13 for the fifth consecutive quarter (+2.3pp), unlike the competition.

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In 1Q14, customer revenues in the Personal segment declined by 6.8% y.o.y to Euro 123 million, on the back of challenging competitive dynamics, namely in terms of pricing, and difficult economic conditions, reflected on lower and volatile recharges and migration to lower tariff plans. The weight of flat fee customer revenues

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increased by +13.5pp y.o.y to 47.9%, underpinned by M4O and unlimited tariff plans performance. Interconnection revenues increased 21.1% y.o.y to Euro 10 million in 1Q14, as MTRs, which declined throughout 2012, averaged out and contributed to an improvement of interconnection revenues. Personal segment ARPU declined by 9.2% y.o.y to Euro 7.0, improving when compared to 4Q13 (-10.8% y.o.y). The weight of non-voice revenues in service revenues stood at 37.7% in 1Q14 (+1.8pp y.o.y), reflecting the solid performance of data packages internetotelemovei .

Personal operating data (1)

	1Q14	1Q13	y.o.y
Mobile Customers (000)	6,316	6,130	3.0%
Postpaid	1,686	1,227	37.4%
Prepaid	4,630	4,902	(5.6)%
Net additions (000)	(73)	53	(239.6)%
Postpaid	116	99	17.7%
Prepaid	(189)	(46)	n.m.
MOU (minutes)	102	91	11.4%
ARPU (Euro)	7.0	7.7	(9.2)%
Customer	6.4	7.2	(10.7)%
Interconnection	0.5	0.5	16.0%
SARC (Euro)	24.9	25.5	(2.6)%
Data as % of service revenues (%)	37.7	35.9	1.8pp

(1) Following the rollout of the convergent CRM, PT has changed its segmentation criteria of customers that are entrepreneurs in an individual basis, with impact in the Residential, Personal and Enterprises segments. 2013 figures were restated accordingly.

Enterprise

Against a backdrop of intense competitive environment, PT maintained a solid leadership, both in large corporate and in small and medium size businesses, anchored on its distinctive products and services to both market segments, leveraged in its state-of-the-art Data Centre.

Enterprise operating data (1)

	1Q14	1Q13	y.o.y
Fixed retail accesses (000)	1,149	1,092	5.2%
PSTN/ISDN	714	736	(3.0)%
Broadband customers	271	237	14.0%
Pay-TV customers	165	118	39.1%
Retail RGU per access	1.61	1.48	8.5%
Mobile Customers (000)	1,489	1,460	1.9%
Net additions (000)			

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Fixed retail accesses	10	12	(20.6)%
PSTN/ISDN	(6)	(12)	50.8%
Broadband customers	6	13	(52.0)%
Pay-TV customers	9	11	(17.6)%
Mobile Customers	32	(1)	n.m.
ARPU (Euro)	20.3	22.1	(8.2)%
Non-voice revenues as % of revenues (%)	57.6	52.8	4.8pp

(1) Following the rollout of the convergent CRM, PT has changed its segmentation criteria of customers that are entrepreneurs in an individual basis, with impact in the Residential, Personal and Enterprises segments. 2013 figures were restated accordingly.

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Operating revenues of the Enterprise customer segment declined by 6.5% y.o.y to Euro 190 million in 1Q14, impacted by: (1) the public administration strong cost cut initiatives and significant reduction in investments in new projects throughout last quarters; (2) the large corporate cost reduction initiatives, more visible in certain sectors, such as banking and financial services and pharmacies, and (3) intense price competition across the various segments, mainly in mobile. It is worth highlighting that revenue trends from the Corporate segment improved in 1Q14 both fixed and mobile revenues. In 1Q14, non-voice services from Enterprise segment represented 57.6% of Enterprise retail revenues, up by 4.8pp y.o.y.

Consolidated financial performance in Portugal

In 1Q14, revenues from Portuguese telecommunications businesses declined by Euro 22 million (-3.4% y.o.y) to Euro 613 million, reflecting: (1) revenue decline at the Enterprise customer segment (Euro 13 million, -6.5% y.o.y, improving when comparing to previous quarters), notwithstanding an improving trend from Corporate, and (2) revenue decline at the Personal customer segment by 4.9% y.o.y to Euro 151 million, on the back of challenging competitive dynamics. Revenues from the Residential segment remained broadly stable at Euro 179 million also due to increased competition, namely in terms of pricing with impact in retention programmes, and the shifting of market share gains coming from pay-TV market expansion in price sensitive segments. Wholesale, other and eliminations revenues declined to Euro 93 million (-0.5% y.o.y), benefiting from higher revenues associated with certain traffic contracts and higher ULL revenues, notwithstanding a Euro 2 million decline in the directories business (-22.9% y.o.y).

Against revenue pressure in the Portuguese telecommunications businesses, the measures implemented to control costs and the transformation initiatives undertaken are allowing PT to continue to reduce costs and maintain solid margin performance with a 0.6pp y.o.y improvement.

Table of Contents**Portuguese telecommunications businesses financial information (1)****Euro million**

	1Q14	1Q13	y.o.y
Operating revenues	612.6	634.4	(3.4)%
Residential	178.8	179.2	(0.2)%
Service revenues	175.3	176.9	(0.9)%
Sales and other revenues	3.5	2.2	57.0%
Personal	150.9	158.6	(4.9)%
Service revenues	132.6	139.9	(5.2)%
Customer revenues	122.6	131.6	(6.8)%
Interconnection revenues	10.0	8.2	21.1%
Sales and other	18.3	18.7	(2.6)%
Enterprise	190.0	203.2	(6.5)%
Wholesale, other and eliminations	92.9	93.4	(0.5)%
Operating costs	347.0	362.9	(4.4)%
Wages and salaries	60.4	63.0	(4.0)%
Direct costs	114.0	114.4	(0.4)%
Commercial costs	54.7	59.8	(8.5)%
Other operating costs	117.9	125.8	(6.3)%
EBITDA (2)	265.6	271.6	(2.2)%
Post retirement benefits	10.4	10.6	(2.2)%
Depreciation and amortisation	154.4	161.8	(4.6)%
Income from operations (3)	100.8	99.1	1.7%
EBITDA margin (4)	43.4%	42.8%	0.6pp
Capex	79.6	99.2	(19.8)%
Capex as % of revenues	13.0%	15.6%	(2.6)pp
EBITDA minus Capex	186.0	172.4	7.9%

(1) Following the rollout of the convergent CRM, PT has changed its segmentation criteria of customers that are entrepreneurs in an individual basis, with impact in the Residential, Personal and Enterprises segments. 2013 figures were restated accordingly. (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. (4) EBITDA margin = EBITDA / operating revenues.

In 1Q14, operating costs excluding D&A and PRBs declined by 4.4% y.o.y (Euro 16 million), to Euro 347 million. Wages and salaries decreased by 4.0% y.o.y to Euro 60 million explained by higher efficiency levels in certain internal processes. Direct costs declined by 0.4% y.o.y to Euro 114 million in 1Q14, reflecting mainly lower directories and interconnection costs, offset by higher traffic costs. Commercial costs decreased by 8.5% y.o.y to Euro 55 million in 1Q14, despite the marketing campaigns supporting the rebranding of PT's mobile business from TMN to MEO. Other operating expenses decreased by 6.3% y.o.y in 1Q14 to Euro 118 million, primarily explained by a relentless focus on cost cutting and profitability and also an increase in maintenance productivity due to the implementation of new generation access networks (FTTH) as referred to in the past.

In 1Q14, EBITDA from the Portuguese telecommunications businesses amounted to Euro 266 million (-2.2% y.o.y), equivalent to a 43.4% margin, having improved strongly the quarterly trend when comparing to 4Q13 (-5.8% y.o.y), 3Q13 (-9.1% y.o.y), 2Q13 (-9.7% y.o.y) and 1Q13 (-11.7% y.o.y). The EBITDA performance is the result of the decline in service revenues (Euro 23 million), which have high operating leverage, and also of lower margin in new services provided by the Enterprise segment. In effect, in a context where service revenues minus direct costs declined by Euro 23 million, EBITDA declined only by Euro 6 million, reflecting a continuous focus on cost cutting and efficiency gains. EBITDA performance in Portugal was also penalised by a continuous decline in the directories business.

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Capex from Portuguese telecommunications businesses decreased by 19.8% y.o.y to Euro 80 million in 1Q14 and stood at 13.0% of revenues (-2.6pp y.o.y), mainly due to lower infrastructure and technology related capex,

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as a result of the strong investments made in the past years, both on FTTH and 4G-LTE networks. As a result, EBITDA minus capex in 1Q14 was up by 7.9% y.o.y to Euro 186 million. In 1Q14, the investment in the Portuguese telecommunications businesses was primarily directed to: (1) technology and infrastructure capex (Euro 25 million, -21.1% y.o.y); (2) investments in IT/IS projects, which represented 24% of total capex in 1Q14, and (3) customer capex, which amounted to Euro 34 million (-15.5% y.o.y).

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International Businesses

Oi

In 1Q14, Oi's revenue generating units (RGUs) stood at 74,600 thousand, stable when compared to 1Q13, including: (1) 17,661 thousand residential RGUs (-4.4% y.o.y), mainly impacted by a 6.7% y.o.y decrease in fixed lines; (2) 48,145 thousand personal mobile customers, which grew by 3.4% y.o.y, underpinned by prepaid customers growth, and (3) 8,137 thousand Corporate and SMEs RGUs, down by 9.1% y.o.y, negatively impacted by fixed and mobile customers mainly as a result of the customer base clean-up referred to last quarter and notwithstanding a 4.3% y.o.y growth in broadband. Oi continued to focus on customer quality, including bad debt reduction and disconnections, through a more conservative commercial strategy, in order to increase profitability. The initiatives in place reflect a less buoyant macro environment and a renewed focus on financial discipline and aim at achieving sustainable growth.

In 1Q14, Oi's pro-forma consolidated net revenues, as reported by Oi, decreased by 2.3% y.o.y to R\$ 6,877 million, impacted by: (1) lower MTRs; (2) a decrease on traffic in the Corporate / SMEs segment, and (3) the focus on profitability and protection of Oi's financial position. These effects were partially offset by the positive performance of pay-TV and fixed broadband in the residential segment. EBITDA, as reported by Oi, stood at R\$ 2,957 million, with a margin of 43.0%, impacted by the gain related to the mobile towers disposal. Capital expenditures stood at R\$1,208 million in 1Q14 (-28.6% y.o.y) reflecting primarily past investments in mobile and broadband networks as well as best allocation of investments. As a result, EBITDA minus capex in 1Q14 reached R\$ 1,749 million. Net debt stood at R\$30,291 million as at 31 March 2014.

Please see additional information in Oi's first quarter 2014 press release.

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Consolidated financial statements

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Table of Contents**PORTUGAL TELECOM, SGPS, S.A.****CONSOLIDATED INCOME STATEMENT****FOR THE THREE MONTH PERIODS ENDED 31 MARCH 2014 AND 2013****Euro**

	Notes	1Q14	1Q13 Restated (Note 3)
REVENUES			
Services rendered		654,160,824	685,299,169
Sales		27,663,613	24,089,338
Other revenues		8,152,310	8,246,894
	5	689,976,747	717,635,401
COSTS, LOSSES AND (INCOME)			
Wages and salaries		100,246,825	108,823,714
Direct costs		114,777,708	114,433,845
Commercial costs		55,316,087	63,887,427
Supplies, external services and other expenses		125,599,348	123,927,206
Indirect taxes		12,024,775	11,547,823
Provisions and adjustments		2,691,673	5,084,027
Depreciation and amortisation	12	173,524,820	181,918,291
Post retirement benefits costs	6	10,416,815	10,684,991
Curtailment costs	6	263,873	643,893
Gains on disposal of fixed assets, net		(159,716)	(918,604)
Net other losses (gains)	7	6,240,630	(24,253,394)
		600,942,838	595,779,219
Income before financial results and taxes	5	89,033,909	121,856,182
FINANCIAL LOSSES AND (GAINS)			
Net interest expenses	8	65,651,250	64,341,744
Equity in earnings of joint ventures	17	18,204,317	16,982,768
Equity in earnings of associated companies, net	5	(21,661,989)	(41,099,432)
Net other financial losses	9	15,976,566	7,651,323
		78,170,144	47,876,403
Income before taxes		10,863,765	73,979,779
Income taxes	10	16,003,864	34,245,808
NET INCOME (LOSS)		(5,140,099)	39,733,971
Attributable to non-controlling interests		9,582,621	12,987,319
Attributable to equity holders of the parent	11	(14,722,720)	26,746,652
Earnings per share			
Basic	11	(0.02)	0.03
Diluted	11	(0.02)	0.03

The accompanying notes form an integral part of these financial statements.

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PORTUGAL TELECOM, SGPS, S.A.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE THREE MONTH PERIODS ENDED 31 MARCH 2014 AND 2013

Euro

	Notes	1Q14	1Q13 Restated (Note 3)
Net income (loss) recognised in the income statement		(5,140,099)	39,733,971
Income (expenses) recognised directly in shareholders' equity			
Items that may be reclassified subsequently to the income statement			
Foreign currency translation adjustments			
Translation of foreign operations (i)		106,823,303	162,289,194
Hedge accounting of financial instruments			
Change in fair value			508,800
Tax effect			(127,200)
Share in other comprehensive income of joint ventures		9,466,233	(2,201,515)
Items that will not be reclassified to the income statement			
Post retirement benefits			
Net actuarial gains (losses)	6	28,330,757	(4,257,024)
Tax effect		(6,516,074)	1,064,256
Other gains (expenses) recognised directly in shareholders' equity, net		6,606,483	(12,589,709)
Total earnings and reserves recognised directly in shareholders' equity		144,710,702	144,686,802
Total comprehensive income		139,570,603	184,420,773
Attributable to non-controlling interests		9,709,128	12,373,481
Attributable to equity holders of the parent		129,861,475	172,047,292

(i) Gains recorded in the three month periods ended 31 March 2014 and 2013 relate mainly to the impact of the appreciation of the Brazilian Real against the Euro on Portugal Telecom's investments in Oi and Contax.

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PORTUGAL TELECOM, SGPS, S.A.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE THREE MONTH PERIODS ENDED 31 MARCH 2013 AND 2014

	Euro								
	Share capital	Treasury shares	Legal reserve	Reserve for treasury shares	Revaluation reserve	Other reserves and accumulated earnings	Equity excluding non-controlling interests	Non-controlling interests	Total equity
Balance as at 31 December 2012	26,895,375	(337,520,916)	6,773,139	6,970,320	524,724,045	2,076,740,633	2,304,582,596	232,674,346	2,537,256,942
Dividends								(6,250,000)	(6,250,000)
Acquisitions, disposals and share capital increases/decreases								(792,784)	(792,784)
Realization of revaluation reserve					(7,937,828)	7,937,828			
Income (expenses) recognized directly in equity						145,300,640	145,300,640	(613,838)	144,686,802
Income (loss) recognized in the income statement						26,746,652	26,746,652	12,987,319	39,733,971
Balance as at 31 March 2013 (restated)	26,895,375	(337,520,916)	6,773,139	6,970,320	516,786,217	2,256,725,753	2,476,629,888	238,005,043	2,714,634,931

	Euro								
	Share capital	Treasury shares	Legal reserve	Reserve for treasury shares	Revaluation reserve	Other reserves and accumulated earnings	Equity excluding non-controlling interests	Non-controlling interests	Total equity
Balance as at 31 December 2013	26,895,375	(337,520,916)	6,773,139	6,970,320	516,587,428	1,421,614,031	1,641,319,377	225,495,738	1,866,815,115
Realization of revaluation reserve					(8,149,504)	8,149,504			
Income (expenses) recognized						144,584,195	144,584,195	126,507	144,710,702

directly in equity										
Income (loss) recognized in the income statement						(14,722,720)	(14,722,720)	9,582,621	(5,140,099)	
Balance as at 31 March 2014	26,895,375	(337,520,916)	6,773,139	6,970,320	508,437,924	1,559,625,010	1,771,180,852	235,204,866	2,006,385,718	

The accompanying notes form an integral part of these financial statements.

Table of Contents**PORTUGAL TELECOM, SGPS, S.A.****CONSOLIDATED STATEMENT OF FINANCIAL POSITION****31 MARCH 2014 AND 31 DECEMBER 2013****Euro**

ASSETS			
Cash and cash equivalents		1,276,838,612	1,658,950,514
Accounts receivable - trade		754,928,563	762,936,473
Inventories		85,391,870	85,872,948
Prepaid expenses		63,857,684	65,244,104
Non current assets held for sale		4,653,741	4,653,741
Accounts receivable		1,064,208	1,284,622
Investments in joint ventures	17	2,498,722,705	2,408,246,860
Other investments		32,467,917	22,243,652
Intangible assets	12	709,336,333	717,703,676
Post retirement benefits	6	1,877,793	1,834,000
Judicial deposits		619,730	594,998
Total assets		11,825,366,413	12,020,395,182
LIABILITIES			
Short-term debt	13	1,350,732,359	1,491,976,460
Accrued expenses		522,326,662	534,656,119
Taxes payable		97,638,977	80,107,942
Other current liabilities		3,945,106	13,980,981

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Medium and long-term debt	13	5,876,417,596	5,879,161,433
Provisions		2,239,868	2,271,075
Deferred taxes	10	243,120,857	243,824,693
Total non-current liabilities		7,052,048,923	7,129,013,937
Share capital		26,895,375	26,895,375
Legal reserve		6,773,139	6,773,139
Revaluation reserve		508,437,924	516,587,428
Equity excluding non-controlling interests		1,771,180,852	1,641,319,377
Total equity		2,006,385,718	1,866,815,115

The accompanying notes form an integral part of these financial statements.

Table of Contents**PORTUGAL TELECOM SGPS, S.A.****CONSOLIDATED STATEMENT OF CASH FLOWS****FOR THE THREE MONTH PERIODS ENDED 31 MARCH 2014 AND 2013****Euro**

OPERATING ACTIVITIES			
Payments to suppliers		(345,948,290)	(397,922,773)
Payments relating to income taxes		(19,435,908)	(19,370,467)
Payments relating to indirect taxes and other	14.a	(46,674,635)	(71,163,289)
Cash receipts resulting from:			
Financial investments		5,850,860	165,166
Interest and related income	14.c	23,399,954	26,708,473
Other investing activities		145,517	6,303
Payments resulting from:			
Financial investments		(9,782,472)	(4,306,527)
Other investing activities			(393)
Cash flows from investing activities(2)		(288,084,393)	(89,746,172)
FINANCING ACTIVITIES			
Loans obtained	14.e	36,511	80,106,950
		1,111,536	80,233,950
Loans repaid	14.e	(150,178,444)	(384,116,234)
Dividends	14.f	(9,798,073)	(16,631,061)
		(316,697,864)	(520,293,518)

Change in cash and cash equivalents (4)=(1)+(2)+(3)	(386,626,622)	(336,913,622)
Cash and cash equivalents at the end of the period	1,276,838,612	1,658,627,995

The accompanying notes form an integral part of these financial statements.

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Portugal Telecom, SGPS, S.A.

Notes to the Consolidated Financial Statements as at 31 March 2014

(Amounts stated in Euros, except where otherwise mentioned)

1. Introduction

Portugal Telecom, SGPS, SA (Portugal Telecom) and its subsidiaries (Group , Portugal Telecom Group , or the Company) are engaged in rendering a comprehensive range of telecommunications and multimedia services in Portugal, Brazil and other countries in Africa and Asia. These services have not significantly changed during the three months period ended 31 March 2014, as compared to those reported in Portugal Telecom 's last annual report.

On 1 October 2013, Portugal Telecom, Oi S.A. (Oi), AG Telecom Participações S.A. (AG Tel), LF Tel S.A. (LF Tel), Bratel Brasil S.A. (Bratel), Pasa Participações S.A. (Pasa), EDSP 75 Participações S.A. (EDSP75) (which together with Telemar Participações S.A. (Tpart) are defined as Oi Holding Companies), Banco Espírito Santo (BES) and Nivalis Holding B.V. (Ongoing) signed a memorandum of understanding setting out the basis for a proposed merger of Portugal Telecom, Oi and the Oi Holding Companies (the Business Combination) into a single Brazilian incorporated listed entity (CorpCo or Telemar Participações). The merger is a natural fulfillment of the industrial alliance established in 2010 creating a leading telecoms operator.

On 19 February 2014, Portugal Telecom and Oi signed the definitive agreements relating to the combination of their businesses. These agreements govern the steps necessary to implement the Business Combination, which include the following primary transactions:

- On 5 May 2014, Oi realised a share capital increase under which it issued a total of 2,142,279,524 ordinary shares at the price of R\$2.17 per share and of 4,284,559,049 preferred shares at the price of R\$2.00 per share and on the same date, pursuant to article 24 of CVM Instruction No. 400, Banco BTG Pactual S.A. (Banco Pactual), in its role as Stabilizing Agent for the Public Offering, partially exercised, its option to place an additional 120,265,046 common shares and 240,530,092 preferred shares issued by Oi; the total proceeds from this share capital increase, including the option exercised by Banco Pactual, amounted to R\$13.96 billion, composed of (1) R\$5.71 billion (Euro 1.75 billion) in assets contributed by Portugal Telecom, corresponding to the valuation of PT Assets (as defined below) carried out by Banco Santander (Brasil), S.A., as a result of which Portugal Telecom subscribed for 1,045,803,934 common shares and 1,720,252,731 preferred shares issued by Oi, and (2) R\$8.25 billion in cash proceeds obtained from other investors, which subscribed for the remainder 1,216,740,636 ordinary shares and 2,804,836,410 preferred shares issued by Oi; the participation of Portugal Telecom in the Oi capital increase, through the contribution of assets representing all of the operating assets held directly or indirectly by the Portugal Telecom Group and the related liabilities with the exception of the shares of Oi, the shares of Contax Participações S.A. and the shares of Bratel B.V. (PT Assets), for the amount of Brazilian R\$5.71 billion (Euro 1.75 billion), was approved by a majority of 99.87% of the votes present at a General Meeting of Portugal Telecom 's shareholders held on 27 March 2014.

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- On 5 May 2014, Portugal Telecom subscribed R\$4.8 billion of debentures convertible into shares of AG and LF, the proceeds of which AG and LF shall use to repay its indebtedness and to subscribe convertible debentures to be issued by Telemar Participações, which in turn will also use those proceeds to repay its own indebtedness.
- Also on 5 May 2014, Portugal Telecom exchanged its interests in CTX and Contax for shares of AG and LF, which at that time held only shares of Oi and Telemar Participações.
- Subject to the approvals of the holders of voting shares of Oi and Telemar Participações, Oi shares not owned by Telemar Participações will be exchanged for Telemar Participações common shares and Oi will become a wholly-owned subsidiary of Telemar Participações. This transaction is expected to occur in the second half of 2014.
- A merger of Portugal Telecom with and into Telemar Participações, with Telemar Participações as the surviving company, pursuant to which each of Portugal Telecom's issued and then outstanding ordinary shares will be cancelled and the holder thereof will automatically receive Telemar Participações common shares, ceasing Portugal Telecom to exist. This transaction is expected to occur in the second half of 2014.

As a result, following the share capital increase mentioned above and also the option exercised by Banco BTG Pactual S.A., Portugal Telecom owned, directly and indirectly, 35.8% of Oi's issued and outstanding share capital (excluding Portugal Telecom's interest in the shares of Oi owned by Telemar Participações S.A., AG and LF).

Portugal Telecom shares will continue to trade until the conclusion of the merger with Telemar Participações. As a result of the merger, Portugal Telecom shareholders will receive 3.64 shares of Telemar Participações per each Portugal Telecom share. Additionally, and as approved by its General Meeting held on 30 April 2014, Portugal Telecom shareholders will receive, before completion of the Business Combination, a dividend of Euro 10 cent per share.

The accompanying consolidated financial statements were approved by the Board of Directors and authorized for issue on 13 May 2014.

2. Basis of presentation

These consolidated financial statements have been presented in accordance with IAS 34 *Interim Financial Reporting* (IAS 34). These financial statements do not include all the information required by the International Financial Reporting Standards (IFRS) and accordingly should be read in conjunction with the consolidated financial statements for the year ended 31 December 2013. In addition, further explanations for the main changes of revenues and costs are disclosed in our interim management report, which should be read in conjunction with these interim consolidated financial statements.

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The consolidation principles followed in the preparation of these interim financial statements are the same as were applied in the preparation of the last annual consolidated financial statements.

During the three month periods ended 31 March 2014 and 2013, there were no relevant changes in the scope of consolidation regarding companies consolidated by the full consolidation method. Detailed information related to the investments in joint ventures and the Company's share in the earnings of joint ventures is disclosed in Note 17.

Table of Contents**3. Accounting policies, judgments and estimates**

As referred to in the 2013 annual report, in the fourth quarter of 2013, Portugal Telecom chose to early adopt the package of five standards issued by the IASB in May 2011 (IFRS 10, IFRS 11, IFRS 12 and revised versions of IAS 27 and IAS 28), although its application in the European Union was only mandatory as from 1 January 2014. The impacts of the adoption of IFRS 11 consisted of recognizing the investments in joint ventures by the equity method of accounting, including primarily Oi, Contax and its controlling shareholders, which prior to the adoption of this standard were proportionally consolidated as allowed by IAS 31, standard has been replaced by IFRS 11. Summarized financial information related to the investments in joint ventures is disclosed in Note 17.

As a result of the adoption of IFRS 11 for the first time in the fourth quarter of 2013, the Consolidated Statement of Financial Position as of 31 December 2013 presented in the Company's last annual report already reflected the impacts of the adoption of this standard, but the Consolidated Income and Cash Flows Statements for the three months period ended 31 March 2013 presented in last year's interim report did not reflect the impacts of the adoption of IFRS 11 and therefore were restated accordingly, as follows:

Consolidated Income Statement for the three months period ended 31 March 2013**Euro**

	Prior to restatement	Adjustments IFRS 11	Restated statement
Total revenues	1,552,591,584	(834,956,183)	717,635,401
Costs, losses and (income)			
Wages and salaries	248,241,918	(139,418,204)	108,823,714
Direct costs	266,182,268	(151,748,423)	114,433,845
Commercial costs	122,224,947	(58,337,520)	63,887,427
Supplies, external services and other expenses	299,571,656	(175,644,450)	123,927,206
Indirect taxes	58,567,274	(47,019,451)	11,547,823
Provisions and adjustments	31,551,743	(26,467,716)	5,084,027
Depreciation and amortisation	340,356,813	(158,438,522)	181,918,291
Post retirement benefits costs	12,522,928	(1,837,937)	10,684,991
Curtailement costs	643,893		643,893
Losses (gains) on disposal of fixed assets, net	(365,057)	(553,547)	(918,604)
Other operating expenses (gains), net	(21,144,565)	(3,108,829)	(24,253,394)
Income before financial results and taxes	194,237,766	(72,381,584)	121,856,182
Net interest expenses	145,674,248	(81,332,504)	64,341,744
Equity in earnings of joint ventures		16,982,768	16,982,768
Equity in earnings of associated companies, net	(40,062,337)	(1,037,095)	(41,099,432)
Net other financial losses	17,561,121	(9,909,798)	7,651,323
Income taxes	32,292,311	1,953,497	34,245,808
Net income	38,772,423	961,548	39,733,971
Attributable to non-controlling interests	12,025,771	961,548	12,987,319
Attributable to equity holders of the parent	26,746,652		26,746,652
Earnings per share attributable to the equity holders of the parent			
Basic	0.03	0.00	0.03
Diluted	0.03	0.00	0.03

Table of Contents**Consolidated Statement of Cash Flows for the three month periods ended 31 March 2013**

	Prior to restatement	Adjustments IFRS 11	Restated statement
OPERATING ACTIVITIES			
Collections from clients	1,867,341,800	(1,037,710,065)	829,631,735
Payments to suppliers	(815,562,973)	417,640,200	(397,922,773)
Payments to employees	(275,782,145)	171,628,554	(104,153,591)
Payments relating to income taxes	(44,709,934)	25,339,467	(19,370,467)
Payments relating to post retirement benefits, net	(52,788,615)	8,659,118	(44,129,497)
Payments relating to indirect taxes and other	(397,784,542)	326,621,253	(71,163,289)
Cash flows from operating activities (1)	280,713,591	(87,821,473)	192,892,118
INVESTING ACTIVITIES			
Short-term financial applications	80,600,014	(80,908,856)	(308,842)
Interest and related income	33,676,900	(6,968,427)	26,708,473
Dividends	25,240,512	49,994,371	75,234,883
Financial investments	(4,141,361)		(4,141,361)
Tangible and intangible assets	(358,414,975)	171,169,740	(187,245,235)
Other investing activities	1,570,911	(1,565,001)	5,910
Cash flows from investing activities (2)	(221,467,999)	131,721,827	(89,746,172)
FINANCING ACTIVITIES			
Loans obtained	242,422,894	(162,315,944)	80,106,950
Loans repaid	(484,003,688)	99,887,454	(384,116,234)
Interest and related expenses	(163,487,190)	43,940,967	(119,546,223)
Dividends	(31,522,175)	14,891,114	(16,631,061)
Other financing activities	(41,230,003)	41,357,003	127,000
Cash flows from financing activities (3)	(477,820,162)	37,760,594	(440,059,568)
Cash and cash equivalents at the beginning of the period	2,507,099,156	(518,302,018)	1,988,797,138
Change in cash and cash equivalents (4)=(1)+(2)+(3)	(418,574,570)	81,660,948	(336,913,622)
Effect of exchange differences	30,876,380	(24,131,901)	6,744,479
Cash and cash equivalents at the end of the period	2,119,400,966	(460,772,971)	1,658,627,995

4. Exchange rates

As at 31 March 2014 and 31 December 2013, assets and liabilities denominated in foreign currencies were translated to Euros using the following exchange rates to the Euro:

Currency	31 Mar 2014	31 Dec 2013
Brazilian real	3.1276	3.2576
US dollar	1.3788	1.3791

During the three month periods ended 31 March 2014 and 2013, the income statements of subsidiaries and joint ventures denominated in foreign currencies were translated to Euros using the following average exchange rates to the Euro:

Currency	1Q14	1Q13
Brazilian real	3.2400	2.6368
US dollar	1.3696	1.3206

Table of Contents**5. Segment reporting**

The operating segments are based on the manner the Board of Directors reviews and assesses the performance of the Group's businesses to make decision about resources to be allocated up to 31 March 2014, are as follows: (i) Telecommunications in Portugal; and (ii) Telecommunications in Brazil - Oi. There is no difference between operating and reportable segments.

The operating segment named Telecommunications in Portugal includes wireline and mobile telecommunications in Portugal.

The operating segment named Telecommunications in Brazil - Oi includes Oi, S.A., the parent company of the Oi Group, Telemar Norte Leste and the subsidiaries of both these companies. Portugal Telecom discloses Oi as an operating segment since the Company's management currently reviews and assesses its performance periodically, notwithstanding Oi being a joint venture in accordance with IFRS 11 and thus accounted for by the equity method.

In addition to the above mentioned reportable segments, the Group has other businesses that do not comply individually or in the aggregate any of the quantitative thresholds that would require a disclosure as a reportable segment. These businesses relate primarily to the following Group companies: (1) MTC, Cabo Verde Telecom and Timor Telecom, which render wireline and mobile telecommunications services; and (2) certain Portuguese support companies, namely PT Cloud e Data Centers, PT Inovação e Sistemas, PT Pro Serviços Administrativos e de Gestão Partilhados and PT Contact Telemarketing e Serviços de Informação.

In the three month periods ended 31 March 2014 and 2013, revenues by consolidated operating segments and its contribution to the Group's consolidated revenues were as follows:

	Euro					
	Standalone revenues	1Q14 Intragroup revenues	Consolidated revenues	Standalone revenues	1Q13 Intragroup revenues	Consolidated revenues
Revenues relating to Telecommunications in Portugal (i)	612,609,794	(3,963,495)	608,646,299	634,447,020	(4,668,148)	629,778,872
Revenues relating to other businesses (ii)	187,352,461	(106,022,013)	81,330,448	197,797,177	(109,940,648)	87,856,529
Group consolidated revenues			689,976,747			717,635,401

(i) The reduction of Euro 22 million in standalone revenues from Portuguese telecommunications business in the first quarter of 2014 was compared to the same period of the previous year, is primarily explained by: (1) lower revenues driven by the Enterprise customer segment (Euro 13 million), penalized by continued pricing and consumption pressure, as companies continue to reduce investments and undertake cost

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cutting initiatives; and (2) revenue decline in the Personal customer segment (Euro 8 million), mainly as a result of lower customer revenues reflecting the adverse macroeconomic environment that translates into lower and volatile recharges, price competition and migration to lower tariff plans. Revenues from residential customers, which continue to be impacted by pricing and competitive dynamics, remained broadly stable, notwithstanding continued market share gains of MEO triple-play and quadruple play offers.

(ii) The lower contribution from other businesses to consolidated revenues reflects mainly the impact of the depreciation of the Namibian Dollar against the Euro and other negative currency effects (Euro 11 million). Adjusting for this effect, other revenues would have increased by Euro 4 million to Euro 92 million in the three months period ended 31 March 2014, primarily explained by a higher contribution from MTC, reflecting higher data and internet services and retail voice revenues, partially offset by a lower contribution from Timor Telecom, reflecting the entrance of two new competitors in the market during the year 2013.

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In the three month periods ended 31 March 2014 and 2013, the reconciliation between income before financial results and taxes relating to the consolidated operating segments and the Group's consolidated net income is as follows:

	Euro	
	1Q14	1Q13
Income before financial results and taxes relating to Telecommunications in Portugal (i)	94,414,728	124,618,493
Income (loss) before financial results and taxes relating to other businesses	(5,380,819)	(2,762,311)
Income before financial results and taxes	89,033,909	121,856,182
Financial gains and (losses):		
Net interest expenses (Note 8)	(65,651,250)	(64,341,744)
Equity in earnings of joint ventures (Note 17)	(18,204,317)	(16,982,768)
Equity in earnings of associated companies, net (ii)	21,661,989	41,099,432
Net other financial losses (Note 9)	(15,976,566)	(7,651,323)
Income taxes (Note 10)	(16,003,864)	(34,245,808)
Net income (loss)	(5,140,099)	39,733,971

(i) The reduction of Euro 30 million in this caption reflects mainly (1) lower operating revenues (Euro 22 million), as explained above, and (2) lower net other gains (Euro 31 million), explained by a gain recorded in the first quarter of 2013 related to the Wireline Concession Agreement, as explained in Note 7. These effects were partially offset by (1) a reduction in depreciation and amortization expenses (Euro 7 million), benefiting from lower investments undertaken in 2013, (2) lower wages and salaries explained by higher efficiency levels in certain internal processes and lower costs related to the restructuring plan implemented in the second quarter of 2013, and (3) lower commercial and third party costs (Euro 13 million), reflecting Portugal Telecom's relentless focus on cost cutting and profitability and also an increase in maintenance productivity due to the implementation of new generation access networks, notwithstanding the increased push of commercial activities due to the rollout of M40.

(ii) The decrease in equity in earnings of associated companies reflects primarily lower results of Unitel. In the first quarter of 2013, this caption also includes Portugal Telecom's share in the earnings of CTM, amounting to Euro 8 million, which was disposed of in the second quarter of 2013.

In the three month periods ended 31 March 2014 and 2013, capital expenditures by consolidated operating segment and their reconciliation to the consolidated capital expenditures are as follows (Note 12):

	Euro	
	1Q14	1Q13
Telecommunications in Portugal	79,566,437	99,165,819
Other businesses	22,998,487	20,564,491
	102,564,924	119,730,310

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In the three months period ended 31 March 2014, capital expenditures in the Portuguese telecommunications business amounted to Euro 80 million, a decrease of Euro 20 million over the same period last year, reflecting: (1) lower infrastructure and technology related capital expenditures, as a result of the strong investments made in the past years, both on FTTH and 4G-LTE networks; (2) lower IS / IT related capital expenditures, primarily explained by the investment made in Portugal Telecom's data centre in 2013, and (3) lower customer related capital expenditures, explained by lower unitary equipment costs and lower churn across the pay-TV and broadband services.

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As mentioned previously, Oi is classified as a joint venture and is accounted for by the equity method, in accordance with the requirements of IFRS 11. Nevertheless, Oi is still an operating segment in accordance with IFRS 8 *Reportable Segments* and, therefore, we present below its financial information for the three month periods ended 31 March 2014 and 2013 considering the 25.6% joint control interest held by of Portugal Telecom:

Euro

	1Q14	1Q13
Revenues (i)	556,195,707	723,943,188
Income before financial results and taxes (ii)	104,214,844	68,108,709
Capital expenditures (iii)	95,520,439	164,252,004

(i) The reduction of Euro 168 million in revenues from Oi is primarily explained by the impact of the depreciation of the Brazilian Real against the Euro (Euro 127 million) and, on a constant currency basis, reflects mainly a lower interconnection revenues and decrease in other operating revenues.

(ii) The increase of Euro 36 million in Oi's income before financial results and taxes reflects primarily a gain recorded in the first quarter of 2014 regarding the disposal of 2,007 telecommunications mobile towers, amounting to R\$1,322 million (Euro 105 million). This effect was partially offset by (1) the impact of the depreciation of the Brazilian Real against the Euro (Euro 24 million) and, on a constant currency basis, (2) lower operating revenues (Euro 41 million), as explained above, (3) higher depreciation and amortization expenses (Euro 10 million), reflecting the increased investments made in previous years, and (4) higher wages and salaries (Euro 30 million), explained mainly by a reversal of variable remunerations recorded in the first quarter of 2013.

(iii) On a constant currency basis, excluding the impact of the depreciation of the Brazilian Real against the Euro (Euro 22 million), Oi's capital expenditures would have decreased to Euro 117 million in the three months period ended 31 March 2014, a decrease of Euro 47 million over the same period of last year, reflecting more granular approach to investment and a focus on strengthening the partnership with key suppliers, including the rationalisation of supplies, the renegotiation of key contracts and focus on optimising the total cost of ownership of the network and extrating network synergies amongst different technologies and with other partners.

6. Post retirement benefits

As at 31 March 2014, the Company did not obtain an actuarial valuation to recognize post retirement benefits and, therefore, costs recorded during the three months period ended 31 March 2014 are based on the 31 December 2013 actuarial valuation, adjusted only by curtailment costs incurred during that period.

As at 31 March 2014, the projected post retirement benefits obligations, which relate to pension complements and healthcare benefits, totalled Euro 492 million and the fair value of plan assets amounted to Euro 418 million, as compared to Euro 494 million and Euro 386 million as at 31 December 2013, respectively. In addition, Portugal Telecom had liabilities with salaries payable to suspended and pre-retired employees amounting to Euro 816 million as at 31 March 2014, as compared to Euro 852 million as at 31 December 2013, which are not subject to any legal funding requirement. These salaries are paid on a monthly basis directly by Portugal Telecom to beneficiaries until retirement age. Consequently, as at 31 March 2014, net benefits obligations amounted to Euro 891 million, as compared to Euro 959 million as at 31

December 2013.

During the three month periods ended 31 March 2014 and 2013, the changes in post retirement benefits obligations, net of the fair value of plan assets, were as follows:

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Euro

	Pension complements benefits	Healthcare benefits	Salaries due to pre-retired and suspended employees	Total
Balance as at 31 December 2013	22,559,836	84,815,958	851,670,275	959,046,069
Periodic post retirement benefits costs	246,854	1,522,500	3,798,250	5,567,604
Work force reduction costs			37,012	37,012
Net actuarial losses (gains)	(1,082,575)	(27,248,182)		(28,330,757)
Payments, contributions and reimbursements	(1,341,475)	(4,782,412)	(39,268,588)	(45,392,475)
Balance as at 31 March 2014	20,382,640			